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GREENSTEIN: The stimulus is actually working

By Robert Greenstein
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ANALYSIS/OPINION:

With the economy still mired in recession, critics have labeled the $787 billion stimulus package that the administration and Congress adopted earlier this year a failure.

To a large degree, however, their main criticisms of the package and key elements within it reflect some misunderstanding of how it was supposed to work and what it was supposed to do. In fact, the stimulus is working pretty much as policymakers intended. Without it, the economy and the job prospects for millions of Americans would be worse.

The single-biggest misconception about the stimulus is that it was supposed to revive the economy immediately and reverse the rise in unemployment.

No mainstream economist believed that it would, or could, do that. Instead, it was supposed to slow the economy's downward spiral and help generate an economic turnaround sooner than would otherwise occur. And that's what it seems to be doing.

Last autumn, the economy appeared to be in free fall, with no end or bottom in sight. Fears rose of a possible depression. Those fears have not been realized, and most economists now expect the economy to stop shrinking and start growing again (albeit slowly) within the next few months.

While aggressive action by the Treasury and the Federal Reserve certainly played important roles, so apparently has the stimulus law, according to numerous experts with no political or ideological stake in this debate.

Goldman Sachs, for instance, recently stated that "the stimulus seems to have helped stabilize the level of [economic] activity." The nonpartisan Congressional Budget Office (CBO), which now predicts the recession will end this fall, stated that without a stimulus, the economy probably would have continued to contract sharply throughout 2009.

Unemployment traditionally acts as a "lagging indicator" of economic improvement. As in past recessions, it will continue to rise until well after the economy begins growing again. But here, too, experts say the stimulus will have a significant impact, ensuring that unemployment will not rise as much as it otherwise would have.

Economist Mark Zandi of Moody's Economy.com projects that at the end of 2010, the unemployment rate will be almost two percentage points lower than it would have been without the stimulus. CBO projects that the stimulus will boost employment substantially -- by about 2.5 million jobs by the second half of 2010.

Another misconception is that states were not supposed to use the fiscal relief in the stimulus package as they are doing -- to help balance their budgets.

In fact, that's exactly what they were supposed to do. Although most states had healthy "rainy day funds" or other reserves to help them weather the loss of tax revenue that occurs in a recession, this recession has been so severe -- and state revenue collections have fallen so much -- that states are facing extremely large budget gaps.

Since states also face balanced-budget requirements, they must cut programs, raise taxes, or both in response. Nearly all states have cut programs, often deeply. And 30 states have now raised taxes. These budget cuts and tax increases are further slowing an already weak economy by reducing overall demand.

But without the stimulus, it would have been worse. To help states avert even more dramatic budget cuts and tax increases, which would cost more jobs and make the recession more painful, the stimulus is providing states with roughly $140 billion in fiscal relief over the next two years (primarily for health care and education). These funds are having a decided impact.

Virginia, for instance, has reversed plans to end funding for hundreds of sheriffs' deputies, thousands of school personnel, and three mental health facilities. New York reversed a big proposed cut to senior citizens' prescription drug benefits and another big cut to school funding. Of 16 states that the Government Accountability Office studied, at least eight found that stimulus funds helped school districts keep teachers on the payroll.

Finally, some critics assert that the stimulus package is making the nation's daunting long-term budget problems much worse.

Not quite. The stimulus will add only about 3 percent to the total budget shortfall through 2050. That's because the tax cuts and new spending in it are temporary, while the nation's long-term budget problems stem mainly from ongoing factors, especially rising health care costs and the built-in mismatch between projected spending and revenues.

To be sure, the stimulus package is not flawless. Goldman Sachs argued that a bigger package -- one that totaled $1.2 trillion -- was needed to offset the drop in private-sector spending.

Nor will every item in the enacted package provide effective stimulus. Congress should have enacted the higher level of state fiscal relief that the administration recommended --

so that states' overall budget cuts and tax increases could have been smaller and states could have avoided some actions altogether -- in lieu of several items the final package contained.

But there's little doubt that the economy is better off because of the stimulus. Without it, the recession would have been longer and deeper, and the number of unemployed Americans would have been even greater than it is.

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