Yes, stimulus was the right move

 By Mark Zandi

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The following is a synopsis of themes discussed in my new book, "Paying the Price," published this month by FT Press.

Question: Did the federal fiscal stimulus succeed or fail as an antidote to the Great Recession?

Answer: It succeeded. The temporary tax cuts and government spending increases launched in 2008 and 2009 were aimed at ending the recession and jump-starting an economic recovery. They did that. There were several rounds of stimulus, beginning with tax rebates sent out in the Bush administration's final days, but the stimulus most people remember is the American Recovery and Reinvestment Act. Worth nearly $800 billion, this legislation was passed in February 2009; just weeks after President Obama took office. The recession officially ended in June of that year and job growth resumed in February 2010. This was no accident.

The fiscal stimulus was never intended to permanently drive economic growth; it was supposed to temporarily fill the vacuum left as panicked businesses slashed jobs and terrified consumers stopped spending. The goal was to give the private sector time to rebuild confidence, after which the stimulus would fade away. This is precisely what happened.

Q: Should the banks have been bailed out?

A: Unfortunately, yes. The U.S. banking system nearly collapsed in late 2008. Most of the nation's largest financial firms either failed or would have without government help. That help came in part from the $700 billion Troubled Asset Relief Program, which provided lifesaving capital to the banks. Stakeholders in the banks lost money, and while they arguably should have suffered more as punishment for imprudent risk-taking, the entire economy would have suffered immeasurably more if the banking system had been allowed to go down.

This became clear to me during the height of the panic, when the CEO of one of the nation's largest retailers told me a bank had just cut off one of his largest suppliers. That meant some stores' shelves would soon be empty. Without a well-functioning banking system, the rest of the economy ceases to function. The TARP money put banks back in business, and they ultimately repaid the government's loans back with interest.

Q: What about the automakers? Was that bailout worth it?

A: This is a closer call, but letting General Motors and Chrysler go into bankruptcy would have probably been a serious mistake. There was little chance the companies would have found the money to stay open in bankruptcy, forcing them to liquidate. Many auto suppliers would then have also gone belly-up, likely causing Ford, which relied on the same suppliers, to shut down as well. It is not hyperbole to say that a million more jobs would have been lost in early 2009 if the automakers had not received help, on top of the millions already lost to the recession. The psychological blow of losing an iconic American industry would have been devastating, moreover.

The auto bailout had a cost, which will be determined by what the government receives for its remaining GM stock, but it will be worth it. The auto industry is staging an impressive comeback and has become a significant source of job growth.

Q: Was the public cost of the stimulus and bailouts justified?

A: Taxpayers have paid dearly, but they would have paid even more if policymakers had not been so aggressive. The bill for the government's response to the financial panic and Great Recession will ultimately total $1.8 trillion. This is huge; for context, it nearly equals the last two years of total economic output in Pennsylvania, New Jersey, and Delaware. And since the Treasury has borrowed to pay for this, it roughly doubled the nation's debt load.

But if policymakers had sat on their hands while the economy cratered, the cost would have been immeasurably greater. The Great Recession would have become a 1930s-style depression. Tax revenue would have shriveled and government spending would have ballooned automatically for existing income-support programs, forcing the Treasury to borrow far more than it did. We have big problems with deficits and debt that must be addressed, but those problems would be completely overwhelming if not for the government's aggressive reaction to the crisis.

Q: Are we better off today than we were when President Obama took office?

A: By most measures, yes. Obama was inaugurated in January 2009, when the recession's slide was steepest. U.S. payrolls lost 820,000 jobs that month, affecting every industry and region, and the unemployment rate rose by a half percentage point. Stock prices had fallen nearly in half and house prices by a third.

Today the economy is still struggling, but the United States is adding about 100,000 jobs a month across nearly every industry and region. While unemployment remains much too high at more than 8 percent, it is stable. Stock prices are almost back to their prerecession highs and house prices are rising in earnest again. Household incomes are lower and poverty rates are higher than when Obama took office, but this only shows how far the economy had fallen by the start of the president's term.

Q: Will the economy perform better over the next four years under President Obama or President Romney?

A: It probably won't make a big difference. Whoever is elected will have to deal with our fiscal problems. This includes scaling back the so-called fiscal cliff - the massive tax increases and spending cuts scheduled to occur in 2013 - as well as raising the Treasury debt ceiling again and laying out a credible path for tax increases and spending cuts over the next decade to stabilize the nation's debt load. The political stars are aligned so that either President Obama or President Romney will have to address these issues in roughly the same way.

But here's the good news: If lawmakers tackle these fiscal issues responsibly, as I expect they will, the difficult choices made over the last four years will begin to pay off. The economic wrongs that got us into the mess have largely been righted. Businesses have cut costs and are highly profitable, banks are well capitalized, and household debt loads are about as low as they have ever been. It is important that future generations facing similar economic crises know where the credit for all this lies.

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