

Some Economics and Politics of the Stimulus Package

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You may be a bit exhausted of hearing about the economic stimulus package that Congress is putting together. If so, I don't blame you . . . but it is, after all, the important news of the day. The unemployment rate just took another tick upward and, at this writing, it looks as though an over \$800 billion deficit spending package will be passed. So, at the risk of wearing you out on this topic a little more, I'm going to talk about it in this column. I will try very hard to give you a unique perspective. So hang with me, folks.

The upshot is that, whatever your view on the effectiveness and wisdom of the present bill in Congress, we will get more government in our economy and in our lives. Thus, we are getting "change" as promised by President Obama. I wonder, though, whether this was the type of change the electorate had hoped for. I also wonder whether the Republican strategy of opposition without a distinct alternative is a wise one.

As regular readers of this column probably know, I am a skeptic of the helpfulness of most of what's proposed in the present package. I have run across several particularly interesting news items over the past few weeks that have bolstered my view. One is a recent *Wall Street Journal* column by Alan Blinder, a prominent Keynesian economist, who wrote in favor of the stimulus package (see <http://online.wsj.com/article/SB123371199080646225.html>). He notes, however, that the proposed stimulus spending will increase the federal, non-discretionary budget by about 70% and asks, "What government . . . can manage a rapid 70% budget increase without some waste, fraud, and abuse?" I certainly agree with Blinder on this. The size and rapidness of the spending virtually insures pork and inefficient projects that do the economy no good. But this makes the case for opposing the stimulus bill. Equally prominent economists Gary Becker and Kevin M. Murphy emphasize this and other points in their skepticism of the present bill (see <http://online.wsj.com/article/SB123423402552366409.html>).

During President Obama's press conference on February 9, he emphasized the importance of avoiding an experience like Japan's "lost decade;" a period of minimal economic growth that ensued a real estate market collapse in Japan in the 1990s. However, as reported recently by the *New York Times* (see <http://www.nytimes.com/2009/02/06/world/asia/06japan.html>), Japanese policymakers responded to this crisis by an unprecedented level of fiscal stimulus during this period. Nevertheless, the Japanese economy continued to stagnate. The culprit, evidently, was spending on large infrastructure projects that were not valuable.

We are given assurances by advocates of our present spending plan that pains will be taken to avoid wasteful projects. While this is an admirable sentiment, it's hard to see how it will be accomplished. For private sector projects, the money comes from voluntary investors, so there has to be a strong expectation that the project will end up producing value. Governments don't face such strong incentives. Governments are subject to electoral approval at some level, but obtaining that approval often entails favoring feel-good but questionable projects and catering to powerful special interests.

Regardless of how effective one thinks the stimulus and other spending programs will be in generating recovery from recession, we are going to have a larger government. The Congressional Budget Office (see http://www.cbo.gov/ftpdocs/99xx/doc9958/01-08-Outlook_Testimony.pdf) estimates that federal government spending will move from about 21% of the U.S. economy to 25% even without any of the programs of the Obama administration. Those can easily jump us up another two or three percentage points. Government spending is the best measure of the cost of government since this is the amount that has to be paid either in taxes today or by borrowing and taxes tomorrow. The question is whether we are getting our money's worth from government. This one source of my concern about the large and rapid rise is spending . . . I fear that we are not getting value from our tax dollars.

So what are some alternatives to the proposed government programs and how might our political parties view them? It's clear that the Democratic Party has staked out the position of big (and growing) government with the present proposals. It would be nice if there were a clear alternative articulated. Even if it's voted down, I'd just like to see one proposed! Presently, the Republican Party seems pretty unified in its opposition to the stimulus package. However, we don't hear of much of other options except for a slightly smaller stimulus package. So the choice seems to be between more government (Republican Party) and a lot more government (Democratic Party). Regardless of your party affiliation, this would seem to be an unwise road for the Republicans to go down. If the voters want more government, why not support the party that does it best?

If the voters want "change" in the form of less government, it would be helpful to see options that propose to do so. In the present context, alternatives that do so require engaging the private sector and dealing with the problems that led us down this recessionary path. We know that a big part of our problems stem from overly expansive monetary policy, loose mortgage loan standards (encouraged by Fannie Mae and Freddie Mac), a plethora of high-risk and now problem mortgages, over investment in housing relative to other capital, and, in the wake of falling housing prices, failing financial firms. It's easy to deal with some of these. Stop encouraging high-risk lending. Maintain a stable monetary policy (aside from injections needed to offset recession). This gives individuals, firms, and investors a stable economic environment without the inducement to overinvest in housing. The private sector will adjust appropriately.

The other issues are not quite so straightforward to handle. Mortgage modification is a way in which the private sector often has dealt with problem mortgage loans. This process evidently has been impeded by the large volume of delinquent

payments and the securitization of mortgages. It's perhaps sensible to set up government programs to expedite mortgage modifications. Likewise, a number of financial firms are essentially bankrupt and have lost the trust of the marketplace. The private sector typically deals with firms like these via the bankruptcy and restructuring process. Because of the large number of such firms and the importance of financial markets in the economy, it's probably prudent for government to facilitate this process. We may want to examine some regulations, not with a punitive intent but to improve information and transparency so that private parties can more easily deal with one another.

With the above sort of proposals, the amount of spending required is orders of magnitude less than what's in the current administration plans. I'd very much like to see a proposal of this type put forth. It may very well be voted down, but I'd still love to see it put out there.