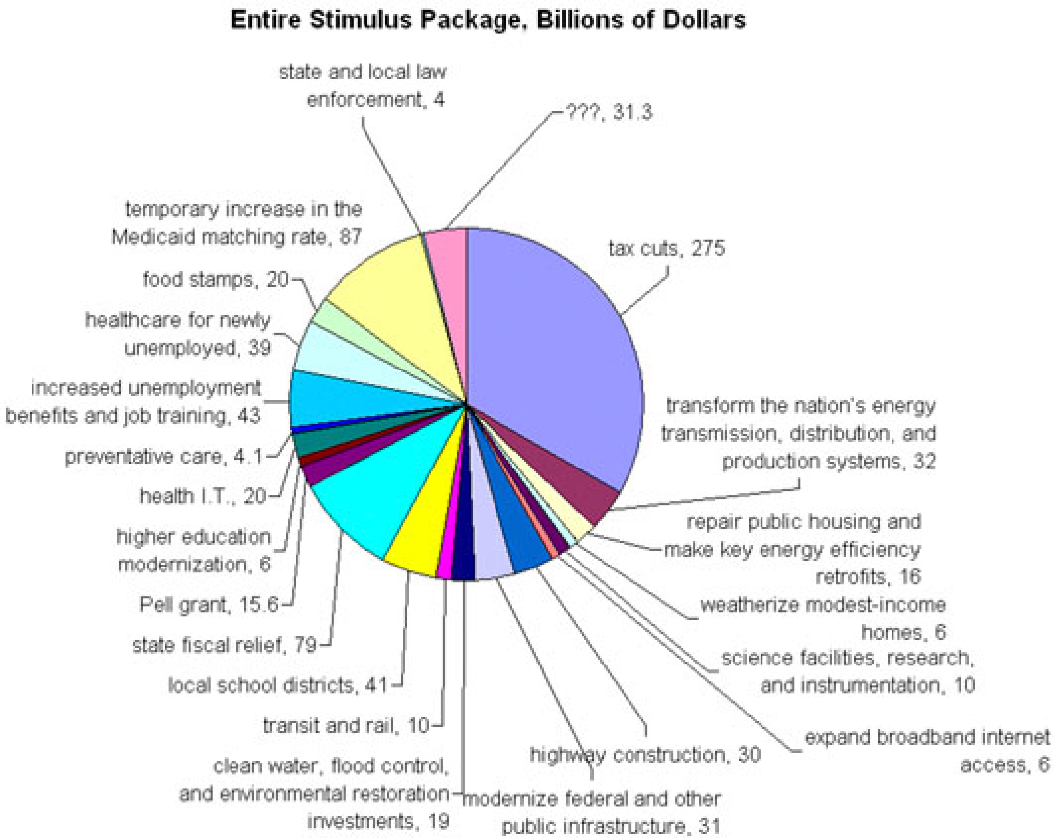
The Department of Economics welcomes students, faculty, and staff to:

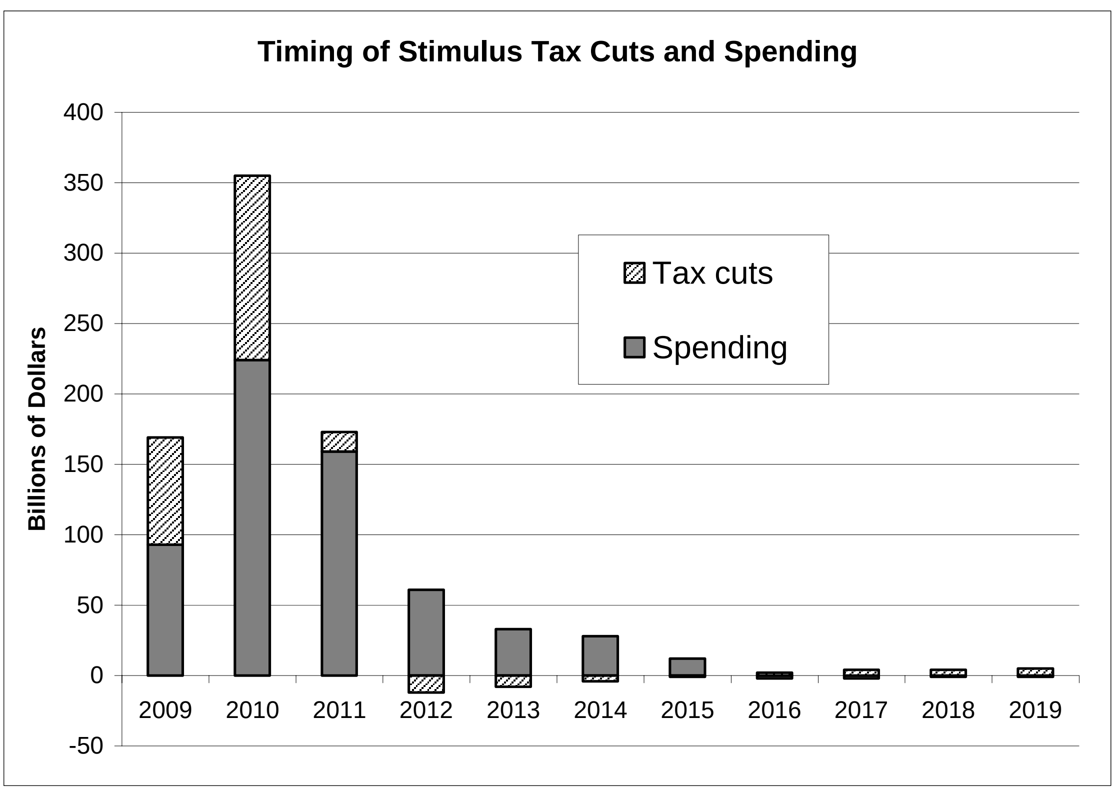
Current Issues in Economics: Stimulus and Bailouts

Tuesday, Feb. 3rd
4:30- 6:00
Farrell Room, St. Edmund's Hall

As the economic crisis deepens, policymakers are bailing out banks and major corporations, and are discussing a huge stimulus package. Are the bailouts sound policy, or just corporate welfare? Will the bailouts cushion the current downturn, or just enable continued irresponsibility? Should the stimulus package focus on tax cuts, spending, or some combination? Is the stimulus too large or too small? **Assistant Professor Patrick Walsh of the Economics Department** and **Professor Robert Letovsky of the Business Department** will discuss these issues, and take questions from audience.



Breakdown of $825 billion stimulus package introduced by House Democrats (as of Jan 15 2009)



Breakdown of when the money will be spent (Source: Congressional Budget Office)

Who should get the federal stimulus funds

By Edward L. Glaeser
Boston Globe, January 5, 2009

BUFFETED by recession, our nation has elected a president determined to act. President-elect Obama's advisers have called for a vast stimulus package of $750 billion or more. But macroeconomic events should never lead us to toss out the first rule of prudent policy: fund projects only when benefits exceed costs. The Obama administration, therefore, faces the challenge of spending at least three quarters of $1 trillion at breakneck speed on sensible stimulus projects.

The difficulties inherent in this challenge explain why Keynesian fiscal policy has been out of fashion for decades. Until last year, the economic consensus was that monetary policy could smooth the business cycle with greater speed and less waste than countercyclical taxes or spending. Fiscal policy has made a comeback, not because its flaws have disappeared, but because the alternatives don't seem to be working. Yet, any macroeconomic benefits of the stimulus package will be easily undermined if stimulus funds are spent building bridges to nowhere.

What will minimize the risks of a fiscal fiasco? There are three plausible plans: new tax cuts for middle-income Americans; investing in infrastructure; and providing aid to states. Tax cuts can be implemented quickly and entail minimal waste, since the money shows up directly in people's pockets. The big problem with using the tax system to fight recession is that consumers don't necessarily spend the money. At least some may save, recognizing that current federal largesse will be offset by future taxes.

Perhaps the best way to avoid this problem is to target tax cuts toward lower-income Americans who are most likely to spend anything they get. The bulk of the fiscal stimulus could be used to radically reduce the Social Security and Medicare taxes paid by lower- and middle-income Americans over the next 18 months. A payroll tax cut should boost the economy by getting money in the hands of people who will spend it. The tax cut would also make work pay more for poorer Americans, and that should increase employment. Even if the tax cut doesn't end the recession, it would at least ease the downturn's burden on poorer Americans.

While the mechanics of a payroll tax cut are simple, spending hundreds of billions wisely on infrastructure is hard. Currently, the federal government spends about $40 billion a year in transportation, and another $20 billion on other forms of infrastructure. There is a case for significantly increasing this amount. Our roads do need repairing, and it makes sense to invest more in a downturn when unemployment is high. But even doubling the current federal infrastructure expenditure, a vast increase, would represent only 8 percent of a $750 billion package.

The country needs to invest steadily and wisely on infrastructure, not rush hundreds of billions of dollars out the door. Really expensive projects, like the Big Dig, can take many years to plan, permit, and build. Our roads require ongoing maintenance, not a big push. Moreover, fairness and economic efficiency dictate that infrastructure should generally be paid for by users, not general tax revenue. It is appropriate that gas taxes pay for federal highway aid. Using general revenues to build highways means more subsidies for carbon-emitting cars. The country should take infrastructure investment seriously, but infrastructure spending is unlikely to be sound stimulus.

There is a better case for direct aid to state and local governments. Many states, like Massachusetts, face balanced-budget rules that force spending to contract during a recession, just when that spending is most needed. Federal aid can offset the drops in local revenue and maintain spending levels on vital services like schools and police. Our children are an even more important investment than our roads.

The best way to make sure that a vast stimulus package doesn't turn into a federal boondoggle bonanza is for that money to go directly to private citizens and local governments. Reducing payroll taxes for middle- and lower-income people harkens back to the Jacksonian idea of small-government egalitarianism. Shoring up the balance sheets of state and local governments would help ensure that those governments don't make the downturn worse by cutting spending during a recession.

The Confidence Surplus

By **DAVID BROOKS**
New York Times, January 9, 2009

Christina Romer is Barack Obama’s choice to lead his Council of Economic Advisers. In 1994, Romer and her husband, David, wrote an essay entitled “What Ends Recessions?” In the first paragraph, the Romers noted that “economists seem strangely unsure about what to tell policy makers to do to end recessions.”

The Romers surveyed the recessions of the previous 50 years to try to reach some conclusions about what works. “Our central conclusion is that monetary policy alone is a sufficiently powerful and flexible tool to end recessions,” they wrote. Automatic spending policies like unemployment insurance have sometimes helped. Discretionary policies, like tax cuts and stimulus plans, have not been of much use. As they put it: “Discretionary fiscal policy, in contrast, does not appear to have had an important role in generating recoveries.”

The Romers briefly described how different administrations responded to recessions. All the administrations, Democratic and Republican, resisted large-scale fiscal stimulus plans. They didn’t believe they could time a stimulus correctly. They didn’t trust Congress to pass the bills quickly or cleanly. They decided they shouldn’t be making policy in what Kennedy administration economists called “an atmosphere of haste and panic brought on by recession.”

The Romers’ essay exemplifies the economic doctrine that reigned up until a few months ago: fiscal stimulus plans that try to time a recession are dangerous, unproven and unnecessary.

That doctrine has suddenly vanished. But not because we suddenly know how to create effective stimulus plans. Last year, the Congress passed a $165 billion plan that seems to have done almost nothing for the economy. The doctrine has vanished because this recession is deeper than the others and we’ve run out of other stuff to do.

Today there is wide support for fiscal stimulus. It’s just that there is no historical experience to tell us how to do it, and there is no agreement on how to make it work. The economists’ prescriptions are all over the map.

Obama is compelled to jump into unchartered territory, with no compass or guide. He could have chosen to spend the big money that is apparently required in cautious ways. He could have chosen to pick out a few easily implemented policies that could be enacted in a way that is targeted, temporary and timely. He could have chosen to merely cut the payroll tax, boost aid to the states and do infrastructure projects.

But the Obama presidency is going to be defined by his audacious self-confidence. In Thursday’s speech, he vowed to do everything at once. He vowed to throw the big things into the stimulus soup — tax cuts, state aid, road and bridge repair — but also the rest of the pantry. He proposes broadband projects, special education programs, a new power grid, new scientific research, teacher training projects and new libraries.

This will be the most complex piece of legislation in American history, and as if the policy content wasn’t complicated enough, Obama also promised to pass it via Immaculate Conception — through a new legislative process that will transform politics. The process, he said, will be totally transparent. There will be no earmarks, no special-interest pleading. In a direct rebuttal to Federalist No. 10, he called on lawmakers to put aside their parochial concerns and pass the measure in weeks.

And as if that isn't enough, he promised next month to make repairing Social Security and Medicare a "central part" of his budget. "I'm not out to increase the size of government long-term," he told John Harwood of The Times.

This is daring and impressive stuff. Obama's team has clearly thought through every piece of this plan. There's no plank that's obviously wasteful or that reeks of special-interest pleading. The tax cut is big and bipartisan. Obama is properly worried about runaway deficits, but he's spending money on things one would want to do anyway. This is not an attempt to use the crisis to build a European-style welfare state.

The problem is overload. Four months ago, no one knew how to put together a stimulus package. Now Obama wants to use it to rush through instant special-ed programs and pre-Ks. Repairing the power grid means clearing complex regulatory hurdles. How is he going to do that in time to employ workers in May?

His staff will be searching for the White House restrooms, and they will have to make billion-dollar decisions by the hour. He is asking Congress to behave and submit in a way it never has. He has picked policies that are phenomenally hard to implement, let alone in weeks. The conventional advice for presidents is: focus your energies on a few big things. Obama just blew the doors off that one.

Maybe Obama can pull this off, but I have my worries. By this time next year, he'll either be a great president or a broken one.

Other sources of info on bailouts and stimulus:

Bailouts:

Economist Magazine, Jan 22, 2009:
http://www.economist.com/opinion/displayStory.cfm?story_id=12987495&source=hptextfeature

Washington Post, Jan 15, 2009:
http://www.washingtonpost.com/wp-dyn/content/article/2009/01/14/AR2009011403177.html

Finance economist Luigi Zingales, Jan 19, 2009:
http://www.voxeu.org/index.php?q=node/2807

Economist Joseph Stiglitz on automaker bailouts, December 1, 2008:
http://www.ft.com/cms/s/0/1a2e2042-c79f-11dd-b611-000077b07658.html

Stimulus:

Stimulus proponents:

Obama Administration economist Larry Summers:
http://www.washingtonpost.com/wp-dyn/content/article/2008/12/26/AR2008122601299.html

New York Times, Jan 6, 2009:
http://www.nytimes.com/2009/01/07/business/economy/07spend.html

Financial Times:
http://www.ft.com/cms/s/0/8b2f754e-e012-11dd-9ee9-000077b07658.html
http://www.ft.com/cms/s/0/715fe07e-f082-11dd-972c-0000779fd2ac.html?nclick_check=1

Nobel-laureate economist Paul Krugman:
http://krugman.blogs.nytimes.com/2009/01/19/getting-fiscal/
http://krugman.blogs.nytimes.com/2009/01/19/economists-ideology-and-stimulus/
http://www.nytimes.com/2009/01/26/opinion/26krugman.html?_r=1

Stimulus skeptics:

University of Chicago panel on the stimulus:
http://gsbmedia.chicagogsb.edu/GSBMediaSite/Viewer/?peid=439a24a984fa449a8833412955afac45

Economist Robert Barro:
http://online.wsj.com/article/SB123258618204604599.html

Refereeing the debate:

Economist Arnold Kling on the stimulus debate:
http://business.theatlantic.com/2009/01/how_economists_analyze_the_stimulus.php

Economists Brad DeLong vs. Kevin Murphy:
http://delong.typepad.com/sdj/2009/01/best-anti-stimulus-argument-from-kevin-murphy.html

Blogger Marc Ambinder on when different parts of the stimulus will take effect:
http://marcambinder.theatlantic.com/archives/2009/01/cbo_anticipates_that_implement.php

New York Times historical perspective on past recessions and stimulus:
http://www.nytimes.com/interactive/2009/01/26/business/economy/20090126-recessions-graphic.html?hp

Detailed Congressional Budget Office report on the stimulus proposal:
http://www.cbo.gov/ftpdocs/99xx/doc9968/hr1.pdf