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Will We Be Stimulated? Economists Sound Off on Obama's Stimulus Package Reason

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Compiled by Nick Gillespie

On February 17, President Barack Obama signed into law a sweeping $787 billion stimulus plan that, he said, would begin "the essential work of keeping the American dream alive in our time." During the contentious debate over what ended up passing Congress on a nearly party-line vote, Obama declared, "There is no disagreement that we need action by our government, a recovery plan that will help jump-start the economy."

Suspecting that there was more disagreement out there than the president was letting on, **reason** asked 10 economists what they expect from the stimulus package. The results were not very optimistic.

Our panelists:

Robert Higgs, a senior fellow in political economy at the Independent Institute; editor of the institute's quarterly journal, *The Independent Review*; and author of the classic 1987 study of government growth *Crisis and Leviathan*.

Jeffrey Rogers Hummel, an associate professor of economics at San Jose State University.

Megan McArdle, who writes about economics, business, and politics at *The Atlantic*.

Deirdre McCloskey, a **reason** contributing editor who teaches economics, history, English, and communication at the University of Illinois at Chicago.

Allan H. Meltzer, a professor of political economy and public policy at Carnegie Mellon University and a visiting scholar at the American Enterprise Institute.

President Barack Obama signs the Economic Stimulus Bill into law, February 17, 2009. London Entertainment/Splash News/Newscom

Jeffrey A. Miron, a senior lecturer in economics at Harvard.

Michael C. Munger, a professor of economics and chairman of the Department of Political Science at Duke.

William A. Niskanen, a former member of President Ronald Reagan's Council of Economic Advisers and chairman emeritus of the Cato Institute.

Johan Norberg, a senior fellow at the Cato Institute who is writing a book on the financial crisis.

Mark J. Perry, a professor of economics and finance at the Flint campus of the University of Michigan.

Outside of the obvious pork, what are the biggest problems you see with the stimulus package?

Munger: The creation of new bureaucratic and regulatory structures, restrictions on creation of liquidity. The genius of the American system, for all its flaws, has been that we can mobilize lots of liquidity quickly. Silicon Valley exists because you could sit down, make a pitch, and get $10 million that afternoon.

If we start governing finance like we govern universities, or city councils, we are going to lose that. Having committees, and a bunch of forms to sign off on, and stamps...Hernando de Soto wrote about systems like this. They strangle business, investment, and growth.

Higgs: It entails the addition of a huge increment to the burden of debt the public must bear, directly or indirectly. It redirects resources on a grand scale from uses consumers value to uses politicians value and thereby impoverishes the general public.

McArdle: Even if you accept the theory of the stimulus, the package is not well-structured. A good stimulus package should be designed to move money out the door rapidly, then stop. This program is designed to move money out the door slowly and keep going. Moreover, the vast size of the package is going to add big costs in the not-so-distant future which have barely been discussed.

McCloskey: It's not targeted, not temporary, not timely. Especially the last. Too slow, too slow, alas.

Miron: The package is focused on increased spending and tax cuts that fail to improve incentives. I am extremely skeptical that the U.S. has $500 billion in additional productive spending, especially if done in a hurry. In most areas government spending is too high, not too low.

Meltzer: No thought is given to the medium and longer-term consequences. We are very likely to have large inflation in the next few years.

Niskanen: Nothing in the package increases the incentive to work, save, invest, or increase productivity. Any spending stimulus should be limited to increasing the demand for housing, in order to increase the value of the mortgage-backed securities that are limiting the ability of the banks to lend.

Norberg: The biggest problem is that it destroys savings by using them on projects that the majority did not think were reasonable a year ago. We take capital that would have been available to companies and poorer countries and use it to create a stimulus that will have its largest impact after the economy has already turned the corner —so that it will contribute to another round of boom and bust.

Hummel: The biggest problem with the stimulus package is the amount by which it increases total government spending, the national debt, and therefore future taxes.

Perry: First, like all fiscal stimulus packages in the past, the current one will not impact the economy at the right time for the intended stimulus effect, due to the inevitable problems of long lags. Much of the intended expansionary fiscal effects won't happen until next year and even 2011, and it's likely the economy will have recovered sufficiently by then so that the fiscal stimulus will be unnecessary and might actually be destabilizing.

Second, the fiscal stimulus has to be paid for eventually in the form of higher taxes, which will have a negative economic effect in the future, i.e., the "fiscal child abuse" effect. That is, any positive short-term effects of this stimulus package will be more than offset by future negative effects in the form of reduced future economic growth, decreased investments, and lower incomes.

Is there anything in the stimulus package that you think will work? If so, what?

Miron: Roughly, no.

Niskanen: No. Almost all of the tax cuts are welfare payments channeled through the tax system, not reductions in marginal rates.

Higgs: All of it works. The trouble is what it works for, which is to reward virtually every special interest allied with the Democrats and to guarantee the recipients' future support for the pirates who are now sending the booty their way. It is eerily similar to the New Dealers' use of the Works Progress Administration and other big

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relief programs to buy votes and bulk up their political machine.

Norberg: That depends on what the meaning of "works" is. The tax credit will work. Not as they intended it, though. But it gives people more money, which they will save because they can see that the government is building up a huge deficit that they will be forced to pay for in the future. And then those savings will come in handy.

Hummel: If by "work" you mean alleviate the depression, there is nothing in the stimulus that will do so.

McArdle: Expanding unemployment benefits and food stamps—the "automatic fiscal stabilizers"—are relatively low cost and transparent. They target money to the people whose consumption is contracting the most, and they will naturally shrink as the economy recovers.

Meltzer: Extending unemployment compensation, tax subsidy to homebuyers, some of the permanent tax cuts.

McCloskey: At less than full employment the Keynesian stuff works. So the minority of the quickie expenditures will "put people back to work"—until we return to almost-full employment, which will happen pretty quickly in the recovery. At that point the stimulus will merely crowd out private investment. In the short run people might get more cheerful too, always a good thing. But in two years the recession will be over. And the myth will grow up—rather similar to the ones about FDR and war expenditure—that Obama did it. Essentially, Obama will get credit for the self-adjusting character of the economy. I reckon we should start preparing that other face of Mount Rushmore.

Munger: Borrowing money to raise government spending will work, I suppose. But the cost to future generations is enormous. I am amazed by the hypocrisy of both sides. John McCain calls the stimulus "intergenerational theft." Well, he's right, but he came late to this wisdom. The Republicans have been just pouring out new deficit spending since 2002.

And then Obama says he doesn't want to do tired old ideas and failed economics. But he is doing exactly what the Republicans did: huge deficit-financed spending on largely useless or irrelevant programs designed to reward political friends. The only thing that's different is the identity of the "friends."

Some of the spending may increase measured GDP slightly for 2009. But the price is increased inflationary pressures in 2010 and the squandering of the birthright of our children for decades.

Perry: The fiscal stimulus will work only in the sense that it will serve to stimulate the approval ratings of the president and other politicians.

Obama says "doing nothing is not an option." Do you agree?

Perry: No. The market economy has an underappreciated but amazing ability to correct and reverse economic imbalances and problems on its own, and that economic self-correcting resiliency works best in the absence of government interference.

Higgs: For the economy in general, doing nothing is vastly preferable to doing the stimulus package, but doing nothing is not a political option; indeed, it would be political suicide. Which shows that only by adopting economically destructive policies can politicians survive. Do you see something wrong in this picture? Given the dominant ideology and the political institutions that now exist, economically rational public policy is incompatible with political viability. Having hit bottom, the politicians can only do one thing: keep digging. If Hell is down there, they'll reach it, sooner or later.

Hummel: The best thing the government could do is to cut

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spending and taxes. Doing nothing is a second-best option.

McArdle: I would like to see more proof of the statement that doing something is better than doing nothing. The Keynesian arguments upon which Obama's statements are based work out neatly in the textbooks, but there's little proof that they actually make things better, in aggregate, in the real world. And the current situation is all the proof you need that there are massive holes in our old textbook models.

McCloskey: I agree with Obama on the money and banking side, not on the real expenditure side. We are in a financial panic, which happens only in a few recessions (1907, 1929). In other words, the TARP [Troubled Asset Relief Program] is way, way more important than the stimulus. That's based on a logic of second best: The government fouled up the banking system (the most regulated part of the economy), so maybe the government should help clean up the mess. Someone needs to, and I reckon it's not going to be the Icelandic government. J.P. Morgan, where are you when we need you?

Miron: Doing nothing is always an option, and in my view it would be better than the stimulus. Better yet, we should fix those aspects of current policy that ought to be fixed independent of the crisis. The corporate income tax, which collects up to 35 percent of the difference between revenues and costs of incorporated businesses, has never been sensible policy. Repealing it can both stimulate the economy in the short run and enhance efficiency in the long run.

Munger: Doing nothing is not an option—anymore. Because first President Bush, and now President Obama, have engaged in a completely irresponsible fear campaign. "We must do something, or you should cower in helpless fear, behind locked doors, in darkened rooms!" Presidents should not use this kind of fear as a weapon to pass their pet projects. Roosevelt, for all his flaws, got it right: "The only thing we have to fear is fear itself." Well, not quite right: It turns out we need to fear fear itself, and also President Obama.

The sensible thing to do at this point would be to make an offer, at 40 cents on the dollar, for the "toxic" assets, both the collateralized debt obligations packaged by Freddie and Fannie, and also the credit default swap "insurance" derivatives sold by AIG (and some other firms, but mostly AIG). Since AIG wrote so many "naked" credit default swaps, even for people who don't own the underlying, or "insured," asset, they are going to keep hemorrhaging until someone puts a floor on the value of the assets.

So a one-time, take-it-or-leave-it offer. One big reason that credit markets are frozen is the uncertainty created by Treasury indecision and vagueness. Asset owners are holding out for a better price, and they are trying to negotiate through the Senate, not the Treasury. Obama needs to lead here and say: "Take this partial buyout, or hang on to the asset at your peril. There is no better deal coming tomorrow."

Niskanen: No fiscal stimulus program is a viable option. Use monetary policy to stimulate demand. Consider an optional fiscal stimulus plan consisting only of selective marginal tax rate cuts and a temporary subsidy to increase the demand for housing.

Norberg: Every single crisis in the last 100 years shows that doing nothing would have been preferable to doing bad things. But Obama is right that it is not an option in the current political climate. Now what applies is the politicians' logic from *Yes, Prime Minister*: "Something must be done. This is something. Therefore it must be done." ■