The Obama Economy

How trillions in fiscal and monetary stimulus produced a 1.6% recovery.

So two months before an election, and 19 months after the mother of all spending programs, President Obama said yesterday he's rolling out one more plan to stimulate the economy. We'll discuss the details when they're released, but the effort itself is a tacit admission that his earlier proposals have flopped. As the autumn economic debate gets underway, it's important to understand how and why we got here.

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Gibbs Addresses Economy and Quran Burning

White House Press Secretary Robert Gibbs talks to the press about the economy and the concerns about an upcoming Quran burning in Florida.

The recession preceded Mr. Obama's Inaugural by 13 months, according to the National Bureau of Economic Research, and so did the President's fiscal policy ideas. George W. Bush got there first. In February 2008, he and House Speaker Nancy Pelosi agreed on a $168 billion combination of federal spending and temporary tax rebates that were supposed to maintain growth through the housing market decline that election year.

Larry Summers, who would later become Mr. Obama's chief economic adviser, made the case for such a stimulus to boost domestic "demand" in late 2007. Any stimulus, he told the Brookings Institution, should be "timely, targeted and temporary." Peter Orszag, then at the Congressional Budget Office (CBO) before joining the Obama White House, made the same case.

The official GDP statistics did show a growth blip in the second quarter of 2008 to 0.6%, but third quarter GDP fell by 4%, and we all know what happened after the financial meltdown. Stimulus I failed.

Enter Stimulus II, the $814 billion plan that was also supposed to make up for lost private demand. It too was a combination of one-time tax rebates and spending, mostly on social programs like Medicaid rather than on "shovel-ready projects." Mr. Summers promised this would have a 1.5 "multiplier" effect on GDP growth, and White House economists Christina Romer and Jared Bernstein famously predicted the spending would keep the jobless rate below 8%.

All during this time, the Federal Reserve was also feeding the economy with unprecedented monetary stimulus, cutting its benchmark interest rate to near zero and expanding its balance sheet by more than $2 trillion by purchasing mortgage-backed securities and other assets.
During this time, too, Congress passed other industry-specific stimulus bills—cash-for-clunkers, the $8,000 home-buyer’s tax credit, mortgage payment relief, and jobless pay up to 99 weeks. Yet all of this has merely stolen auto and home purchases from the future, with sales falling once the tax benefits expired. The housing market in particular may be softening again, despite historically low interest rates.

The recovery seems to have begun in summer 2009, with GDP growth hitting 5% in the fourth quarter on the backs of an inventory rebound and expansion overseas. But U.S. growth has since decelerated, to a mere 1.6% in the second quarter, and the jobless rate is 9.6% after three consecutive months of job losses. The economy is growing, but far too slowly to restore broad-based prosperity.

In sum, never before has government spent so much and intervened so directly in credit allocation to spur growth, yet the results have been mediocre at best. In return for adding nearly $3 trillion in federal debt in two years, we still have 14.9 million unemployed. What happened?

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The explanations from the White House and liberal economists boil down to three: The stimulus was too small, Republicans blocked better policies, and this recession is different because it began in a financial meltdown. Only the third point has some merit, and for a different reason than the White House claims.

On a too-small stimulus, this isn’t what Democrats or most Keynesian economists told us at the time. Even Paul Krugman, who now denies intellectual paternity for this economy, wrote on November 14, 2008 that “My own back-of-the-envelope calculations say that the package should be huge, on the order of $600 billion.” The White House raised him by 33% two months later, but now we’re told that wasn’t enough.

Given that the stimulus program was so poorly structured and so overtly politicized, how do we know that, say, $500 billion more would have made a difference even on Keynesian terms? The money for government spending has to come from somewhere, which means from the private economy. Our guess is that by ensuring even higher debt and implying higher taxes, a bigger spending stimulus would have done even more harm.

Stimulus godfather Mark Zandi and CBO have produced studies claiming that the stimulus saved millions of jobs and thus prevented an even deeper recession. But these are essentially plug-and-play economic models that multiply the amount of dollars spent by the assumed impact on jobs based on previous studies, and, voila, the jobless rate would have been higher without such spending. In the real world, the economy lost 2.51 million jobs.

The claim that recessions rooted in financial panic pose special problems has more truth to it. Credit excesses built up over many years have to be wound down, and that takes time, while banks have to work down their bad assets. However, one good aspect of this recovery is that business balance sheets have shaped up nicely, thanks to productivity gains, and banks have been making healthy profits. The problem is that banks still aren’t lending and businesses aren’t hiring or investing enough.

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Which brings us to another major cause of the Obama malaise. When it took office in 2009, many of us advised the Administration to focus on nurturing the recovery first and postponing social-policy priorities that would only add more economic uncertainty. All the more so given this recession’s unusual financial roots.

Instead, Democrats embarked on the most sweeping expansion of government since the 1960s, imposing national health care, rewriting financial laws from top to bottom, attempting to re-regulate the telecom industry, and imposing vast new costs on energy, among many other proposals. Not to stop there, in January it plans to impose a huge new tax increase on “the wealthy,” which in practice means on the most profitable small businesses.

Central to Mr. Obama’s political strategy for passing these priorities has been trashing business and bankers as greedy profiteers. His Administration has denounced or held up as political or legal targets the Chrysler bond holders, Wall Street bonuses, Goldman Sachs, health-insurer profits, carbon energy investors, and anyone else who has dared to oppose any of its plans to “transform” U.S. society.
Only yesterday at a Labor Day event in Milwaukee, Mr. Obama was at it again, declaring that "anyone who thinks we can move this economy forward with a few doing well at the top, hoping it'll trickle down to working folks running faster and faster just to keep up—they just haven't studied our history. We didn't become the most prosperous country in the world by rewarding greed and recklessness."

Whatever else one can say about such rhetoric, it is not the way to restore business confidence or turn a fragile recovery into a durable expansion. It has only spread fear and even greater uncertainty.

As for blaming the Republicans, with only 40 and then 41 Senators they couldn't stop so much as a swinging door. The GOP couldn't even block the recent $10 billion teachers union bailout. The only major Obama priorities that haven't passed—cap and tax and union card check—were blocked by a handful of Democrats who finally said "no mas." No Administration since LBJ's in 1965 has passed so much of its agenda in one Congress—which is precisely the problem.

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To put it another way, the real roots of Mr. Obama's economic problems are intellectual and political. The Administration rejected marginal-rate tax cuts that worked in the 1960s and 1980s because they would have helped the rich, in favor of a Keynesian spending binge that has stimulated little except government. More broadly, Democrats purposely used the recession as a political opening to redistribute income, reverse the free-market reforms of the Reagan era, and put government at the commanding heights of economic decision-making.

Mr. Obama and the Democratic Congress have succeeded in doing all of this despite the growing opposition of the American people, who are now enduring the results. The only path back to robust growth and prosperity is to stop this agenda dead in its tracks, and then by stages to reverse it. These are the economic stakes in November.