The Costs and Benefits of Government Spending

Measuring the Bang for the Buck from Government Jobs and Growth Policies

By Nick Bunker and Adam Hersh
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Introduction

Targeted government programs can spur jobs growth. Look no further than the American Recovery and Reinvestment Act of 2009, which contained a wide range of policies that resulted in between 1.4 million and 4 million jobs created or maintained by the summer of 2011, according to the nonpartisan Congressional Budget Office. Not surprisingly, though, these policies varied in their impact and efficiency.

With policies as diverse as cutting taxes for middle-class families, providing unemployment insurance to those in need, helping state governments maintain critical education and other public services, and investing in upgrading transportation and other infrastructure, among other things, it’s not surprising that analyzing whether the Recovery Act “worked” requires more than a yes-or-no answer. The CBO analysis, as well as those from various academic and private-sector economists, proves the act worked overall, but not all parts worked equally well. With more still to be done for the U.S. economy and job creation, it’s important to look at what worked and what didn’t.

A number of economic studies measure the impact of various components of the Recovery Act on economic growth and job creation. In this issue brief we review and compare the evidence from these studies on:

• Tax cuts
• Transportation and infrastructure investment
• Social protection programs such as unemployment insurance, Medicaid, and nutritional assistance
• Financial aid to state and local governments
The studies we reviewed estimate each policy’s “bang for the buck,” or how much $1 of program spending increases overall activity in the economy.

Our analysis of the analyses

The most widely cited studies include those by the Congressional Budget Office, economists Alan Blinder and Mark Zandi, and economists James Feyrer and Bruce Sacerdote. These reports find a range of values for each program. In these studies, the “bang for the buck” value—what economists call the “multiplier,” or how many dollars of economic activity is fueled by one dollar spent—for overall social protection ranges from 0.8 to 2.31. Separately, Blinder and Zandi report a value of 1.61 for unemployment insurance and 1.74 for food stamps.

Research by Urban Institute economist Wayne Vroman estimates that one dollar spent on unemployment insurance fuels between 1.7 and 2.1 dollars of activity in the overall economy. According to these studies, the value for a dollar of spending on infrastructure ranges from 1 to 2.5, while the value for aid to state and local governments ranges from 0.7 to 1.8.

The analyses value middle-class tax cuts, such as the Making Work Pay tax credit that gave tax credits of $400 ($800 for couples), as generating between 0.6 and 1.5 dollars of additional economic activity; the value of extending the Alternative Minimum Tax patch for high-income earners for an additional year ranges from 0.2 to 0.6 dollars of additional activity. And the analyses value the extension of the housing tax credit for first-time homebuyers, providing credits up to $8000, in the Recovery Act from 0.3 to 0.9.

The economic impact of distinct programs within the Recovery Act can be seen clearly in the first accompanying chart. (see Figure 1) The bottom red line shows the path of GDP growth if the Recovery Act had not been passed, as estimated by economists Alan Blinder and Mark Zandi. Using data on the costs of programs and the fiscal mul-

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**FIGURE 1**

Economic benefits of Recovery Act programs

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<tr>
<th>Recovery Act contributions to GDP, by program</th>
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<tr>
<td>Social protection</td>
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<td>Aid to states</td>
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<td>Infrastructure</td>
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<td>Tax cuts</td>
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U.S. GDP without Recovery Act

Source: Authors’ analysis of Blinder and Zandi (2010) fiscal multipliers and American Recovery and Reinvestment Act
Multiplier—the “bang for the buck”—for each program, we calculated how each contributed to GDP growth since implementation of the Recovery Act. Shaded areas above this “baseline” show the cumulative contributions of individual programs within the overall Recovery Act.

The amount each program contributed to the gain should be considered alongside its cost. The second accompanying chart (see Figure 2) depicts the relative cost and benefit of individual Recovery Act programs. Infrastructure spending accounted for 21.3 percent of the gain from the Recovery Act but only amounted to 18.8 percent of its cost. Social protection also punched above its weight, contributing to 39.9 percent of growth while only accounting for 34.6 percent of the cost. Aid to state and local governments contributed a similar amount to the gain and cost of the bill at 22.7 percent and 22.2 percent respectively.

In contrast to the spending provisions of the Recovery Act, tax cut provisions added up to 24.2 percent of the total cost but provided only 16 percent of the Recovery Act’s total benefit.

Conclusion

Clearly, the research shows that government actions can spur economic growth and job creation. But not all actions are created equal. Looking forward to address the ongoing slow recovery from the Great Recession, Congress and President Obama should stay focused on policies that yield the most bang for the buck: social protection programs and infrastructure investments.

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Endnotes

4 One study by economist Daniel J. Wilson of the Federal Reserve Bank of San Francisco finds a result that contradicts results of other studies of the Recovery Act—that tax cuts gave a bigger boost to employment spending programs. This analysis looks only at the Making Work Pay tax credit—the most efficient of the various tax cut programs—and does not look at spending on unemployment insurance, which other studies estimate as having the biggest impact on employment and growth. See: Daniel J. Wilson, “Fiscal Spending Jobs Multipliers: Evidence from the 2009 American Recovery and Reinvestment Act” (San Francisco, CA: Federal Reserve Bank of San Francisco, 2010), available at http://www.frbsf.org/publications/economics/papers/2010/wp10-17bk.pdf.
5 Blinder and Zandi, “How the Great Recession Was Brought to an End.”