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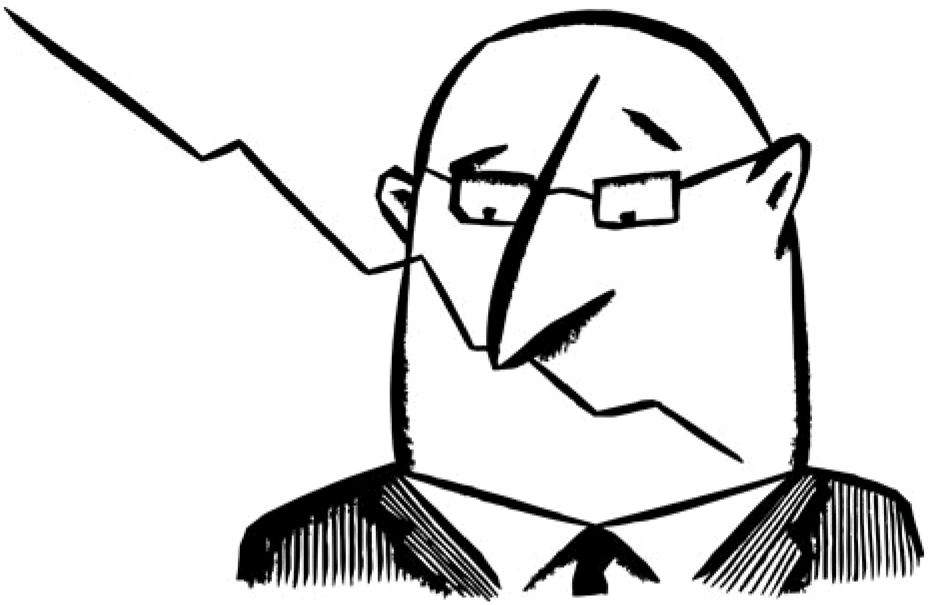
The Anti-Stimulus Economists Bite Their Tongues

So, did Obama's rescue package end up working after all? The free-marketeers who rallied against the stimulus look back and realize they had almost no idea what they were actually talking about. And that, yeah, it probably worked.

By: John H. Richardson



Eight months ago, after President Obama said during his first week in office that economists agreed on the need for a stimulus plan, two hundred indignant free-market economists signed a petition from the Cato Institute:

"Notwithstanding reports that all economists are now Keynesians and that we all support a big increase in the burden of government, we do not believe that more government spending is a way to improve economic performance."

Six months of nonstop GOP attacks followed. Then the economy started to turn around. This is how the story was covered at the Bloomberg financial news service — no hotbed of lefty activism:

> Aug. 12 (Bloomberg) — Recovery from the worst recession since the 1930s has begun as President Barack Obama's fiscal stimulus — derided as insufficient and budget-busting months ago — takes effect, a survey of economists indicated.
>
> The economy will expand 2 percent or more in four straight quarters through June, the first such streak in more than four years, according to the median of 53 forecasts in the monthly Bloomberg News survey. Analysts lifted their estimate for the third quarter by 1.2 percentage points compared with July, the biggest such boost in surveys dating from May 2003.
>
> "We've averted the worst, and there are clear signs the stimulus is working," said Kenneth Goldstein, an economist at the Conference Board in New York."

By September, the story even appeared (gasp!) under the umbrella of Fox News — under the headline "Global Recession Ending," no less:

> Governments and central banks' drastic fiscal and monetary steps to stimulate the economy, their response to the worst crisis since the Great Depression, now looked increasingly like a "success story."

So it seemed like a good idea to check in with those Cato economists and see how they felt about the stimulus now. I called a half-dozen, but none cared to respond. Finally, I reached NYU's Alberto Bison.

ESQUIRE: *So, have you changed your mind about the stimulus?*

ALBERTO BISON: No, no. It takes much more than this to change a mind.

ESQ: *Do you agree that we're coming out of the recession, then?*

AB: Yes, but it's very hard to say exactly why. It may depend on many things. But the stimulus doesn't have a particular effect, because people anticipate they will be taxed in the future, so they don't spend it. Economies have a great resilience, and they come out for one reason or another.

ESQ: *What about the Wall Street bailout? Back in October, it looked like the financial world was going to shut down completely.*

AB: I think the Fed did very well in avoiding a financial implosion — we avoided the huge gridlock in financial markets, and now we're slowly getting out. But the getting out was the same in previous recessions — we come out simply because once there's a recession, there's a cleanup of non-productive investment, so money goes into productive ones. This works by itself. That doesn't mean that you can't help it — but usually helping it means acting on financial markets. However, you can help on the *cost* of the recession. You can avoid that people who are unemployed starve — *that* you should act on.

ESQ: *But wasn't that a big part of the stimulus — supporting state unemployment funds?*

AB: That part is good. It's limiting the cost. It's safety net, which is very good because we don't want people to suffer.

ESQ: *But how do you slice that bag down the middle? What I mean is, maybe knowing there's a safety net increases confidence and keeps the economy from plunging even further?*

AB: That I don't know. It's really very hard. In a couple of years, it might be more clear.

ESQ: *But aren't you free-market guys still disputing the stimulus FDR used on the Great Depression seventy years ago?*

AB: A lot of people have recently made very solid arguments against the Roosevelt take, but I don't think it's fair to say that we *know* Roosevelt did badly.

ESQ: *But in the Cato petition, you are cited as one of the economists who know better than the president what to do with the economy. But you* don't *know.*

AB: Absolutely. The Cato petition was a reaction to the president saying every economist thinks that a stimulus plan is good. I don't. But to measure if I was right or not, it takes a while. But my argument, like many who signed the petition, is about what we know from economic theory and empirical work on past recessions. And everything I know is that it will have no impact, or a very small one.

ESQ: *So let me ask you this: How confident are you? If you were president, would you really have refused to do a stimulus?*

AB: I think it's a hard question to answer — I'm an economist and I think as an economist. But in a political situation there are many other things that you have to consider. I can understand very well if you're seen as the president and don't do anything and it gets worse, you go down in history as the criminal. So I don't know what I would have done. I would have put more money into the safety net than infrastructure probably. And I would have cut tax rates as opposed to giving back checks. But would I have had the guts to say, Look, there's nothing we can do — just sit tight and wait? I don't know.

ESQ: *Paul Krugman says that economists like you are seduced by the beauty of the free-market invisible-hand theory, so you don't look at reality. You think people are "rational economic actors" when they are actually full of impulses and bad judgments.*

AB: I think that's very wrong. But there is one point that Krugman mentions which is true, which is the issue of bubbles. It is true that economists tend to underestimate bubbles. Our models tell us they're very hard to get, so we tend to underestimate them. This might be wrong. We may need better models.

That seems like the money quote to me: The free-market theory defends tends to underestimate bubbles — and the crashes that go with them. In the cloisters of the academy, I guess that seems like a minor detail, a mere statistical deviation. Disregard that bread line! Ignore those tent cities! Just wait for us to tinker with our models.

It all reminds me of the wisdom of that great economic sage, Wallace Stevens:

> *Rationalists, wearing square hats,*
> *Think, in square rooms,*
> *Looking at the floor,*
> *Looking at the ceiling.*
> *They confine themselves*
> *To right-angled triangles.*
> *If they tried rhomboids,*
> *Cones, waving lines, ellipses —*
> *As for example, the ellipse of the half-moon —*
> *Rationalists would wear sombreros.*

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