Shocking the U.S. economy back to life

By Louis Uchitelle

NEW YORK: Now that the U.S. government has spent nearly $1.4 trillion to stabilize the financial system, economists and policy makers — and the president-elect — are trying to figure out how much must be invested in a stimulus package to stop the recession, and what that money should be spent on.

The size of a possible stimulus plan rises as the economy contracts. It is doing so now at a 4 percent annual rate, according to current estimates, or eight times greater than this past summer. Just offsetting that contraction requires an infusion of at least $400 billion, many economists calculate. And even that will not restore a healthy economy.

"The hope is that the next stimulus package will be large enough to move the economy from big negatives to zero growth," said Mark Zandi, chief economist at Moody's Economy.com. "That is the benchmark today: zero growth."

President-elect Barack Obama has not stated what the stimulus plan might cost, though congressional leaders have cited figures upwards of $500 billion. Obama has given a hint, though. He speaks of a recovery that would generate 2.5 million jobs in the first two years of his administration. That would require not just zero economic growth, but a fairly robust expansion — a swing, in effect, from the present 4 percent contraction to a growth rate of 2.5 percent or 3 percent a year.

Achieving such a swing would mean adding nearly $1 trillion in annual output to the economy. The private sector normally does this, stepping up its spending as a recovery takes hold. But if that does not happen, the Obama administration would have to step in, via

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a stimulus package that generated the additional $1 trillion in output, most likely through a mix of government spending and tax breaks.

No policy maker or economist has as yet publicly suggested such a huge sum. Trillions of dollars is a commonplace reference in talking about the financial bailout, but not yet the stimulus. The debate instead revolves around the proper mix for a stimulus package — that is, the most effective combination of outright spending and lower taxes.

Prominent economists argue that more than 50 percent of the next package, whatever its size, should be devoted to spending — on public projects like highway and school repairs, and on items like food stamps and stepped-up aid to state governments to subsidize their spending.

As Zandi declared in testimony this month before the Senate Budget Committee, nearly every dollar spent in this fashion generates $1.50 or more in economic activity. Repairing a road, for example, means hiring workers who spend their new salaries at supermarkets, which in turn hire more store clerks and stock more groceries.

This "multiplier effect" is missing, however, when the stimulus comes as a tax break. A $750 billion stimulus package, devoted entirely to spending, would achieve, through the multiplier effect, the $1 trillion rise in output that the Obama administration apparently seeks in order to generate 2.5 million new jobs.

A stimulus devoted entirely to tax

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