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A $1 Trillion Answer

By JOSEPH E. STIGLITZ
Published: November 29, 2008

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WHAT President-elect Barack Obama will need to do is horribly complicated but also very clear.

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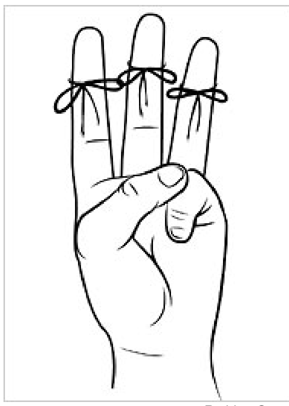

Rodrigo Corral

First, he must stop the economy from going deeper into recession. Then he needs to bring about a robust recovery, preferably in ways that support the long-term needs of the United States: by repairing our neglected public works, invigorating our technological leadership, making our society greener, fixing our health care problems, healing our social and economic divide, and restoring our social compact.

It will not be easy. President Bush's legacy of debt and the opposition of those who benefit from the status quo present major obstacles.

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There is an emerging consensus among economists that a big — very big — stimulus is needed, at least $600 billion to $1 trillion over two years. Mr. Obama's announced goal of 2.5 million new jobs by 2011 is too modest. In the next two years, almost four million workers will enter the labor force — or would if there were jobs. Combined with the loss of employment this year, that means we should be striving to create more than five million jobs.

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A large stimulus package can always be trimmed later if it's not needed because the economy returns to health faster than most economists think. But we need to plan for what looks to be a deep and long downturn. By relying heavily on automatic stabilizers — expenditures like increased unemployment benefits and revenue sharing with states — we can dose out the medicine as needed. The deeper and longer the downturn, the greater the spending.

Faint measures would be foolhardy. A weaker economy will suffer lower tax revenues, more foreclosures and more bankruptcies. Once a firm is bankrupt, you can't unbankrupt it by providing a stronger stimulus later on.

There are other elementary principles that help guide the design of a good stimulus. The

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government could, for instance, temporarily pay (through a tax credit) part of the cost of new private investment for companies that are spending more than, say, 80 percent of what they have spent annually in recent years on equipment like computers and machinery. This would be a high-powered, low-cost stimulus.

Latter-day Hooverites will say the soaring deficit and national debt mean we cannot afford a large stimulus package. Although today they are receiving billions of dollars in aid, once they have their money some from the financial sector will argue that the economy won't recover unless confidence is restored, and that confidence won't be restored until the deficit narrows.

But it's impossible to restore confidence when the economy is in shambles. When millions of Americans are out of work and hundreds of thousands of businesses are going into bankruptcy, there will be no "confidence." This is the reality. To avoid this, we need a big stimulus.

But what you do with the money counts, too. The money needs to be spent carefully to ensure that every dollar provides as much stimulus now as possible while also contributing to long-term growth. That is why it is imperative to restructure the Troubled Asset Relief Program. Treasury Secretary Henry Paulson has already given away close to half of the $700 billion on very generous terms and without adequate restrictions on the use of the money.

The intent of the program was not just to give money to banks but to get them to increase lending. It has not worked, so it needs to be changed. If taxpayers pour our hard-earned money into banks, then the banks should not be allowed to pour out the money as dividends to their shareholders or bonuses to their executives. Nor should they be allowed to use the cash to purchase healthy banks, in further efforts to become "too big to fail."

The Obama administration should not treat Mr. Paulson's plan as immutable simply because "a deal is a deal." The banks knew there was a quid pro quo. Besides, the terms of the relationship between the banks and the government (including the Federal Reserve) have repeatedly been adjusted, though almost always in favor of financial companies. The Fed used to accept only Treasury bills as collateral when it lent to banks. Now it accepts risky assets — junk.

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Joseph E. Stiglitz, a professor of economics at Columbia who was chairman of the Council of Economic Advisers from 1995 to 1997 and was awarded the Nobel prize in economics in 2001, is the author, with Linda J. Bilmes, of "The Three Trillion Dollar War."

A version of this article appeared in print on November 30, 2008, on page WK9 of the New York edition.

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