UNWINDING THE STIMULUS PACKAGE

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Now that the United States has discovered that it was easier to fall into a recession than to climb out of one, the Obama administration needs to learn an equally urgent lesson. Timeliness is important not just for getting into, but also backing out of, an economic stimulus package.

With a price tag of around $800 billion, the package as currently envisioned by the Obama economic team translates into about $7,500 of new cash and new government debt for every household in America. Whether or not you believe that a stimulus program is a good idea, its goal should at least be to get the money out when it is most likely to have the greatest impact on the recession and on the health of the economy.

The sorry record in many past recessions has been that the money was spent when recovery was already well underway or it generated limited impact on demand. For understandable reasons, then, the debate about the package has focused on the front end. Will infrastructure projects be "shovel-ready?" Will other spending or tax cuts have an immediate impact? Congressional Budget Office analysis already makes clear on the front end that a number of projects won't be fully underway until 2010.

But it is equally crucial to start thinking about the back end, however counterintuitive that may sound when crisis is at hand. Not doing so risks an increase in budget deficits and debt that would force interest rates up over the long term, limiting the strength of a recovery.

This issue of "unwinding"—how to back out of the stimulus programs when they might introduce problems into a recovering economy—is a growing concern among economists. Most of them—at least the honest ones—know that our knowledge is limited in dealing with a crisis that is unprecedented in many ways. Smart planning today at least will give us more discretion and latitude over policy choices tomorrow.

Although new countercyclical actions by Congress are being demanded, it is important to remember that countercyclical policies are already in place—automatic "stabilizers" that drain government coffers during downturns and fill them during upturns. With a downturn, federal and state taxes go down and outlays for unemployment insurance and food stamps go up. Accordingly, for every dollar of loss in income in the economy, the government already returns about 35 to 40 cents to households and businesses. This is a far higher level of automatic stimulus or adjustment than occurred when John Maynard Keynes, often considered the intellectual author of deliberate countercyclical policy, first advocated a more active or discretionary government fiscal policy during the Great Depression.

The great advantage of automatic stabilizers is that they get the timing right on both ends—not depending upon discretionary action to begin or end.

Following are some other possibilities for tweaking tax and spending programs so they become more like automatic stabilizers—packing maximum punch in the downturn and pulling back when the economy recovers:

- Beef up the level of food stamp benefits with adjustments downward triggered automatically when no longer needed. Peg higher food stamp and unemployment benefits to the level of unemployment benefit applications, or a similar indicator. In other words, let the spending go up or down automatically during both the downturn and the upturn.
- Make the tax and transfer system as a whole more progressive. When incomes fall, let people's tax rates fall even more. When their incomes rise, they can make up for what they got on the downside.
- Let the tax cut be reflected in withholdings but end on the basis of the economy's condition rather than some arbitrary date like December 31, 2010. At the end of 2010, say, if the unemployment rate was still unacceptably high, the cut would apply for the whole year. If it came down substantially by September 2010, the withholding adjustment would be reduced, possibly to zero depending upon the extent of the economic improvement.
- Peg the continuance of any new assistance to the states to requirements that their own fiscal house be set in better order for the future, e.g. that they establish rainy day funds and during stock market upswings adjust downward assumptions on future rates of return on the stock investments in their pension funds. These requirements needn't slow down the initial flow of payments to the states.

It is not just payments to individuals and states where policy makers seem to set cut-off dates arbitrarily. Consider proposals for new investment incentives, which look very much like the several other "temporary" investment incentives that applied in late 2001, 2002, 2003, 2004, and 2008. No one yet has offered any rationale for the dates any of them ended.

Even as the Obama team joins with Congress, the Federal Reserve and other players to design the best possible recession-induced initiatives, they will be doing a disservice if their discussion does not extend to how to unwind those initiatives when they reach the point of doing more harm than good—to the economy, to the budget, and to your pocketbook.