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## Obamanomics: A Counterhistory

By DAVID LEONHARDT

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WORKING out of cramped, bare offices in a downtown building here in Washington, President-elect Obama's economic team spent the final weeks of 2008 trying to assess how bad the economy was. It was during those weeks, according to several members of the team, when they first discussed academic research by the economists Carmen M. Reinhart and Kenneth S. Rogoff that would soon become well known.

Ms. Reinhart and Mr. Rogoff were about to publish a book based on earlier academic papers, arguing that financial crises led to slumps that were longer and deeper than other recessions. Almost inevitably, the economists wrote, policy makers battling a crisis made the mistake of thinking that their crisis would not be as bad as previous ones. The wry title of the book is "[This Time Is Different](#)."

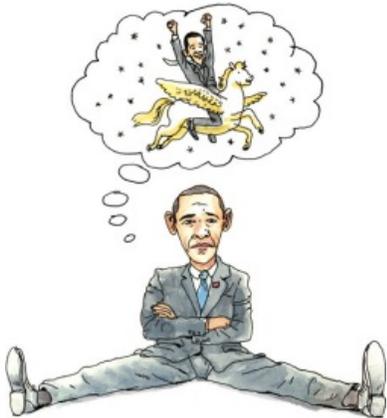
In my interviews with Obama advisers during that time, they emphasized that they knew the history and were determined to avoid repeating it. Yet of course they did repeat it. After successfully preventing another depression, in 2009, they have spent much of the last three years [underestimating the economy's weakness](#). That weakness, in turn, has become Mr. Obama's biggest vulnerability, helping cost Democrats control of the House in 2010 and endangering his [accomplishments elsewhere](#).

[Entire books](#) and countless articles have taken Mr. Obama to task on the economy, and administration officials have a rebuttal that makes a couple of important points. The Federal Reserve and many private-sector economists were also too optimistic, Obama aides note. And they argue that the Senate [would not have passed](#) a much larger stimulus in 2009, given Republican opposition, regardless of the White House's wishes.

But from these reasonable points, the Obama team then jumps to a larger and more dubious conclusion: that their failure to grasp the severity of the slump has had no real consequences.

Even if they had seen the slow recovery coming, they say, they couldn't have done much about it. When Mr. Obama has been asked about his biggest mistake, he talks about messaging, not policy.

“The mistake of my first term — couple of years — was thinking that this job was just about getting the policy right,” **he has said**. “The nature of this office is also to tell a story to the American people that gives them a sense of unity and purpose and optimism, especially during tough times.”



Victor Kerlow

We can never know for sure what the past four years would have been like if the administration and the Fed had been more worried about the economy. But my reading of the evidence — and some former Obama aides agree — points strongly to the idea that the misjudging of the downturn did affect policy and ultimately the economy.

Mr. Obama's biggest mistake as president has not been the story he told the country about the economy. It's the story he and his advisers told themselves.

The notion of insurance is useful here. Suggesting that Mr. Obama and his aides should have bucked the consensus forecast and decided that a long slump was the most likely outcome smacks of 20/20 hindsight. Yet that wasn't their only option. They also could have decided that there was a substantial risk of a weak recovery and looked for ways to take out insurance.

By late 2008, the full depth of the crisis was not clear, but enough of it was. A few prominent **liberal economists** were publicly predicting a long slump, as was Mr. Rogoff, a Republican. The Obama team openly compared its transition to Franklin D. Roosevelt's and, in private, discussed the Reinhart-Rogoff work.

So why didn't that work do more to affect the team's decisions?

There are two main answers. First, the situation was unlike anything any living policy maker had previously experienced, and it was deteriorating quickly. Although officials talked about the Depression, they struggled to treat the downturn as fundamentally different from a big, relatively brief recession.

"The numbers got ramped up," one former White House official told me, referring to the planned size of the stimulus in late 2008. "But the basic frame did not get altered." In particular, the administration did not imagine that the economy would still need major help well beyond 2009 and that Congress would not comply.

The second problem was that Mr. Obama and his advisers believed — correctly — that they and the Fed were already responding more aggressively than governments had in past crises. Even before the election, President George W. Bush signed the financial bailout, a decidedly un-Hooveresque policy. The Fed began flooding the economy with money. The Obama administration pushed for the stimulus and, with the Fed, conducted successful stress tests on banks.

Whatever the political debate over these measures, the economic evidence suggests they made a large difference. Analyses by the Congressional Budget Office and other nonpartisan economists have come [to this conclusion](#). Europe, which was less aggressive, has fared worse. And the chronology of the crisis tells the same story.

In 2008 and early 2009, the global economy was deteriorating even more rapidly than in 1929, [according to research](#) by Barry Eichengreen and Kevin H. O'Rourke. Global stock prices and trade dropped more sharply. But the policy response this time was vastly different, and by the spring of 2009 — just as the measures were taking effect — the economy stabilized.

In this success came the seeds of future failures. Knowing in late 2008 how much policy help was on the way, Mr. Obama and his economic advisers decided that the disturbing pattern of financial crises was not directly relevant. "In a way, they fell into a 'This Time Is Different' trap," another former White House official said.

A banner headline in The Financial Times in June 2009 pronounced the White House "Upbeat on Economy." Nine months later, after the recovery had run into new problems, the administration said the economy was on the verge of "escape velocity."

Even now, the Obama team sometimes suggests that the weak recovery isn't related to the financial crisis. Some problems, like the rise in oil prices, are not in fact related. Many others, like Europe's troubles and this country's still-depressed consumer spending, are.

Imagine if the transition team had instead placed, say, 25 percent odds on a protracted slump. Political advisers like David Axelrod would have immediately understood the consequences. Mr. Obama's policies would look like a failure during the midterm campaign, and the prospects of winning additional stimulus would dwindle. Which is exactly what happened.

Contemplating this outcome, the new administration would have had urgent reasons to take out insurance policies. For starters, Mr. Obama would indeed have told a different story about the economy. **Rather than promising** a "recovery summer" in 2010, he and his aides would have cautioned patience. Bill Clinton's recent Democratic convention speech was a model.

More concretely, the administration would have looked for every possible lever to lift the economy. Despite Republican opposition, such levers existed.

Upon taking office, Mr. Obama could have immediately nominated people to fill the Fed's seven-member Board of Governors, rather than leaving two openings. Ben S. Bernanke, the chairman, works hard to achieve consensus on the Fed's policy committee, and in 2010 and 2011 the committee was skewed toward officials predicting — wrongly, we now know — that inflation was a bigger threat than unemployment.

TWO more appointees may well have shifted the debate and caused the Fed to have been **less cautious**. After the vacancies were finally filled this year, the Fed took further action.

The administration also could have added provisions to the stimulus bill that depended on the economy's condition. So long as job growth remained below a certain benchmark, federal aid to states and unemployment benefits could have continued flowing. Crucially, these provisions would not have added much to the bill's price tag. Because the Congressional Budget Office's forecast was also too optimistic, the official budget scoring would have assumed that the provisions would have been unlikely to take effect. They would have been insurance.

Perhaps most important, the administration might have taken **a different path on housing**. With the auto industry and Wall Street, Mr. Obama accepted the political costs that come with bailouts. He rescued arguably undeserving people in exchange for helping the larger economy. With housing, he went the other way, even leaving some available rescue money unspent — at least until last year, when the policy became more aggressive and began to have a bigger effect.

No one of these steps, or several other plausible ones, would have fixed the economy. But just as the rescue programs of early 2009 made a big difference, a more aggressive program stretching beyond 2009 almost certainly would have made a bigger difference. It would have had the potential to smooth out the stop-and-start nature of the recovery, which has sapped consumer and business confidence and become a problem in its own right.

By any measure, Mr. Obama and his team faced a tremendously difficult task. They inherited the worst economy in 70 years, as well as an opposition party that was dedicated to limiting the administration to one term and that fought attempts at additional action in 2010 and 2011. And the administration can rightly claim to have performed better than many other governments around the world.

But their claim on having done as well as could reasonably have been expected — to have avoided major mistakes — is hard to accept. They considered the possibility of a long, slow recovery and rejected it.

In the early months of the crisis, Mr. Obama and his aides made clear that they would try to learn from the errors of [the Great Depression](#) and do better. They achieved that goal. They also left a whole lot of lessons for the people who will have to battle the next financial crisis.