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Economic Scene

As Economy Turns, Washington Looks Better

By DAVID LEONHARDT

WASHINGTON — What if in the end they got it right?

What if, amid all their missteps and all the harsh criticism, the people in charge of battling the worst financial crisis since the Great Depression — Ben Bernanke, Timothy Geithner, Lawrence Summers, Henry Paulson and the rest — basically succeeded?

It is clearly too soon to know for sure. But the evidence is now pointing pretty strongly in one direction: history books may conclude that the financial crisis of 2008 turned out to be far less bad than it could have been and that Washington deserved much of the credit.

The Labor Department announced Friday that the economy lost fewer jobs in July than in any month since before Lehman Brothers collapsed last fall. Credit markets no longer look anything like they did after Lehman's collapse and are in considerably better shape than just a few months ago. Stocks are up almost 50 percent from their March low. "It's over," the economists at Barclays Capital declared Friday, referring to the Great Recession.

The news has been good enough that the Obama administration spent Friday trumpeting its record. More telling, however, is the fact that even Nouriel Roubini, the prophetically pessimistic economist who saw the crisis coming (and doesn't think the recession has yet ended), is now praising policy makers. He recently urged that Mr. Bernanke be reappointed as Federal Reserve chairman, saying he helped avert a "near depression that seemed highly likely after the financial collapse last fall."

Washington's early responses to the bubbles in real estate and stocks, and then to the crisis that followed, were full of mistakes. But since the collapse of Lehman Brothers, the record has started to change. The government

has undertaken one extraordinary effort after another to revive the economy, and the economy has seemed to respond.

Last September, the Fed, the Bush administration and Congress pushed through an unpopular $700 billion bailout plan to keep other parts of the financial markets from collapsing. In subsequent months, the Fed — the subject of much recent criticism from both Democrats and Republicans in Congress — quickly propped up individual credit markets when they sagged.

And the Obama administration, having failed in its early weeks to calm the financial markets, eventually managed to do just that. It pushed for a stimulus bill, over unanimous Republican opposition in the House, that is certainly imperfect but that has already saved more than 500,000 jobs, according to separate estimates by two prominent research firms, IHS Global Insight and Moody's Economy.com. The White House also endured withering criticism from liberals who argued that credit markets would remain dysfunctional without a government takeover of banks.

"Bernanke, Obama, Geithner and Summers were intelligent enough to know that the right-wing crowd was crazy to say, 'Let the banks go bankrupt,' and confident enough to ignore the left-wing 'Nationalize the banks' crowd," said Robert Barbera, a longtime economist and author of the recent "The Cost of Capitalism," which criticizes the Fed for allowing the housing bubble to grow so large. "I give them very high marks."

Many people, of course, would not be so charitable. And that's understandable. The economy remains in very bad shape, and economists think the unemployment rate still has further to rise.

Most confusing of all, no one can know how bad — or how good — the economy might have been if the government hadn't pursued the aggressive policy it did. But there are certainly some clues.

A central piece of the Obama administration's and Fed's joint financial strategy was the banking stress test. The results of those tests, which showed the system to be in better shape than many (including — full disclosure — me) believed, began to leak in early May. Immediately, credit markets started improving. The TED spread, a comparison of interest rates that measures market fears, fell 43 percent over the next three weeks and is even lower today.

As for the stimulus, economies in countries that enacted relatively large programs, like the United States, China and Australia, have survived fairly well this year, relative to forecasts. Countries that enacted smaller programs, like France, Italy and India, have not done as well, as Christina Romer, a top Obama adviser, pointed out this week.

But the best clue may be history. Washington did not respond proactively to the financial crisis of 1929, and the Great Depression ensued. Japan didn't respond to its 1990s crisis with much force, and its economy languished.

Even the past year makes the case. On Sept. 14, 2008, policy makers allowed Lehman to go under. Financial panic ensued. Indeed, one notable aspect of Washington's recent successes is that they have been fashioned by the same people who helped aggravate the crisis.

Mr. Paulson, then the Treasury secretary, made the main call to let Lehman collapse, as David Wessel, economics editor of The Wall Street Journal, reports in his new book on the crisis. But within days, Mr. Paulson was on Capitol Hill arguing for the $700 billion bailout. Mr. Bernanke played down the housing bubble as a Bush administration adviser and at his 2005 confirmation hearing. Once the crisis began, he oversaw perhaps the most forceful policy response in the history of central banking.

Mr. Geithner may be the most fascinating character in the drama. As the president of the New York Fed, he failed to raise alarm about the Wall Street strategies that made the crisis possible. In his early weeks as the Obama Treasury secretary, his uneven performance led a few House Republicans to call for his resignation. In White House meetings, some advisers told Mr. Obama that they were worried the Geithner approach wasn't aggressive enough.

That could still turn out to be the case: credit markets aren't yet normal, and jobs are still disappearing every month. And some of the administration's specific programs, like the public-private partnership to buy toxic bank assets, have fallen flat. But the sum total of the response has been to erase a pervasive sense of fear in the markets and to allow lending to resume.

Having done that, the White House and Fed face a new set of problems. Mr. Bernanke will have to decide how

slowly to withdraw the Fed's enormous interventions. Mr. Obama will have to sell Congress on an agenda that he has vowed will move the economy away from its boom-and-bust cycles. On every item of that agenda — health care, energy, financial reregulation — there are reasons to wonder whether Mr. Obama and Congress will end up with a bill that makes a big difference.

Just look at the record. Washington may be in the process of proving that it can halt an economic crisis. But it utterly failed to keep that crisis from occurring.

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