Economists here are less dismal — but still dismal

By David Nicklaus
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Practitioners of the dismal science, as economics is often known, are probably less dismal these days than the public at large. One doesn't have to listen to many economists, though, to hear plenty of warnings about the dangers that lie ahead.

More than 80 percent of economists believe the recession is over, according to a survey released Monday by the National Association for Business Economics. NABE's annual convention, which concludes today in St. Louis, even carries an optimistic subtitle: "Gateway to Recovery."

The survey also predicts, however, that unemployment will remain at 9.5 percent a year from now. Lawrence Summers, President Barack Obama's top economic adviser, told the group that a jobless recovery will be a big problem.

"Each percentage point of unemployment adds substantially to the government debt, subtracts from our capital stock and limits our human potential," Summers said Monday. He added that Obama's administration is committed to measures that will stimulate demand and make credit available to consumers and businesses.

Some private-sector economists also said they support such initiatives. Mark Zandi, chief economist at Moody's Economy.com, listed at least $100 billion worth of measures that he would like to see in a new economic stimulus bill.

That price tag would cover extending unemployment benefits, keeping a credit for first-time home buyers in place until June, and prolonging some temporary business tax breaks.

"The economy is going to need more help going into next year," Zandi said. "Unless the job market changes, this recovery is unlikely to evolve into a self-sustaining economic expansion."

In arguing for more intervention in the economy, both Summers and Zandi invoked

a concept known as the output gap. That's the difference between what the nation is producing now and what it could produce in a theoretical state of full employment.

The NABE delegates also

heard a warning about such analysis. James Bullard, president of the St. Louis Federal Reserve Bank, said Sunday that economists may be overestimating the size of the gap.

"The narrative is that the output gap must be large since the recession is severe, and so any medium-term inflation threat is negligible," Bullard said. "I think this narrative overplays the output gap story for understanding medium-term risks."

The gap can't be measured accurately, he noted, and inflation became a problem when economists underestimated it in the 1970s. Moreover, output-gap theory doesn't account for something like a housing bubble.

"If part or most of the fall in output was a collapsed bubble, then today's output gap would be smaller than it appears," Bullard said.

Bullard's former boss, Bill Poole, also is worried that some measures taken during the crisis will be hard to unwind. The Fed, for example, is committed to buy $1.25 trillion of mortgage-backed securities by next March to prop up the housing market.

"The housing and mortgage industry is one of the most politically sensitive sectors in the entire economy," said Poole, a former St. Louis Fed president who is now a senior fellow at the Cato Institute. "The Fed may indeed find itself under pressure to continue buying, because mortgage rates otherwise would rise."

If Bullard and Poole are correct, we're in danger of making policy mistakes that will cause a surge in inflation. If Summers and Zandi are correct, the danger lies in the other direction, of not doing enough to bring down unemployment.

Even when they're in an optimistic mood, these economists can be pretty dismal.

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