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ECONOMIC NEWS UPDATE

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An Unstimulating Stimulus?

If, like John Maynard Keynes, you believe that spending, any spending, will revive a flagging economy, the freshly minted, 1000-page American Recovery and Reinvestment Act of 2009, calling for \$504 billion in deficit-financed spending is for you. Well, not quite. It seems that most of the money will not be spent very soon. About 30% won't hit the economy until 2011, and the balance is likely to be tied up in the procurement processes of the federal and state governments at least until well into 2010. After all, the Department of Energy, given \$40 billion to spend on green projects, has yet to disburse funds authorized by congress in 2005 for just that purpose. And the Congressional Budget Office says it could take eight years for the undermanned Commerce Department to spend the \$7 billion ticketed for the expansion of broadband access in rural areas.

But never mind such caviling: President Obama and Senate Majority Leader Harry Reid get \$8 billion for high-speed rail projects in their home states, Reid's pork to be used to fund a line linking the moneyed classes of Beverly Hills with the casinos of Las Vegas.

Besides, much of the spending will end up boosting other economies -- subsidies for wind machines will benefit workers in countries in which such machines are manufactured, rather than horny handed toilers here in America. And much of the spending will not create jobs for the unemployed: laid-off auto workers do not have the skills to design the software to manage the "smart grid" that is the apple of greens' eye, and funded in the bill.

If you have not jumped onto the new Keynesian spending bandwagon, but believe with Christina Romer, chair of Obama's Council of Economic Advisers, that

tax cuts are more effective in turning an economy around than spending, you should love this bill, with its \$286 billion in tax cuts and credits. Well, not quite. True, individuals earning less than \$75,000 per year and families earning less than \$150,000 will receive credits of \$400 and \$800, respectively, at a cost of "\$116.199 billion over 10 years"; the earned income tax credit for "working families with three or more children" is increased at a cost of \$4.663 billion over ten years; and there is more for pensioners, disabled veterans, families of college students and a host of others. If you are not reassured by the precision of the cost estimates you are not alone.

But the tax-cut contingent is doomed to disappointment, although the incentives to business to invest might, just might be of help, especially if demand shows any sign of recovering. Much of the money directed at individuals will be saved or used to pay down credit card balances, not bad things, but not very stimulative. Much will be spent in Wal-Mart, earning congress the applause of Chinese trainer and t-shirt manufacturers. And much will never be claimed: the specific subsidies for college education are simply too small to have much effect on college enrolments.

If you are a supply-side enthusiast, a reading of this massive bill will add your personal depression to the national recession. Reforms that might increase employment in the oil and gas industries by removing restrictions on drilling are nowhere to be found. Environmental restrictions on the sorts of cars that Americans want to buy remain in

place, consistent with congress' drive to have the begging-bowls-in-hand auto companies produce Schumermobiles, named after the New York senator whose passion is electric vehicles and cars too tiny to need much petrol or to survive in a serious crash. A change in rules that would permit the construction of needed transmission lines without lengthy court reviews initiated by environmental groups remains off the Obama agenda and out of the bill. Most important is the absence of steps to encourage the flow of private capital into toll roads, an alternative to government-financed highways, and into schools free to compete for vouchers, rather than schools built by governments in towns that already have an excess supply of classrooms.

The explanation for these omissions was simply stated by the President, responding to those who want even more tax cuts and some supply-side stimulus, "We won." Not very satisfying intellectually, but who needs intellectually satisfying arguments when his party controls the White House, the Senate, and the House of Representatives?

But enough quibbles. If, like any sensible person, you're not sure spending will work, but not sure it won't; not sure that the bulk of tax cuts will be spent on US manufactures, but not sure they won't; and not sure that doing nothing is a good, though tempting idea, this bill is about the best that can be extracted from a Democratic congress.

So Obama has his stimulus bill, but he has paid a very high price. He now owns the recession.

He has asked to be judged by whether this bill and other measures he will propose create or "save" 3.5-to-4 million jobs, the number lost so far since unemployment turned up. Forget "save" -- if unemployment keeps rising, voters are not likely to rally around the slogan "It would be still worse if I hadn't spent your trillions". What the President has done is to promise what he certainly can't deliver in time for the congressional elections next year -- a reversal of job destruction, and millions of new jobs. If the voters prove patient in 2010, they are unlikely to remain as forgiving when the presidential election rolls around in 2012. Since employment is what economists call a lagging indicator -- employers are not confident enough to start hiring until economic recovery is well underway -- Barack Obama will have a lot of explaining to do. Unless, of course, the Republicans find a candidate so inept that the President can once again rely on his very attractive persona to see off any challenger.

The President has paid a price in reputation as well as in political authority. One reason many who voted for George W. Bush did not mourn his departure was the sheer incompetence of his administration. Along comes Barack Obama, cool, confident, and most of all competent. At least so it seemed as his exquisitely organized campaign rolled over the Clinton machine in the primaries, and trumped the chaos that passed for the presidential campaign of John McCain.

Then came the withdrawal from consideration of three key

nominees who had neglected to comply with tax regulations or were involved in scandal investigations. And the sudden decision of Republican Judd Gregg to remain in the Senate rather than join the Obama cabinet, as the President had announced, contributed to the premature winding down of the President's honeymoon. It seems that the Obama team had neglected to learn that Gregg opposed the stimulus package and the President's plan to politicize the Census so as to inflate the number of Democratic seats in the House of Representatives.

Finally, there is what is now being called the Tim Geithner no-plan. The President used a nationally televised press conference to announce that his Treasury Secretary would the very next day reveal to the nation, and indeed to the world, a plan to save the banks and provide relief for troubled home owners. But Geithner's speech was so lacking in detail -- one wag says Geithner said "Ready, aim, aim, aim" -- that the stock market plunged by about 400 points. It seems that the administration's brainy team of economists has not solved the problem of valuing the toxic assets on the bank's balance sheets -- pay too much for those assets, and the taxpayer gets the bill, pay too little and the banks have to take bankruptcy-producing write-downs.

Geithner will be meeting with his G-7 colleagues in Rome this weekend. Unless he has worked out some effective way of spending the \$2 trillion that Washington rumor says his plan will cost, a gaggle of finance ministers will be heading

home very disappointed. For in between their public attacks on America, they privately say that only America can lead the world out of its current difficulties. They realize that Geithner's job is made more difficult by the anti-banker frenzy whipped up by congress, and politicians in their own countries, at a series of show trials of bonus-grabbing bankers. Having fanned the populist flames, politicians will find it difficult to give Geithner the money he needs to prevent the banks from going not-so-gently into that good night in which Lehman Brothers resides.

That means the President will have to do some heavy lifting to get Geithner's eventual plan passed, rather than wait passively for whatever congress concocts. Which means that he will have to demonstrate that he knows as much about governing as he does about campaigning. As Bush economic adviser Larry Lindsey repeatedly points out, Obama is still in campaign mode. Turn on your television set and there he is: in Indiana, Florida, Virginia, Illinois, campaigning for the stimulus bill. Holding a nationally televised press conference, or a series of tête-à-têtes with news anchors, or meeting with business leaders, or heading off to the presidential retreat at Camp David with his telegenic family. Open your copy of *Vogue*, or merely glance at its cover, and there is Michelle Obama, stylish, about to make the rounds of government agencies to carry the president's message of change to a bureaucracy that knows it will be there long after she is back in Chicago, or touring

college campuses with her daughters.

Meanwhile, the old bulls in congress are drafting legislation, extracting pledges from bankers to suspend temporarily foreclosures on families that are behind in mortgage payments, and planning to run up the already ballooning federal deficit by bailing out families unable to meet their mortgage payments. While Obama campaigns, Pelosi & Co prepare to legislate. And he (or she) who writes the legislation controls policy-making, as the President should have learned when he lost control of the stimulus bill by delegating its drafting to congressional leaders.

Which is perhaps Obama's most important problem. As a result of the Democratic left's victory in its skirmish with the President over the stimulus package, congress is emboldened to go its own way. And the congressional leadership's refusal to accord a meaningful role to the Republican minority has emboldened the opposition to, well, oppose. As a result, the President will find it difficult to rally bipartisan support for the really important business that lies ahead.

Obama's stimulus splurge will bring America's deficit to levels that will drive the dollar down and inflation up unless he can deliver on promises to balance the books when the economy is back on track. To do that he will have to put Medicaid, Medicare and Social Security programs on firm fiscal footings.

These entitlement programs, combined with an ageing population, are simply unaffordable as now constituted. Michael Pakko, an

economist at the Federal Reserve Bank of St. Louis, says that studies show that “the shortfall for government social insurance programs” have a present value of between \$0.9 trillion and \$70 trillion.... The trends are unsustainable.... The unfunded future liabilities of government entitlement programs imply rising deficits and a ballooning public debt far larger than today’s shortfall.” And remember, we have not yet seen the total bill for Obama’s recovery plan. In addition to the \$789 billion stimulus package agreed this week, and the \$700 billion already committed to saving the banks, insurers and sundry other “special cases” (autos, for one), there is the additional \$2 trillion to fund the plan that Geithner will eventually devise. Even in America’s \$14+ trillion economy, that’s real money.

There are some things the President and congressional Democrats can push through without any help from the Republicans. But when it comes to the reform of the entitlements programs that are set to bring the country to the brink of fiscal ruin, he will need political cover from the Republicans. Few Democrats in congress will be willing to vote to cut benefits to staunch the flow of red ink unless there is broad Republican support. Few Republicans will be willing to raise taxes to pay for what they consider bloated welfare programs. Politicians will only back a truly bipartisan reform program so that angry voters blame both parties equally for the pain of reform.

As things now stand, the President will have a hard time controlling his own party, and an

even harder one persuading Republicans, furious at having been denied any significant role in crafting the stimulus package, to share the blame for cutting benefits and/or raising taxes in the next few years. They will tell him, “You won, you fix it.” Unless, of course, Obama stops campaigning and starts governing.

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