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Free Enterprise: Obama administration should listen to economists

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This week, the blogosphere went agog over an economist telling a journalist on a Sunday news show that he was misinterpreting the conclusions of an academic paper. The economist was recent Nobel Laureate Paul Krugman, and the paper in question had been published in 1992 by Berkeley professor Christina Romer, who is now the chairwoman of President Barack Obama's Council of Economic Advisers.

Critics of the stimulus plan had seized on Romer's conclusions in her paper titled "What Ended the Great Depression?" in order to discredit the idea of a fiscal stimulus (the use of increased government spending to jump-start an economy in recession). Romer had written that "Fiscal policy ... contributed almost nothing to the recovery before 1942."

Taken out of context, this sentence stands in sharp contrast to a recent memo by her in which she touts the ability of the stimulus plan to create "many jobs paying good wages and providing full-time employment."

Concentrating on this apparent contradiction is as frivolous as it is fruitless. Anybody who has taken the time to actually read Romer's paper will quickly recognize that she simply described how monetary policy (changes to the amount of money circulating in the economy) was far more effective than fiscal policy in ending the Great Depression.

In light of the fact that the recent unprecedented monetary-policy moves by the Federal Reserve have not yet shown the desired results, her 1992 analysis provides support for rather than evidence against the idea of attempting a fiscal stimulus. Given that the Fed has already lowered its target interest rate to virtually zero and held it there this week, worries are growing that the usual monetary-policy tools are tapped out.

What makes this discussion so important is that it presented the interested public with an illustration of how not to find fault with the stimulus plan that just passed the House and, furthermore, how important it is to separate fact from fiction in this debate.

There are plenty of good reasons to be wary of the $850 billion (and growing) spending plan. This begins with the real and mounting dangers of increasing the federal deficit to record heights.

It continues with the hazard of having government spending (if it is realized too slowly) simply replace private spending that would otherwise have taken place. And it does certainly not end with the inefficiencies and nepotism that huge government spending programs historically have created. The horror stories ($2.25 billion to national parks when the son of the Appropriations chair is their chief lobbyist) are already starting to circulate before the money does.

Two hundred prominent economists just signed an open letter addressed to President Obama stating that "more government spending is not a way to improve economic performance." Many of them have cited academic research in their arguments against the stimulus plan as it stands today.

One can only hope that this "evidence-based" administration will at least consider their reasoning. After all, being able to consult and learn from academics is one of the main reasons why societies finance ivory towers.

Failing to separate fact from fiction will cost real money this time around. To paraphrase an argument often heard in the past few days, "A trillion dollars is a terrible thing to waste."

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