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More on the Effectiveness of Government Intervention During the Crisis

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After three weeks in France, I am just now catching up on all the stimulus literature and the debates that I happily missed. As you may know, at the end of July, Alan S. Blinder, a Princeton professor and former vice chairman of the Fed, and Mark Zandi, chief economist at Moody's Analytics, released a paper that claims to estimate the effects of the economic policy responses of the last few years. They find that "while the effectiveness of any individual element certainly can be debated, there is little doubt that in total, the policy response was highly effective." They also argue that most of the policy successes come from measures adopted in 2008 and TARP rather than the stimulus.

Here is a good response to the paper by economist John Taylor. He writes:

> First, I do not think the paper tells us anything about the impact of these policies. It simply runs the policies through a model (Zandi's model) and reports what the model says would happen. It does not look at what actually happened, and it does not look at other models, only Zandi's own model. I have explained the defects with this type of exercise many times, most recently in testimony at a July 1, 2010 House Budget Committee hearing where Zandi also appeared. I showed that the results are entirely dependent on the model: old Keynesian models (such as Zandi's model) show large effects and new Keynesian models show small effects. So there is nothing new in the fiscal stimulus part of this paper.

In other words, their results rest on running some numbers through Zandi's Keynesian model and asserting that what the model predicted actually happened. If this sounds familiar, it's because it is. That's exactly what the CBO has been doing with job-creation numbers in the last year.

Here is Cato Institute's Alan Reynolds on this issue:

> We should have learned from the White House's reliance on Mr. Zandi's forecasts in January 2009 that magical "multipliers" yanked from some forecaster's black box are evidence of

> *nothing*. They simply reveal dubious assumptions built into that forecasting model. Yet the White House and Congressional Budget Office, as well as Professor Blinder, keep citing such models as if they were evidence the "stimulus" (spending) was effective. On the contrary, recent academic studies of real world events have been unable to find a multiplier effects even half as large as Zandi's model assumes. They find the addition to GDP is significantly *smaller* than the addition to the national debt – a bad bargain indeed.

And EconLog's Arnold Kling says the following:

> What the Blinder-Zandi paper does is explore the properties of a macroeconometric model. The economics profession abandoned those models thirty years ago, so the tool they are using is like a fossil, frozen in time. Of course, there have been many tweaks over the years, but my guess is that if I had access to the full model I would feel like I was returning to what I first worked on when I worked for Blinder thirty-five years ago.

The bottom line is that the models used by Zandi and touted by the administration are old and by design show the effectiveness of the policy. And the authors of the paper don't quite bother with what actually happens in the real world.

By the way, in this TV interview, Zandi argues against increasing taxes at the end of the year.

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