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Did the Stimulus Stimulate?

The Obama team gives macroeconomics a bad name.

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A recent paper by Alan Blinder and Mark Zandi claims that if not for the response of the federal government, the unemployment rate would be 15.7 percent, far higher than the current 9.5 percent. The press quickly reported that this vindicated the Obama stimulus plan. But the fact is that most of the positive effects cited in their paper came not from the stimulus but from stabilizing actions of the Federal Reserve, the FDIC, and TARP.

The paper argued that fiscal stimulus enacted under both Presidents Bush and Obama lowered the unemployment rate by 1.5 percentage points. But it did not measure either the number of people who found work or the effectiveness with which the Obama stimulus created jobs. Instead, it assumed through the use of economic modeling that the recently enacted stimulus was roughly as effective, dollar for dollar, as similar provisions in the past. It then multiplied the past measures of job creating effectiveness by the number of dollars in the current plan and added the result to the current unemployment rate.

This is the economic equivalent of assuming there are 1,000 angels on the head of a pin, observing that we have 10 pins, and therefore calculating that we must have 10,000 angels. The math is fine. But it sheds no light on the key policy issue—were the recently passed acts of government stimulus cost effective? The degree of cost effectiveness was an assumed number, not one calculated using any version of the scientific method.

One way to correct this is to treat the current stimulus as one would treat any other kind of scientific or social scientific experiment: Form a hypothesis before you run the experiment, run the experiment, and then observe how the results of the experiment compare with your original hypothesis. Christina Romer, who resigned last Friday as chairman of the president's Council of Economic Advisers, and Jared Bern-stein, chief economic adviser to Vice President Biden, have done the first part of this experiment. In January 2009, they published a paper using a model similar to the one Blinder and Zandi used to project what would happen if President Obama's proposed stimulus package passed, compared with what would happen if it did not.

The Romer-Bernstein paper has often been cited as saying that if the package passed, the unemployment rate would peak below 8 percent in the middle of 2009 and would decline to below 7.5 percent by now. Obviously this has not happened. The administration, along with Blinder and Zandi, argue that it is not fair to conclude that this proves the package was a failure since Romer and Bern-stein underestimated the severity of the recession and that unemployment was already 8.2 percent in the first quarter of 2009, higher than the assumed peak.

Chart 1: Not Even Close…

Reality vs. Obama administration (Romer-Bernstein) stimulus projections

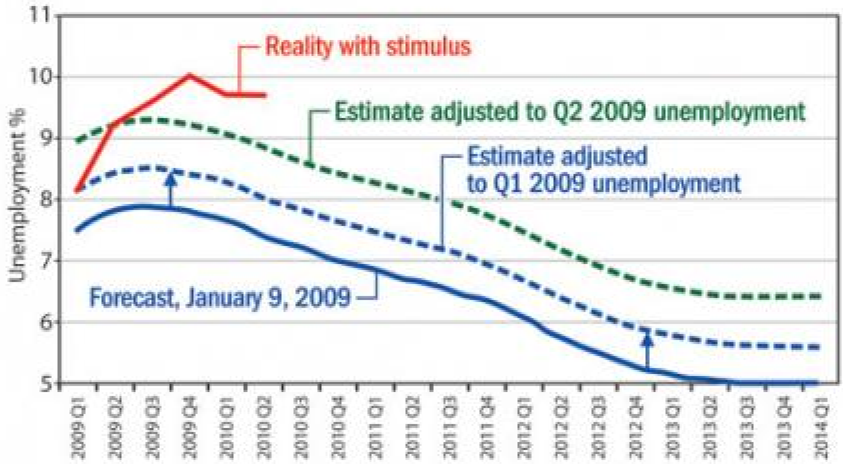
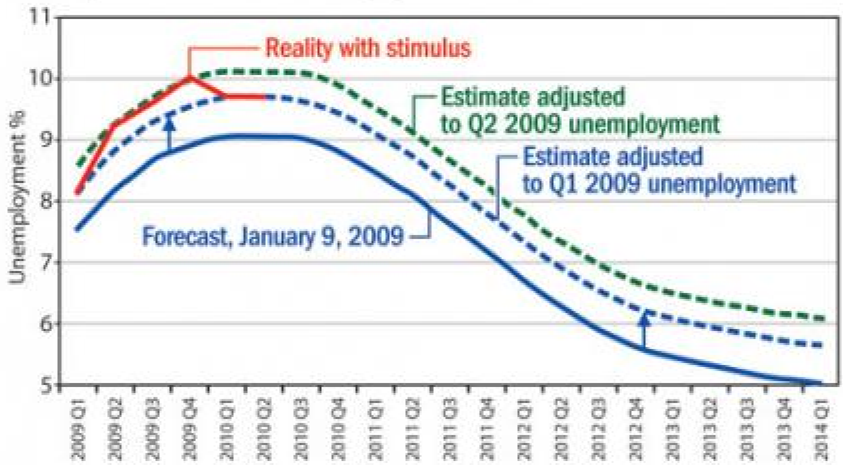


Chart 2: …So Why Bother at All?

Reality vs. Obama Administration projections *without* stimulus



SOURCE: The Lindsey Group

I am sympathetic to their argument and Chart 1 corrects for their complaint by raising their estimate of where unemployment started in their experiment. The lowest line provides the original estimate of the path of unemployment provided by Romer and Bernstein on January 9, 2009. The second line replicates the Romer and Bernstein path, but raises the initial unemployment rate from their assumed 7.5 percent to 8.2 percent. This was the actual average of the unemployment rate in the first quarter of 2009, the period in which the stimulus was passed. The third line provides a more extreme alternative by raising the initial unemployment rate to the 9.3 percent average of the second quarter 2009. The first modification fully compensates for their objection while the second modification more than compensates for their concern.

But as the chart shows, the problem with the stimulus wasn't just the starting point—it was that the stimulus itself has been ineffective at lowering it. Chart 1 shows that the actual unemployment rate, given by the solid line, is not only above the original Romer-Bernstein projections, but also above projections that take account of the “starting point” problem. Actual unemployment has been consistently above all of the projections, regardless of starting point, because the stimulus bill has basically brought no relief in terms of lower unemployment.

Chart 2 shows the Romer-Bernstein projections of what would have happened if the stimulus had not passed, but as in Chart 1, those projections were shifted up to reflect a higher starting unemployment rate. The striking observation is that after correcting for the higher starting point, the actual performance of the economy is almost exactly what Romer and Bernstein said would happen if we had done nothing, rather than passing the $800 billion package.

There are ample reasons for this lack of success. National Economic Council chairman Larry Summers argued that stimulus should be “timely, targeted, and temporary.” But the package that passed was neither timely nor targeted and today Congress is faced with making many of the stimulus programs permanent because unemployment remains stubbornly high.

The bill was not timely because the bulk of the funds were disbursed through the cumbersome government contracting process—and often made doubly complicated because the funds were then channeled through state and local governments. Weekly data collected in 2009 (since discontinued) showed a very consistent $7 billion of stimulus disbursed every week starting in the second quarter of 2009. If you are one of the 6.8 million persons unemployed for six months or more, this slow pace of disbursement is anything but timely.

Nor was the bill targeted, at least in any economically sensible way. It was written not by Larry Summers or Christina Romer, but by Democratic members of congressional appropriations committees, based on the normal political logrolling and reward process. This is the group that notoriously brought us “bridges to nowhere” in the past. The bill was, moreover, rushed through without much review or oversight. One may remember that the stimulus bill was the one that authorized the payment of bonuses to AIG executives, a fact not discovered until well after the bill was signed. This was then followed by days of publicly discussed “mystery” about how such a provision was included. Well-designed targeting would not have included such provisions.

From a macroeconomic perspective, a targeted bill would have injected money directly into the cash flow of American households and small businesses where it was needed. Many of us who supported the administration’s call for a stimulus in early 2009 recommended the reduction of the payroll tax for both employers and employees, something with the same net revenue effect as what was passed. Such a payroll tax cut would have provided an incentive at the margin for continued work and employment for more than 90 percent of the labor force. The tax provision in the actual stimulus that passed did so for less than 15 percent of the labor force, and the spending provisions impacted only 2 percent of the labor force even under the administration’s assumptions. That is bad targeting.

The Blinder and Zandi paper did note that a few provisions of the stimulus appeared to be particularly effective at pulling forward economic activity. These were the “Cash for Clunkers” program and the first time homeowners’ tax credit. But both of these programs were enacted separately from the $800 billion American Recovery and Reinvestment Act and together totaled less than $20 billion. How you spend money is as important as how much you spend. Since the beginning of the recession, the number of unemployed has increased by more than 8 million people. For $800 billion, we could have handed every one of these people a check for $100,000—which gives a sense of what was possible with that much money and just how inefficient the actual program was.

It really should be no surprise that the stimulus bill has created far fewer jobs, dollar for dollar, than past stimulus measures. That is why it is methodologically spurious to assert that unemployment is far lower than it would be in its absence. I say that as one whom the administration itself cited as a supporter of a generic stimulus measure back in January 2009. I continue to believe that it would be a mistake to withdraw stimulus from the economy—such as by raising taxes or by letting existing tax provisions expire. This despite the very high deficits we are now experiencing. Our policy problem today is that the bill that was actually passed into law was both so expensive and so badly flawed that it gives the whole concept of macroeconomic stimulus a bad name.

Lawrence B. Lindsey served in the Reagan, George H.W. Bush, and George W. Bush White Houses and at the Federal Reserve during the Clinton administration. His most recent book is What a President Should Know . . . but Most Learn Too Late*.*