SHORT AND LONG-TERM IMPACTS OF US FISCAL STIMULUS ON US INCOME

Deergha Raj Adhikari, University of Louisiana at Lafayette, LA, U.S.A.

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ABSTRACT

Our study examines the impact of US government's stimulus spending on the nation's income. We apply the VECM model on US data from 1980 to 2020. We also estimate impulse response of our model variables by giving one standard deviation positive shock to each of our model variables. From our VECM estimates as well as impulse responses, we find that, while the long-term impact of US fiscal stimulus spending on US GDP is positive and significant, the short-term effect is insignificant.

Keywords: *fiscal stimulus spending, stationarity, cointegration, VECM, short-term impact, long-term impact*

1. INTRODUCTION

The use of an expansionary fiscal policy has a long history in US economy. In an attempt to take the U.S. economy out of the Great Depression the nation fell into in 1929, President Franklin D. Roosevelt used expansionary policy by initiating several public works projects.

This policy worked fine in the beginning. Later, the president's effort to balance the economy caused the reappearance of the depression, which prompted him to resort to an expansionary fiscal policy one more time. To rescue the nation's economy out of the 1960 recession, President John F. Kennedy used expansionary policy to stimulate the economy.

Similarly, the recession of 2001 caused by a tech bubble bust prompted the then Bush administration to embrace an expansive fiscal policy. The then president introduced an expansionary fiscal policy through the Economic Growth and Tax Relief Reconciliation Act, which authorized the government to mail out tax rebate checks and lower income tax slabs.

But, the terrorist attacks of September 11, 2001 sent the U.S. economy back into recession. The president, therefore, launched a war on terror and cut business taxes in 2003 through the Jobs and Growth Tax Relief Reconciliation Act to stimulate the economy.

In an attempt to dig the nation's economy out of recession caused by a demand shock mainly due to the housing bubble bust combined with a supply shock due to surges in oil prices, the Obama administration used an expansionary fiscal policy by introducing the American Recovery and Reinvestment Act in 2009. This Act cut taxes, extended unemployment benefits, and funded public works projects. The law was meant to stimulate the weak economy that cost $787 billion in tax cuts and government spending.

The Trump administration used an expansionary policy through the Tax Cuts and Jobs Act and also increased discretionary spending—especially for defense.

Although the long term impact of an expansionary fiscal policy is subject to intensive debate, both democratic and republican presidents alike seem to believe that an expansionary fiscal policy stimulates the economy at least in the short run.