# stimulus good

## generic

### aggregate demand

#### **Stimulus is best for recovery—principles of aggregate demand**

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What is the optimal response of monetary and fiscal policy to an economy-wide decline in aggregate demand? This question has been at the forefront of many economists’ minds for decades, but especially over the past few years. In the aftermath of the housing bust, financial crisis, and stock market decline of the late 2000s, households and firms were less eager to spend. The decline in aggregate demand for goods and services led to the most severe recession in a generation or more. The textbook answer to such a situation is for policymakers to use the tools of monetary and fiscal policy to prop up aggregate demand. And, indeed, during this recent episode the Federal Reserve reduced the federal funds rate, its primary policy instrument, almost all the way to zero. With monetary policy having used up its ammunition of interest rate cuts, economists and policymakers increasingly looked elsewhere for a solution. In particular, they focused on fiscal policy and unconventional instruments of monetary policy.

Traditional Keynesian economics suggests a startlingly simple solution: the government can increase its spending to make up for the shortfall in private spending. Indeed, this was one of the motivations for the stimulus package proposed by President Barack Obama and passed by Congress in early 2009. The logic behind this policy should be familiar to anyone who has taken a macroeconomics principles course anytime over the past half century.

Yet many Americans (including quite a few congressional Republicans) are skeptical that increased government spending is the right policy response. Their skepticism is motivated by some basic economic and political questions: If we as individual citizens are feeling poorer and cutting back on our spending, why should our elected representatives in effect reverse these private decisions by increasing spending and going into debt on our behalf? If the goal of government is to express the collective will of the citizenry, shouldn’t it follow the lead of those it represents by tightening its own belt? Traditional Keynesians have a standard answer to this line of thinking. According to the paradox of thrift, increased saving may be individually rational but collectively irrational. As individuals try to save more, they depress aggregate demand and thus national income. In the end, saving might not increase at all. Increased thrift might lead only to depressed economic activity, a malady that can be remedied by an increase in government purchases of goods and services.

The goal of this paper is to address this set of issues in light of modern macroeconomic theory. Unlike traditional Keynesian analysis of fiscal policy, modern macro theory begins with the preferences and constraints facing households and firms and builds from there. This feature of modern theory is not a mere fetish for microeconomic foundations. Instead, it allows policy prescriptions to be founded on the basic principles of welfare economics. This feature seems particularly important for the case at hand, because the Keynesian recommendation is to have the government undo the actions that private citizens are taking on their own behalf. Figuring out whether such a policy can improve the well-being of those citizens is the key issue, and a task that seems impossible to address without some reliable measure of welfare.

The model we develop to address this question fits solidly in the New Keynesian tradition. That is, the starting point for the analysis is an intertemporal general equilibrium model that assumes prices to be sticky in the short run. This temporary price rigidity prevents the economy from reaching an optimal allocation of resources, thus giving monetary and fiscal policy a possible role in helping the economy reach a better allocation through their influence on aggregate demand. The model yields several significant conclusions about the best responses of policymakers N. Gregory Mankiw and Matthew Weinzierl 211 under various economic conditions and constraints on the set of policy tools at their disposal.

To be sure, by the nature of this kind of exercise, the validity of any conclusion depends on whether the model captures the essence of the problem being examined. Because all models are simplifications, one can always question whether a conclusion is robust to generalization. Our strategy is to begin with a simple model that illustrates our approach and yields some stark results. We then generalize this baseline model along several dimensions, both to check its robustness and to examine a broader range of policy issues. Inevitably, any policy conclusions from such a theoretical exploration must be tentative. In the final section we discuss some of the simplifications we make that might be relaxed in future work. Our baseline model is a two-period general equilibrium model with sticky prices in the first period. The available policy tools are monetary policy and government purchases of goods and services. Like private consumption goods, government purchases yield utility to households. Private and public consumption are not, however, perfect substitutes. Our goal is to examine the optimal use of the tools of monetary and fiscal policy when the economy finds itself producing below potential because of insufficient aggregate demand.

We begin with the benchmark case in which the economy does not face the zero lower bound on nominal interest rates. In this case the only stabilization tool that is necessary is conventional monetary policy. Once monetary policy is set to maintain full employment, fiscal policy should be determined based on classical principles. In particular, government consumption should be set to equate its marginal benefit with the marginal benefit of private consumption. As a result, when private citizens are cutting back on their private consumption spending, the government should cut back on public consumption as well.

We then examine the complications that arise because nominal interest rates cannot be set below zero. We show that even this constraint on monetary policy does not by itself give traditional fiscal policy a role as a stabilization tool. Instead, the optimal policy is for the central bank to commit to future monetary policy actions in order to increase current aggregate demand. Fiscal policy continues to be set on classical principles. A role for countercyclical fiscal policy might arise if the central bank both hits the zero lower bound on the current short-term interest rate and is unable to commit itself to expansionary future policy. In this case monetary policy cannot maintain full employment of productive resources on its own. Absent any fiscal policy, the economy would find itself in a nonclassical short-run equilibrium. Optimal fiscal policy then looks decidedly Keynesian if the only instrument of fiscal policy is the level of government purchases: increase those purchases to increase the demand for idle productive resources, even if the marginal value of the public goods being purchased is low.

#### Stimulus will generate enough demand to boost the economy

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Our nation's economy is approaching a precipice. The continuing housing market crisis has stripped about $10 trillion from families' assets, and nearly 1 in 10 workers are unemployed. Nearly 1 in 10 others are either working less than they want or have given up their job search. Family income is now back where it was in 1996, in inflation-adjusted dollars. This all means there is less money flowing through our economy. That's just math. The lingering consequences of the Great Recession—the housing crisis, the jobs crisis, the fear among businesses to invest their earnings despite record profits—continue to pull against faster economic growth and job creation. Because customers have less money to spend due to the collapse of the housing bubble and the ensuing high unemployment, businesses have little incentive to hire and invest. [Check out a roundup of editorial cartoons on the economy.] Even Federal Reserve Chairman Ben Bernanke says there is a role for fiscal policy. Monetary authorities have already pushed interest rates down to zero. And they have few levers left to spur growth, although there are some steps that would continue to help on the margin. In short, the economy continues to suffer from a lack of demand. The federal government can help with this. We know that government spending can help restart an economy. Over the past two years, increased investments in infrastructure have saved or created 1.1 million jobs in the construction industry and 400,000 jobs in manufacturing by March 2011. Almost all of these jobs were in the private sector. [Rick Newman: Who Would Win Under Obama's Jobs Plan] Money targeted toward the long-term unemployed helped not only those individual families hardest hit by the Great Recession but also kept dollars flowing into their local communities, keeping an average of 1.6 million American workers in jobs every quarter during the recession. But now, the threat of jobs again disappearing looms large. Unless Congress acts, the private sector will continue to generate insufficient demand. A sweeping consensus of economists and forecasters across the political divide now calls for the government to forcefully intervene in precisely this way, to create demand for goods and services, which will in turn boost hiring and business growth. Goldman Sachs, for example, said the positive effect of the president's American Jobs Act would increase U.S. gross domestic product by 1.5 percent in 2012. Conservatives want us to believe that America's broke, that we cannot afford to address our most pressing issue—mass unemployment and stagnating incomes. The reality is that there are clear steps that we can take to pave the way for economic growth. Congress just needs to act.

#### Direct economic intervention is key to ensure maximum demand

Franco et al. 10 – managing director of Banca d’Italia (Daniele, Fiscal Policy: Lessons from the Crisis, pp. 257-258)//HK

During the Great Depression years of the 1930s, John Maynard Keynes explained that the cause of the high unemployment was insufficient demand. Aggregate demand had fallen to a level below that necessary to ensure the full and optimal utilisation of the economy’s productive capacities, in terms of both labour and capital utilisation. Left to themselves, economies could remain in such a state of insufficient demand indefinitely. The answer to this deficiency was for the government to boost demand and bring the level of aggregate demand up to the level of optimal aggregate supply, thus ensuring full employment and stable inflation.

Government intervention in the economy happens through both the expenditure side and the income side. On the expenditure side, government outlays are, in part, linked to mechanisms laid down in laws. These public expenditures are commonly referred to as non-discretionary or entitlement spending. Other spending items are called discretionary, because governments can decide to change the level of spending on these items without going through changes in legislation. Most income is usually raised through taxation rates, which are usually laid down in laws and are thus non-discretionary.

Changes in the business cycle have a direct influence on government income and expenditure levels, even without any changes in discretionary spending. Indeed, in a recession, unemployment levels rise and lead to automatic increases in unemployment benefits paid out. This in turn tends to mitigate the effect of the cyclical downturn on income and employment. Similarly, a recession can lead to a decline in household incomes and push households into lower average tax brackets. This tends to increase after-tax incomes and mitigate the effect of the cyclical downturn on income and employment, while leading to reduced tax receipts for the government. However, alongside the working of the government’s automatic fiscal stabilisers, a government can also intervene directly in the economy through discretionary fiscal policy, enhancing or counterbalancing the effects of automatic stabilisers.

#### Government spending solves every internal link employment and doesn’t cause inflation – it stimulates demand

Harvey, 11 – Professor of Economics @ TCU (John, “How to Destroy the US Economy? Balance the Budget,” 6-5, <http://blogs.forbes.com/johntharvey/2011/06/05/how-to-destroy-the-us-economy/>)//AH

Situations like the 1930s and today benefit no one. Unemployed workers would like jobs, employed workers would like not to have to support (formally or informally) the unemployed, and entrepreneurs would like to sell more output. There is an obvious solution: the federal government can supplement demand. Start off with a simple example: just imagine that they pay people $30,000/year to stand on a street corner and make nice comments about passers by to raise national morale: “My, don’t you look handsome today!” “Go get ‘em, tiger!” “You’re important and people like you!” While this may make the others feel uncomfortable and cause them to avoid these particular street corners, it is nevertheless a net addition to aggregate demand. This is so because when these public greeters go home from work, they spend money from their incomes. This takes nothing from the mouths of existing workers because we already had the ability to produce more (again, compare the Roaring Twenties with the Great Depression). On top of that, the formerly unemployed now have jobs plus the ability to purchase goods and services and entrepreneurs earn more income because their sales rise–everyone is better off. Now let’s make the example a little more realistic and actually give the government employees something useful to do (but not necessarily profitable, since that’s what the private sector already does). Instead of street corner greeters, they could be soldiers, airmen, sailors, marines, librarians, teachers, police officers, firemen, social workers, national park rangers, et cetera. This adds even more to the nation’s wealth because now even the formerly employed enjoy more goods and services (for example, protection from domestic and foreign aggression and a place to go camping). Remember, the core economic problem is the private sector’s inability to generate sufficient demand to employ everyone. This solves it by supplementing demand. It creates more employment, higher wages, and greater profits. How the Government can Finance its Spending Whence comes the money the government uses to pay the soldiers, airmen, sailors, marines, librarians, teachers, police officers, firemen, social workers, and national park rangers? It could tax the private sector, but that’s not terribly effective since it raises demand in one place by lowering it in another. So, they should deficit spend. To keep with my desire for simplicity in this entry, let’s say the manner in which this is accomplished is direct borrowing from the Federal Reserve (something that is illegal at the moment but can be, and is, done via a less direct route). This means the Treasury sells its debt to another branch of the government, in exchange for which it receives the cash it needs to pay those workers. When the debt becomes due, they sell more. Because all US debt is owed in a currency we are legally permitted to print, it is impossible to face debt default. We can choose to default, but we are never forced to. Nor is this inflationary. This is true for a variety of reasons, the most critical of which being that it does not represent more money chasing fewer goods since the quantity of the latter rose–that was the whole point of the exercise. We wanted to lower unemployment and produce more output. I have, incidentally, two longer entries on how inflation really works: Money Growth Does Not Cause Inflation! What Actually Causes Inflation (and Who Gains from It) Conclusions That’s the essential story in as few words as I can tell it. For those who are more visual, several months ago a friend of mine used one of my blog posts to make this YouTube explanation of the core issues: http://www.youtube.com/watch?v=Ei\_B5MTJofI The bottom line is that the private sector does not generate sufficient demand to hire all those who are willing to work. The real irony is that we have plenty of capacity to produce output for them, they just can’t afford to buy it. But, if we supplement this with public sector deficit spending–something we can finance forever since the debt is owed in our own currency–then this absolutely, totally unnecessary problem can be solved. To do the opposite, to lower government spending (or raise taxes) in the midst of a period of high unemployment, is not only counterproductive, it’s cruel. The federal government does not borrow in order to be able to afford something it could not otherwise buy. Rather, the goal of deficit spending (at least when we are at less than full employment) is to stimulate demand. This is not analogous to how a household budget works.

#### Stimulus works, it’s just a matter of size

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The answer to the question of whether stimulus spending works is the same answer I'd give my toddler if she asked for an extra helping of spinach: absolutely, yes. In fact, like asking for more spinach, there's really no credible reason for a "no" answer. Spinach is good for the body; stimulus is good for the economy. The most recent case of stimulus spending, the American Recovery and Reinvestment Act of 2009, did work. Here's what we know about the impact of the stimulus: according to a report from the Congressional Budget Office, the Recovery Act lowered the unemployment rate by between ½ a percentage point to 1.6 percentage points, and increased employment by 1 to nearly 3 million jobs. Private estimates from Global Advisors, Macreconomic Advisors, and Moody's Economy.com all estimate that by the end of the first quarter in 2011, just over 2.4 million jobs were added due to the ARRA. Similarly, even more private analysts, including from Goldman Sachs, estimate that the ARRA boosted GDP by 1.7 to 2.7 percentage points above what it would have been without the stimulus spending. [Rick Newman: How Politicians Are Wrecking the World Economy] So why all this talk about the stimulus not working? The stimulus was disappointing because it only filled less than half of the giant hole in the economy. At the time, the economic gap in the economy was around $2 trillion—the stimulus package was roughly $825 billion. Given the pace of the 24-hours news cycle and the constant bickering in Congress, one can be forgiven for forgetting that the big debate about the stimulus among economists at the time was not about whether it would work—it was about it not being big enough to fill the crater left by the financial crash. The stimulus law performed well given its size and scope. It's a moral tragedy that so many in our nation remain jobless and so many remain unable to refinance their underwater mortgages. But our stubborn jobs crisis isn't a symptom of any inherent deficiency in stimulus spending—it's political. We could have done more, and we still need to do more to get Americans to work and increase consumer demand so that businesses start hiring again. Common sense (and mounds of evidence) tells us "yes" is the obvious answer. Unfortunately, both common sense and empirical wisdom seem irrelevant to many in the halls of Congress.

#### Despite Republican hype, the government can fill the gap

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IN RECENT YEARS one of the most salient philosophical divides between those on the right and those on the left has involved the putative ability of government to improve our lives. Ronald Reagan became famous for reiterating the adage that the most feared words in the English language were “We’re from the government, and we’re here to help.” The consequences of putting a political party that frequently disparaged government in charge of providing essential government services became clear, however, in the federal government’s response to Hurricane Katrina. While the micropolitics may have seemed like a win for ideologically driven Republicans—provision of shoddy government services could reinforce the claim that only the private sector is able to provide decent services—the philosophy eventually turned a cropper at the polls and has been decisively rejected. It is clear that the American public wants well-thought-out government programs and policies, competently executed. Whereas the political economic landscape has changed dramatically in recent months, the gut-level response of many with conservative inclinations to blame the government has not. We are now in the midst of what will likely be the most serious economic and ﬁnancial crisis since the Great Depression. How did we get into this mess, what responsibility does government bear in allowing this to happen, and what does the history of the Great Depression tell us about how we should go forward? In the presence of an unusual decline in consumption spending as households come off a debt-fueled binge, a collapse of private-sector investment spending (much of which until recently was for residential housing), and export weakness due to worldwide recession, the federal government is the only entity now that can step in to ﬁll the gap in aggregate demand. For these reasons, the 2009 stimulus plan is basically well motivated, although probably too small. The current administration has not, however, put forward a fully persuasive plan to deal with the ﬁnancial/banking/insurance crisis. Ben Bernanke, Larry Summers, and Timothy Geithner all seem to believe that what we have here is a classic liquidity problem and that the large banks only look insolvent because wealth holders irrationally do not want to buy securitized debt obligations at much more than twenty to thirty cents on the dollar. I have heard several times from colleagues who share the Bernanke/Summers view that ultimately these ﬁnancial assets, if held to maturity, will yield sixty to seventy cents on the dollar.

### consumer spending kt growth

#### Lack of consumer spending results in crisis

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According to Keynesian economic theory, recessions are caused by a fall in economy-wide (―aggregate‖) demand. Since one person‘s spending is another‘s income, a fall in demand makes the nation poorer. When the now poorer nation cuts back on spending, it sets off yet another wave of falling income. So, according to this view, a big shock to consumer spending or business confidence can set off waves of job losses that ripple through the economy. Can anything stop this ripple effect? Keynesians say yes. Government spending can take the place of private spending during a crisis. This spending can take a number of forms: public service employment, cash transfers, state revenue sharing, or infrastructure projects.

### demand kt employment

#### A huge portion of current job losses stem from declining aggregate demand

Mian and Sufi, 12 - \*professor of economics at UC Berkeley AND\*\*professor of finance at UChicago (Atif R. and Amir, “What Explains High Unemployment? The Aggregate Demand Channel,” National Bureau of Economic Research, February 2012, <http://faculty.chicagobooth.edu/amir.sufi/MianSufi_WhatExplainsUnemployment_Nov2011.pdf>)//HK

Can the decline in demand associated with household balance sheet shocks explain the sharp reduction in employment in the U.S. from 2007 to 2009? We show that the answer to this question is **a resounding yes**. We refer to this channel as the aggregate demand channel for unemployment and our analysis demonstrates that it explains a substantial fraction of jobs lost from 2007 to 2009.

Our test of the aggregate demand hypothesis is based on one of its main implications: a negative consumer demand shock in a given location should reduce employment in industries producing non-tradable goods in that specific location, but should reduce employment in industries producing tradable goods throughout the country. For example, when Califomians cut back on consumption significantly more than Texans, the non-tradable sector in Califomia loses more jobs than the non-tradable sector in Texas. However, because Califomians buy tradable goods produced throughout the country, job losses in the tradable sector will be distributed evenly across all counties, including those in Texas.

The starting point of our empirical approach is based on Mian, Rao and Sufi (2011), who show that negative consumer demand shocks were strongest in counties with high household leverage. We utilize industry-by-county data on employment broken down by non-tradable and tradable industries. Industries are classified as non-tradable if they are focused in the retail or restaurant business. In order to remove any direct effect of the residential housing boom and bust, we explicitly remove construction or any other real-estate related sector from the nontradable definition.

Consistent with the aggregate demand channel, job losses in the non-tradable sector from 2007 to 2009 were significantly higher in high leverage counties that experienced sharp demand declines. In particular, a one standard deviation increase in the 2006 debt to income ratio of a county is associated with a 3 percentage point drop in non-tradable employment during this time period, which is 2/5 a standard deviation. Moreover, the large decline in employment in the tradable sector is completely uncorrelated with 2006 debt to income - exactly as predicted by the aggregate demand channel.

Can the cross-sectional job loss pattems in non-tradable and tradable sectors be explained by altemative hypotheses? One explanation for sustained low employment levels is based on heightened economic and policy uncertainty. However, in its most basic form, the uncertainty view does not predict such large cross-sectional differences across the country in employment losses. Further, it is unlikely that the uncertainty hypothesis can rationalize the distinct relations between household leverage and non-tradable versus tradable sector job losses that we find here.

A second explanation for unemployment is based on the structural adjustment of the labor force, as displaced labor from overly-inflated housing, constmction, and financial sectors relocate to altemative sectors. One may also argue that such structural adjustment issues are more prevalent in more levered counties. However, we show that this argument is unlikely to be an explanation for our results for several reasons. First, our definition of non-tradable job losses explicitly removes job losses associated with const|'uction and other related industries. Second, including control variables for either the constmction share of employment as of 2007 or the growth in the const|'uction sector from 2000 to 2007 does not change our results. ln fact, these controls are uncorrelated with non-construction non-tradable sector job losses.

Further, we show that both the construction share as of 2007 and the growth in the construction sector during the housing boom are uncorrelated with county-level household leverage when instrumented with housing supply elasticity. The reason for this perhaps surprising result is that low housing supply elasticity areas had higher price appreciation during the boom and hence more leverage, but it was also more costly to expand the housing stock in these areas.'

We also examine other margins of adjustment in the labor market. Given the disproportionate job losses in high leverage counties, one would expect to fmd evidence of a relative wage decline in these counties. We find such evidence: a one standard deviation increase in household leverage is associated with a l/5 standard deviation reduction in wages. One might also expect that workers would move out of high household leverage counties in response to deterioration in local labor markets. However, we iind no evidence of such mobility. In fact, as of 2009, net migration into high leverage counties is positive. Mobility out of high household leverage counties does not explain the employment losses in these areas.

In the final section of our analysis, we use our results to quantify the total employment losses due to the aggregate demand channel. Our methodology for doing so is based on the insight that one can use the cross-sectional county level estimate of the effect of demand shocks on unemployment in the non-tradable sector to back out the effect of aggregate demand on unemployment in all sectors.2 We estimate that aggregate demand channel can account for 4 million of the 6.2 million jobs lost between March 2007 and March 2009. The methodology behind this calculation is described in Section 2 and the details of this aggregate calculation are in Section 5. Taken together, our results suggest that **a decline in aggregate demand** related to household balance sheet weakness is **the primary explanation for high and persistent unemployment during the economic slump.**

### **investment**

#### Government stimulus creates growth – it incentivizes investment and consumer confidence

Reynolds, 8 - Economics Graduate @ Tarleton State University (Jackie, “W.W.K.D”, 11-28, [http://jackiedewaynereynolds.info/files/1108\_WWKD.pdf)//AH](http://jackiedewaynereynolds.info/files/1108_WWKD.pdf%29/AH)

While little consensus exists as to what caused the current economic crisis or how bad it’s going to get, liberal and conservative economists alike are asking themselves one simple question: What would Keynes do (Kondracke)? And the largely bipartisan response has caught many observers by surprise: make like a Keynesian and spend! Specifically, “what we need now is to have a major (government) spending program, which takes the place of the arms build-up that happened as we went to World War II,” according to conservative Harvard University economist Martin Feldstein (News Hour). His more left-leaning counterpart from Princeton University, Alan Blinder, agrees. “It almost doesn't matter what kind of spending, but we'd like . . . something that's valuable in its own right” (News Hour). The height of government spending came in the 1940s as America transitioned to a war- time economy. In 1945, the country’s debt was 109% of its gross domestic product, 2 the highest it’s ever been. By comparison today’s $10 trillion (that’s “trillion” with a “t”) debt (Treasury Direct) is only 20% of our current GDP (GAO). At current rates of spending, and assuming growth remains static, the ratio of debt to GDP is not expected to exceed the historic high of 109% until 2040 (GAO). Despite our debt topping 100% of our GDP during World War II, America’s economy continued to thrive, save for the inevitable contractionary business cycles, particularly pronounced in the late ‘70s and early ‘80s. So reaching that same level of spending in the near future doesn’t automatically spell doom, particularly if the spending leads to robust economic growth, as was generally the case following the war. In his *Treatise on Money*, Keynes attempted to address the maddening question of why economies “evidence a wavelike succession of expansions and contractions, not unlike a kind of economic breathing. . . . What lay behind this alternation of prosperity and depression?” he asked (Heilbroner 263). Keynes’ answer was not original: economies enter contractionary business cycles when individual savings aren’t loaned to expanding business firms for reinvestment in its capital stock (266). The “central characteristic of an economy is the flow of incomes from” one hand to the next (265), according to Keynes. “If Enterprise (investment) is afoot, wealth accumulates whatever may be happening to Thrift (savings); and if Enterprise is asleep, wealth decays whatever Thrift may be doing” (Keynes 149). Keynes further speculated that as savings became so abundant that interest rates declined, borrowing would become cheaper and investment would be incentivized (Heilbroner 269). As more money was borrowed, interest rates would inevitably rise, as would the incentive to save, in turn diminishing the incentive to borrow and invest, thus repeating the cycle. Unfortunately, as sound as this theory was, it did NOT hold true during the Great Depression. It turns out that “saving [is] a kind of luxury that could not withstand hard times” (271). And with no surplus savings, there was no pressure to borrow and invest. The economy got stuck! Keynes’ follow up disquisition, *The General Theory of Employment, Interest, and Money*, provided the blue print for unsticking it: “the deliberate undertaking of government spending to stimulate the economy” (Heilbroner 274). And so we have returned to where we began: to escape the morass of our current economic crisis, we must make like a Keynesian and spend! Or more specifically, our government must. If massive government spending is required to right our economy and there are few if any constraints (political, fiscal or otherwise) on how the money is spent, then the next question should be how can we spend in such a way that stimulates the economy, reduces unemployment, meets (or at a minimum does not conflict with) national strategic goals and provides both short- term and long-term opportunities for economic growth? There’s no shortage of answers.

#### Stimulus quickly reverses the unemployment trend and leads to investment

Dolan, 12 (Eric W., “Eliot Spitzer: U.S. needs ‘big, old-fashioned Keynesian stimulus’” 6-4, [http://www.rawstory.com/rs/2012/06/04/eliot-spitzer-u-s-needs-big-old-fashioned-keynesian-stimulus/)//AH](http://www.rawstory.com/rs/2012/06/04/eliot-spitzer-u-s-needs-big-old-fashioned-keynesian-stimulus/%29/AH)

Former New York Gov. Eliot Spitzer said Monday that the United States needed to invest in the public sector, because the country’s current policies clearly were not revving up the economy. “One thing that could help is a big, old-fashioned Keynesian stimulus,” he said on his Current TV show Viewpoint. “First, realize we’ve tried the Republican approach,” Spitzer explained. “As Paul Krugman and others point out, taxes have been cut and government spending has fallen, once you adjust for population and inflation. In fact, it has not fallen this quickly since the demobilization after the Korean war. So it’s no surprise that public sector employment is way down.” He noted that now was a good time for the U.S. government to borrow more money, because of the extremely low interest rates. “A myriad of investments can spur future growth and create jobs right now. We could even have a modern WPA for kids coming out of high school and college who desperately need jobs,” Spitzer said, making reference to programs enacted under The New Deal by President Franklin D. Roosevelt. “These programs would pay for themselves in the long run.”

#### Stimulus curves demand without leading to a bubble – restores employment

Baker, 10 - economist and Co-Director of the Center for Economic and Policy Research (Dean, “Feel No Pain: Why a Deficit In Times of High Unemployment Is Not a Burden” http://129.132.57.230/serviceengine/Files/ISN/121973/ipublicationdocument\_singledocument/7884a664-f053-4506-9a14-35332c859dc1/en/2010-09\_FeelNoPain.pdf)//AH

If the idea of the Federal Reserve just holding the debt sounds like a free lunch, it should, because it is. We are seeing mass unemployment right now for a simple reason – insufficient demand. The problem is not the economy’s lack of ability to produce more output, uncertainty of business owners, or a lack of access to credit. The problem is that there is not enough demand for the output that the economy could produce. Before the downturn, this demand was generated in large part by $8 trillion in housing wealth that turned out to be illusory. While the source of the demand was illusory, the additional goods and services that the economy was producing before the recession were real. The problem that we face right now is simply finding another way to generate the same level of demand. This is fundamentally a political problem, not an economic problem. We simply need a way to prompt additional spending from any source whatsoever. If the housing bubble re-inflated, so that people again believed they had an additional $8 trillion in equity, then we would see enough spending to bring the economy back to full employment. This is not likely to happen and would not be sustainable even if it did. (People would build more homes, leading to enough over-supply to crash the bubble, again.) However, it certainly makes no sense for policymakers to be more worried about demand stimulated by the government than demand stimulated by housing bubble wealth. If we can just get policymakers to focus on the economy’s real problems, it will be possible to solve them.

### **deflation**

#### **Stimulus resolves deflationary spirals—three factors**

Christiano et al., 09 – professor of economics at Northwestern (Lawrence, “When Is the Government Spending Multiplier Large?” National Bureau of Economic Research, October 2009, http://www.nber.org/papers/w15394)//HK

This scenario resembles the paradox of thrift originally emphasized by Keynes (1936) and recently analyzed by Krugman (1998), Eggertsson and Woodford (2003), and Christiano (2004). In the textbook version of this paradox, prices are constant and an increase in desired saving lowers equilibrium output. But, in contrast to the textbook scenario, the zero-bound scenario studied in the modern literature involves a deflationary spiral which contributes to and accompanies the large fall in output.

Consider now the effect of an increase in government spending when the zero bound is strictly binding. This increase leads to a rise in output, marginal cost and expected inflation. With the nominal interest rate stuck at zero, the rise in expected inflation drives down the real interest rate, which drives up private spending. This rise in spending leads to a further rise in output, marginal cost, and expected inflation and a further decline in the real interest rate. The net result is a large rise in output and a large fall in the rate of deflation. In effect, the increase in government consumption counteracts the deflationary spiral associated with the zero-bound state.

#### Huge risk of deflation now—unsuccessful inflationary policies prove

Mittlestaedt, 12 – author and reporter focused on investment (Martin, “Deflation next big trend, says Comstock,” The Globe and Mail, 6/22/2012, <http://www.theglobeandmail.com/globe-investor/markets/market-blog/deflation-next-big-trend-says-comstock/article4363710/?cmpid=rss1)//HK> **Comstock Partners is a prominent U.S. investment firm**

But Comstock Partners, a U.S. money manager, says forget about an inflationary resolution to the debt problem. The most likely next big trend, in their view, is deflation, or falling price levels. They believe deleveraging, or the elimination of debt either through repayment or bankruptcy, will lead to deflation.

"We have long maintained that a debt bubble followed by a credit crisis leads to a deflationary recession or depression, and a major secular bear market," the firm said in a recent letter to clients. "In our view, it is the overwhelming force of the debt deleveraging that has overcome government efforts to inflate."

While deflation hasn't happened yet in Canada, it might be getting close. The May CPI numbers reported today showed consumer prices fell 0.2 per cent from April and were up a mere 1.2 per cent over the past year. Japan has been experiencing deflation for years, and Switzerland has been starting to experience falling consumer prices as well.

Comstock's report makes an interesting observation. So far, governments and monetary authorities have tried nearly every trick they have to jump start the global economy, but it hasn't worked.

There have been massive deficits, two rounds of quantitative easing, or money printing, by the Federal Reserve Board and just this week it announced an extension of Operation Twist, another Treasury bond purchase program. In the U.S., the Fed has tripled the monetary base, without leading to runaway money supply growth or much economic growth, for that matter. Something is working against the efforts by policy makers.

Comstock thinks it has the answer: people are trying to get out of debt (witness the fall in household debt in the U.S. to 84 per cent of GDP recently, from its peak of 98 per cent in 2008). If consumers are using their money to repay debt then they're not buying things, so the demand for goods is weak, so businesses have little reason to hire or make capital expenditures. This sets up a vicious circle of weak demand that starts to feed on itself and is difficult to arrest. Deleveraging still has a long way to go for household debt to even fall back to the 55 per cent of GDP average over the past 60 years.

"Under these circumstances, we believe that inflation cannot take hold in the real world. Businesses feel minimal pressure from rising wages and have no compelling need to raise prices. Even if they tried, consumers would not have enough income to pay the higher prices and would resist, forcing producers to rescind whatever price increases they try to put through," Comstock says.

### **New Deal proves**

#### New Deal proves stimulus causes growth while tightened fiscal policies reverse expansion

Field 09 is the Michel and Mary Orradre Professor at Santa Clara University and executive director of the Economic History Association (Alexander, “The Great Depression, the New Deal, and the Current Crisis” July-August 2009 http://dl2af5jf3e.search.serialssolutions.com/?ctx\_ver=Z39.88-2004&ctx\_enc=info%3Aofi%2Fenc%3AUTF-8&rfr\_id=info:sid/summon.serialssolutions.com&rft\_val\_fmt=info:ofi/fmt:kev:mtx:journal&rft.genre=article&rft.atitle=The+Great+Depression%2C+the+New+Deal%2C+and+the+current+crisis.%28The+Recession%29&rft.jtitle=Challenge&rft.au=Field%2C+Alexander&rft.date=2009-07-01&rft.pub=M.E.+Sharpe%2C+Inc&rft.issn=0577-5132&rft.volume=52&rft.issue=4&rft.spage=94&rft.externalDBID=n%2Fa&rft.externalDocID=207870537)//BM

Although the banking/ﬁnancial situation remains a mess, President Obama deserves credit for pushing through a stimulus plan that, although too small, is certainly far superior to inaction or Republican calls for a spending freeze. This view is, of course, not universally shared across the political spectrum. Over much of the discussion of the need for or likely success of the stimulus package looms the shadow of the 1930s. Indeed, a running battle is taking place in the pages of the Wall Street Journal and elsewhere regarding the historical legacy of Franklin Delano Roosevelt and the New Deal. In the context of this discussion, a number of misconceptions and frankly silly claims have been made, by both economists and non-economists. First, did New Deal spending get us out of the depression in the sense of restoring us to full employment? Of course not—tha**t**’s been the consensus of economists and economic historians for over half a century, going all the way back to E. Cary Brown’s famous article (1956). The increase in government spending was simply too small to compensate for the collapse of private-sector autonomous spending in the 1930s. Autonomous spending is not closely linked to or induced by current receipts of income, and it includes investment spending—purchases of plant and equipment including residential housing—as well as big-ticket consumer items such as cars, furniture, and large appliances. Both types of spending plummeted between 1929 and 1933. Although they did not restore us to full employment until the war, New Deal ﬁscal policies nevertheless operated in the right direction through Roosevelt’s ﬁrst term. Both real output and employment grew very strongly between 1933 and 1937, with unemployment falling more than 10 percentage points. The expansion reversed itself in 1938 because of tightened ﬁscal policy (a modest reduction in government spending and the institution of a new payroll tax to ﬁnance the social security system) as well as tightened monetary policy (the Fed pushed interest rates up because it was concerned that the rising quantities of unborrowed reserves held by banks for precautionary reasons presaged inﬂation). These moves toward tight money and ﬁ scal “responsibility” drove the unemployment rate up almost 5 percentage points, to 19 percent. Economist Lee Ohanian (2008) has been arguing that the New Deal kept the economy from recovering through such policies as the National Industrial Recovery Act (NIRA) and the National Labor Relations Act (NLRA). For several reasons, these arguments are unpersuasive. First, although the NIRA undoubtedly introduced some distortions at the microeconomic level, at the macro level it played a role—in conjunction with monetary and ﬁscal policies, including the abandonment of gold—in arresting deﬂation. In any event, the NIRA was gone by 1935. As far as the NLRA is concerned, high unionization did not pose an obstacle to prosperity during the golden age (1948–73), and an examination of data show that it is unlikely it did so in the 1930s. A simple look at GDP data conﬁrms this. The latest methodology for calculating real GDP uses the chained index method. The problem in comparing the magnitude of output or its components at different times is that prices change, and calculations of growth vary depending on whether one uses current prices or prices of a previous year. This is the famous index number problem, a staple of ﬁrst-year economics courses. The solution now adopted by the Bureau of Economic Analysis is, for each year, to calculate the change in GDP using last year’s prices and then again using this year’s prices, and then to take a geometric average of the two (multiply the two together and take the square root of the product). The old way of doing this was to choose a given base year, calculate changes using base period prices, and then periodically change the base year, which resulted in revisions of what one thought to have been established as the historical record. The current procedures eliminate this problem, but at the cost of producing estimates for GDP components that do not necessarily sum to GDP. The chained index method is good for looking at the growth of real magnitudes over time—of interest here, but if one wants to see how GDP breaks down into its different components in a given year, current dollar numbers are better. That said, what do the latest calculations of GDP and its major components—consumption, investment, and government spending— show (www.bea.gov/national/nipaweb/SelectTable.asp?Popular=Y, table 1.1.6)? They show that real GDP, which (in chained 2000 dollars) had fallen from $865.3 billion in 1929 to $635.5 billion in 1933, had risen to $911 billion in 1937. In other words, GDP had completely recovered from its collapse during the Hoover administration and by 1937 was, in real terms, more than 5 percent above its 1929 peak. Gross private domestic investment, which plummeted disastrously from $91.3 billion in 1929 to $11.5 billion in 1932, had come within a hair’s breadth of reattaining 1929 levels in 1937 ($91.1 billion). Both real consumption and real GDP surpassed 1929 levels in 1936. To be sure, unemployment was still far too high in 1936 and 1937, the result of growth in the labor force; very strong productivity advance, which contributed to something of a “jobless recovery”; and the failure of investment in residential housing to recover. The latter was in part the consequence of poor land-planning policies of the 1920s and the wreckage of the real estate/residential construction boom that had peaked in 1926.

#### Roosevelt proves – deficit spending stimulates growth and aggregate demand

Dau-Schmidt 12 Indiana University Maurer School of Law, Ph.D. in Economics and J.D. from the University of Michigan (go blue) (Kenneth “Keynes Was Right!” Indiana Law Journal 1/1/12 <http://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=2970&context=ilj&sei-redir=1&referer=http%3A%2F%2Fscholar.google.com%2Fscholar%3Fas_ylo%3D2011%26q%3Daggregate%2Bdemand%2Band%2Bkeynes%26hl%3Den%26as_sdt%3D0%2C23#search=%22aggregate%20demand%20keynes%22>)//BM

In planning this conference, I chose Professors Golden and Flanagan to discuss the current economic context for American labor and employment law policy because I thought they would give two very different accounts. Both distinguished academics in their own right, Professor Golden hails from a “progressive” economics department and has a strong track record for analyzing and advocating government labor policies, while Professor Flanagan hails from a business school and has had a long and illustrious career analyzing and advocating on behalf of the machinations of the labor market: a “liberal” economist and a “conservative” economist, to use the political vernacular. They did not disappoint. Yet while our two speakers expressed significant differences on the merit of active labor market policies to reduce unemployment and decrease income inequality, I prefer to focus on what they agreed on. Both speakers agreed that education and training were the best methods to raise employee wages; both agreed that income inequality could most effectively be addressed through tax policy; and, most importantly, both agreed that fiscal policy, including prominently direct government deficit spending on infrastructure, was the best way to address the current crisis we face in unemployment. This last point is vital to the current health of our economy and the futures of our children and students as they venture out to find jobs. Why Republican politicians and sectors of the American public have suddenly become obsessed with balancing state and federal budgets at a time when this will clearly do harm to the recovery, the economy, and our children’s future, after almost a decade of profligate spending on the war in Iraq, is beyond me. 1 Indeed the point has become so politically charged that Alabama Senator Richard Shelby has blocked the appointment of Nobel laureate and unemployment expert, Peter Diamond, for appointment to the Federal Reserve merely because Diamond is a “Keynesian” and has advocated expansionist fiscal policy—even though the Federal Reserve of course has no responsibility for the federal budget. 2 But, of course, the current economic crisis shows that John Maynard Keynes was right and that his teachings have a lot to offer us in resolving our current problems. Keynes developed his theories in response to the persistent unemployment during the Great Depression, an economic circumstance eerily similar to the predicament in which we now find ourselves. On “Black Thursday,” October 24, 1929, a speculative bubble in stock market prices burst when stock speculators, many of whom had bought stock on margin, began to panic and sell off their shares, which resulted in a decline in stock prices of twenty-four percent in less than a week. 3 Many of the nation’s banks were heavily invested in the market, and the market’s decline forced the banks into default either directly or by undermining people’s confidence in the security of their deposits. These defaults forced the banks to recall loans, restricting the availability of credit and causing a contraction in the money supply. As the nation’s wealth and money supply contracted, aggregate demand for goods and services declined, which depressed prices and wages and caused employers to lay off employees. 4 For over a decade, the nation’s unemployment rate exceeded ten percent and reached heights estimated at twenty five to thirty percent. 5 By 1933, the nation’s gross domestic product had dropped by a third. 6 Initial government reactions to the Great Depression were minimal or even counterproductive. President Hoover argued that the nation’s problems could be solved through “belt-tightening.” 7 He reasoned that in such a time of uncertainty, the government should be stable—balancing its budget and shoring up its currency. Unfortunately, these measures further contracted the money supply and decreased aggregate demand, further increasing the unemployment rate. 8 There were also those in Hoover’s administration who believed that the pain people were enduring would have a therapeutic effect on the economy. Secretary of the Treasury Andrew Mellon argued, “Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate. . . . [That] will purge the rottenness out of the system. . . . People will work harder, live a more moral life. . . . and enterprising people will pick up the wrecks from less competent people.” 9 Keynes hypothesized that, in order to escape the Great Depression, the government should actively stimulate aggregate demand to increase employment and consumer spending and thus encourage the economy to spiral upward, not downward. 10 This should be done, according to Keynes, by expanding the money supply, or by direct government deficit spending to increase demand for goods and investment in capital. 11 Although merely adjusting the money supply might be adequate to combat small recessions, Keynes argued that direct government deficit spending would be the most effective tool in combating unemployment when interest rates had dropped to the point that further increases in the money supply did not increase aggregate demand. Keynes referred to this situation as “the liquidity trap” because, at a low enough interest rate, businesses and consumers became indifferent between holding cash (liquidity) and making investments, and thus further increases in the money supply would not increase aggregate demand or employment. 12 Franklin Delano Roosevelt adopted Keynes’s theories as a basis for the New Deal and undertook an aggressive policy of deficit spending on infrastructure to employ people and put money in their hands for consumption and improvement of the economy. 13 This policy significantly improved the economy, which fully recovered with the massive deficit spending required for World War II. 14 As a result of the economic recovery, people had jobs and government coffers were filled, so that in the long run the direct government deficit spending improved both the lives of Americans and the government’s balance sheet. 15 We now find ourselves in a very similar predicament in which investment speculation has resulted in the failure of financial institutions and a significant decline in the money supply, aggregate demand, and employment. 16 The Federal Reserve has valiantly and appropriately combated the recession by expanding the money supply, but with interest rates to banks basically at zero, interest rates have fallen to the point where there is no more room for purely monetary policy to stimulate the economy. 17 Balancing state or the federal budgets at this time would merely repeat the errors of the Hoover administration, decreasing aggregate demand and killing, or even reversing, the recovery. 18 Although deficit spending increases future commitments on debt maintenance, well-designed deficit spending now will shorten the recession, improve our children’s and student’s job prospects, increase employment and tax revenues, and lessen the long-run government budget deficit. General tax cuts for businesses and the wealthy—the “job creators” as the Republicans like to call them—would be a very ineffective way to stimulate aggregate demand because not all of these tax cuts would be spent on consumption, 19 and much of what was spent on consumption would just be spent on more crap from China—benefiting Chinese workers but not American workers. 20 Direct government deficit spending on the infrastructure ensures that that money is spent on jobs in the United States and that the money purchases something that will benefit our children who will be left with any debt load. 21 Keynes himself once said, “Ideas shape the course of history.” 22 On the vital issue of determining the appropriate policy to increase employment and get us out of the Great Recession, it is imperative that wiser minds like that of Professors Golden and Flanagan prevail. 23 Regardless of your normative or political beliefs, balancing the state and federal budgets now will decrease aggregate demand and employment while direct government deficit spending will increase aggregate demand and employment. Although we should not undertake additional government debt lightly, under the current circumstances further fiscal stimulus will shorten the Great Recession and increase the gross domestic product enjoyed by Americans and tax revenues.

#### Depression Era recovery proves- Government stimulus fosters long term growth

 Field 09 is the Michel and Mary Orradre Professor at Santa Clara University and executive director of the Economic History Association (Alexander, “The Great Depression, the New Deal, and the Current Crisis” July-August 2009 <http://dl2af5jf3e.search.serialssolutions.com/?ctx_ver=Z39.88-2004&ctx_enc=info%3Aofi%2Fenc%3AUTF-8&rfr_id=info:sid/summon.serialssolutions.com&rft_val_fmt=info:ofi/fmt:kev:mtx:journal&rft.genre=article&rft.atitle=The+Great+Depression%2C+the+New+Deal%2C+and+the+current+crisis.%28The+Recession%29&rft.jtitle=Challenge&rft.au=Field%2C+Alexander&rft.date=2009-07-01&rft.pub=M.E.+Sharpe%2C+Inc&rft.issn=0577-5132&rft.volume=52&rft.issue=4&rft.spage=94&rft.externalDBID=n%2Fa&rft.externalDocID=207870537>)//BM

Real government spending, which remained at roughly the same level in 1930–33 (about 10 percent above 1929 levels), accelerated under Roosevelt, particularly after 1935. The idea that the multipliers associated with such spending were less than 1 or possibly even 0 has been advanced by a number of economists, in particular Robert Barro. Barro (2009) makes this claim based on what happened during World War II. But we had already reached potential output by late 1942. No serious Keynesian ever argued that there would be a real spending multiplier if one started at potential. The argument had to do with being inside the production-possibility frontier, with slack labor and capital that could be sucked into production if the government primed the pump with spending. Parenthetically, the argument that tax cuts are preferable as stimulus ignores the fact that in a heavily indebted economy, most tax cuts will simply be used to reduce debt rather than increase spending on goods and services, which is what we need now. It is regrettable that we have reached this point (in 2009) after a long orgy of both private and governmental consumption. It would have been better, now that we need to run large deﬁcits, if President Bush had forgone some of his tax cuts and military initiatives and left us with a smaller government debt. But these are the cards we have been dealt; the past cannot be changed. On the aggregate supply front, the argument, repeated over and over again, that tax cuts beneﬁt aggregate supply by reducing disincentives to work focuses exclusively on the substitution effect, with no mention of possible income effects. As a result of the recent crisis, most academics have had their salaries frozen and have also taken a big hit on their pension accumulations. The salary freeze, in its effects on after-tax income, is equivalent to a tax increase. I know not a single academic who, as a consequence of the economic crisis, plans to retire earlier. The facts are that within the ranges we are discussing, reductions in take-home pay can as easily increase desired labor supply as reduce it. In thinking about the stimulus provided by government spending, it is critical that we distinguish between effects on aggregate demand and effects on aggregate supply. For the former, it makes no difference whether the spending is of long-term value to the economy. Keynes is famous for suggesting that in a deep recession it would pay to divide the unemployed into Team A and Team B, then pay Team A to dig holes and Team B to ﬁ ll them in. Useless pork barrel projects such as bridges to nowhere and wasteful military spending add nothing of permanent value to the economy, but if the economy is severely depressed, it is better to have such spending than not. Ideally, of course, stimulus spending would consist of government investment that produces something of value. On this account, depression-era spending, some of it started under Hoover and continued and ramped up under Roosevelt, measures up pretty well. Government infrastructure projects contributed in important ways to the largely unheralded expansion of potential output between 1929 and 1941. That expansion underlay the successful prosecution of World War II and laid the foundation for the age of high mass consumption that followed. My studies indicate that the build-out of the surface road network contributed to the very high rate of total factor productivity (TFP) and labor productivity growth across the depression years, generating private-sector spillovers both in transportation, where it facilitated a growing complementarity between rail and trucking, and in wholesale and retail distribution. Combined with TFP growth within manufacturing that was world class by any standard of comparison other than the 1920s, one ended up with TFP growth between 1929 and 1941 for the private nonfarm economy (about 75 percent of the aggregate; agriculture and government are excluded) of 2.31 percent per year without a cyclical adjustment, or 2.78 percent per year with one. No other comparable period, including the golden age (1948–73) and the IT period (1995–2005), approaches this result. Virtually all of the growth in private-sector output, as well as output per hour during the depression years, is attributable to TFP advance. In part this outcome reﬂected the maturing of a private-sector research and development system, before its trajectory was distorted by the Manhattan project and postwar military spending. The number of scientists and engineers in manufacturing R&D almost tripled in the United States between 1933 and 1940, and one sees similar trends in National Research Council data charting the establishment of R&D labs or spending. It is true that TFP growth in manufacturing was higher in the 1920s (but not in the private nonfarm economy as a whole, because not much was happening outside of manufacturing). The 1920s record in manufacturing was largely the result of transitioning from internal power distribution using overhead metal shafts with leather belts bringing power to each machine’s drive shaft to distribution based on electricity ﬂowing through wires to small electric motors. This was, however, a one-time shift, which produced a large boost to TFP levels in the sector but could not be expected to generate a permanent acceleration in TFP growth. The other main contributor to the depression-era growth in potential output, in the absence of growth in hours or private-sector physical capital, was Roosevelt’s public spending. The rise in real wages for those employed across the depression years was certainly consistent with Roosevelt’s efforts to facilitate the growth of unions. But high TFP growth would have to have been reﬂected in some combination of growth in real wages and the return to capital. Both wages and earnings, which bottomed out in 1932, went up dramatically under Roosevelt. In particular, recipients of capital income, who had, with the exception of holders fixed income securities, done terribly under Hoover, did far better in the New Deal. Both proprietors’ income and corporate earnings recovered strongly between 1933 and 1937. The Dow Jones Industrial Average advanced from a nadir of 43 in 1932 to 187.70 in 1937, although it fell by almost half in the 1938 recession. Finally, in ways that are sometimes not fully recognized, Franklin Roosevelt’s New Deal laid the foundation for postwar prosperity. Banking and ﬁnancial legislation, such as the Securities Act of 1933 and the Securities and Exchange Act of 1934, provided a basis for several decades of ﬁnancial stability. Whereas its short-run macroeconomic effects were contractionary, social security established a basis for dealing with the problem of old-age security. Innovations in the layout and design of residential housing developments—pioneered, along with amortized mortgages, by the FHA—combined with street and highway construction to create preconditions for the postwar housing boom, allowing serious construction in this sector to resume after more than a two-decade hiatus. Hydropower, ﬂood control, and rural electriﬁcation projects provided beneﬁts to many parts of the country. In addition to highways, bridges, and tunnels, the country was dotted with libraries, municipal airports, and improvements in national parks, which have been of lasting beneﬁt to citizens. Roosevelt’s New Deal spending was indeed too small to restore the economy to full employment prior to the war. But, on the aggregate supply side, it contributed to the extraordinary expansion of potential output that took place between 1929 and 1941. The country today is navigating perilous waters. President Obama’s administration, as was Roosevelt’s, is called socialist or worse by some on the right. The problem, if anything, however, is that key economic advisors, in particular Larry Summers and Tim Geithner, have been too deferential toward Wall Street, have seemed too accepting of the idea that what is good for Goldman Sachs is also good for the country. They need help in ﬁnding the right path, not hopes that they will fail. And in studying history for lessons about the future, we need to be clear-eyed. Slipping into New Deal denialism, as some have called it, will no more help the progress of economic science or the practice of economic policy than will endorsing creationism facilitate advance in evolutionary biology.

### **ARRA proves**

#### Experts and Congressional Budget Office mark the stimulus as a success

**Benen 6-7-12**- Article refers to Elmendorf, director of the Congressional (Steve, “Case closed: the stimulus worked”, The Maddow Blog, June 7, 2012, <http://maddowblog.msnbc.msn.com/_news/2012/06/07/12104923-case-closed-the-stimulus-worked?lite)//sjl>

Among those who know what they're talking about, however, there is no real doubt that the stimulus was a success. Douglas Elmendorf, the director of the non-partisan Congressional Budget Office**, reminded Congress** of this inconvenient truth yesterday. Did the stimulus work? Certainly not according to Republicans, who regularly blast President Obama's "failed" economic policies on the campaign trail. GOP presidential candidate Mitt Romney has called the $787 billion package of temporary tax cuts and spending hikes "the largest one-time careless expenditure of government money in American history." But on Wednesday, under questioning from skeptical Republicans, the director of the nonpartisan (and widely respected) Congressional Budget Office was emphatic about the value of the 2009 stimulus. And, he said, the vast majority of economists agree. In a survey conducted by the University of Chicago **Booth** School of Business, 80 percent of economic experts agreed that, because of **the** stimulus, **the** U.S. unemployment rate was lower at the end of 2010 than it would have been otherwise.

#### Stimulus good—numbers prove the first worked, we just need a bigger stimulus

**Benen 6-7-12**- Article refers to Elmendorf, director of the Congressional (Steve, “Case closed: the stimulus worked”, The Maddow Blog, June 7, 2012, <http://maddowblog.msnbc.msn.com/_news/2012/06/07/12104923-case-closed-the-stimulus-worked?lite)//sjl>

For another, on a substantive/policy-driven level, there's value in knowing what worked and what didn't when it came to making the economy stronger. It's common sense -- if, given certain economic conditions, a Keynesian fiscal stimulus worked, we should do more of it. If it made things worse, we should do less of it. And I've got some charts that help separate fact from fiction. Here, for example, is a chart showing the nation's GDP before and after the stimulus. Note, once the stimulus kicked in, the economy immediately started growing. Here's a chart showing private-sector job growth before and after the stimulus. Note, once the stimulus kicked in, job growth immediately improved. And here's a chart showing the Dow Jones Industrial Average before and after the stimulus. See that low point in March 2009? That's just before the stimulus kicked in. Now, a Republican might look at this and argue, "Yeah, but the gains didn't last." That's true; they didn't. In the spring of 2010, the Eurozone debt crisis rattled international markets and through the global economy a curve ball. The U.S. gains quickly stalled, right around the time the stimulus funds started to wane. In 2011, unrest in the Middle East, coupled with a Japanese tsunami and Eurozone austerity, provided more global troubles. But that's not an argument against the stimulus; it's an argument for more stimulus. The most accurate criticism of the Recovery Act comes from the left -- it was too small.

### **other policies**

#### **Well-planned spending is key to growth—complements other policies and provides certainty**

Franco et al., 10 – managing director of Banca d’Italia (Daniele, Fiscal Policy: Lessons from the Crisis, pp. 259-260)//HK

In all cases, an economic downturn will also lead to an autonomous counter-cyclical fiscal policy through the working of the automatic fiscal stabilisers. However, if the expected downturn appears to be particularly sudden and large, there is a case that can be made for an accompanying expansionary and discretionary fiscal policy. This is particularly relevant in situations where monetary authorities have all but exhausted the scope for conventional monetary policy intervention through reductions in policy interest rates. It has also been shown to be the optimal response in the face of uncertainty as to the true impact of monetary and fiscal policy options. Furthermore, recent research indicates that an active discretionary fiscal policy based on counter-cyclical public **spending can be more important for growth than a fiscal policy based only on automatic fiscal stabilisers.**

When monetary policy is deemed insufficient to stabilise the economy on its own, or in the case of a liquidity trap, an expansionary fiscal policy should be devised so as to correspond to a number of basic principles. There are the now well-known three “Ts”: an expansionary fiscal policy should be timely, targeted and temporary (Elmendorf and Furman, 2008). Then, there are the three “Cs”: an expansionary fiscal policy should also be contingent, credible and coordinated. All in all, poorly crafted fiscal stabilisation packages might result in too little economic boost coming too late, and lead only to rising interest rates and increased public borrowing and debt. In this case, having no fiscal stimulus could be better than a badly thought-out stimulus plan, in limiting the present value of the sum of current and future output losses.

#### **Government spending is more economically effective than tax cuts and inflation**

Eggertsson, 10 – Federal Reserve Bank of New York (Gauti B., “What Fiscal Policy is Effective at Zero Interest Rates?” National Bureau of Economic Research, 2011, http://www.newyorkfed.org/research/staff\_reports/sr402.pdf)//HK

The main problem facing the model economy I have studied in this paper is insuﬃcient demand. In this light, the emphasis should be on policies that stimulate spending. Payroll tax cuts may not be the best way to get there. The model shows that they can even be contractionary. What should be done, according to the model? Traditional change in government spending is one approach. Another is a commitment to inﬂate. Ideally, the two should go together. Government spending has the advantage over inﬂation policy in that it has no credibility problems associated with it.

Inﬂation policy, however, has the advantage of not requiring any public spending, which may be at its "ﬁrst best level" in the steady state of the model studied here. Any ﬁddling around with the tax code should take into account that deﬂation might be a problem. In that case, shifting out aggregate supply can make things worse.

It is worth stressing that the way taxes are modeled here, although standard, is special in a number of respects. In particular, tax cuts do not have any "direct" eﬀect on spending. The labor tax cut, for example, has an eﬀect only through the incentive it creates for employment and thus "shifts aggregate supply," lowering real wages and stimulating ﬁrms to hire more workers. One can envision various environments in which tax cuts stimulate spending, such as old-fashioned Keynesian models or models where people have limited access to ﬁnancial markets. In those models, there will be a positive spending eﬀect of tax cuts, even payroll tax cuts like the ones in the standard New Keynesian model.

It is also worth raising another channel through which tax cuts can stimulate the economy. Tax cuts would tend to increase budget deﬁcits and thus increase government debt. That gives the government a higher incentive to inﬂate the economy. As we have just seen in Section 9, higher inﬂation expectations have a strong positive impact on demand at zero interest rates. Eggertsson (2006) models this channel explicitly. In his model, taxes have no eﬀect on labor supply, but 29 instead generate tax collection costs. In that environment, tax cuts are expansionary because they increase debt and, through that, inflation expectations.

What should we take out of all this? There are two general lessons to be drawn from this paper. The first is that insufficient demand is the main problem once the zero bound is binding, and policy should first and foremost focus on ways in which the government can increase spending. Policies that expand supply, such as some (but not all) tax cuts and also a variety of other policies, can have subtle counterproductive effects at zero interest rates by increasing deflationary pressures. This should — and can — be avoided by suitably designed policy.

## topic-specific

### multiplier

#### Infrastructure spending is a unique form of stimulus – benefits last longer than the government program, creating a strong multiplier effect

Derviş, 11 – Director of Global Economy and Development at the Brookings Institution, Ph.D. from Princeton (Kemal, “To Solve the Fiscal Dilemma, Look to the Details,” Financial Times, 9/1/2011, http://www.brookings.edu/research/opinions/2011/09/01-fiscal-dilemma-dervis)//HK

One should beware, however, of a naive version of the “stimulate now, retrench later” argument. Companies and households do not base spending decisions on immediate income and incentives only. They do look ahead. An immediate tax cut, matched by an expectation of tax increases two or three years from now, is unlikely to be expansionary. One does not have to be a strong believer in what economists call “Ricardian equivalence,” to expect economic agents to look at prospects over a few years when making their spending decisions, rather than at their immediate income only. This means that the high debt overhang in many of the advanced economies, which makes fiscal retrenchment unavoidable over time, is of itself a brake on private spending and makes it difficult to stimulate in the short run. Some argue, therefore, that there is no way out of the current crisis and that we have to endure a prolonged slowdown, because short term stimulus will be self-defeating.

To solve the fiscal conundrum, one has to look beyond aggregates at details and structure. In the United States, for example, immediate tax breaks accompanied by the promise or strong expectation of future tax increases cannot be an effective stimulus, unless targeted on the poorest, who tend to spend whatever they can. On the contrary, federal or state spending to improve infrastructure, whose cost could be recovered through tolls or other charges, and which would also raise productivity in the private sector, could be strongly expansionary if well designed. After all, the government today can borrow at real interest rates close to zero. If the financial rate of return on investment so financed is modestly positive, such spending will actually improve the public sector’s balance sheet, reducing future pressure to tax. Moreover, the economic return on good infrastructure will be greater than the financial return to the public sector alone, because of its positive effects on the activity and income of private sector businesses, both small and large.

Structural reforms of entitlements can also contribute to the recovery, if they succeed in making the system more sustainable without creating a fear of the future among the broad middle class. For example, raising the age of access to Medicare, by itself, may not pass that test. It would save money and appear to reduce future debt, but that could be offset, at least in part, by increased anxiety among those with insufficient medical coverage, leading them to cut back spending at once and so reducing growth. A more targeted reform of Medicare, with greater cost sharing by those most able to afford it, would have the same effect in reducing debt with less deflationary anxiety.

Simplicity is generally a virtue, but there can be too much of a good thing. Neither fiscal stimulus nor fiscal retrenchment is the answer to our current dilemma. Stimulate now and announce future retrenchment can be the answer. But the stimulus must be targeted to lead to an immediate rise in effective demand and be mindful of the public balance sheet, while the retrenchment must not create anxiety about the future that would nullify the stimulus. Taking into account the likely response of different groups and distinguishing between public investment and pure consumption is key for both measures.

#### Infrastructure stimuli have the largest multipliers and will be most effective now

Hall, 10 – professor of economics at Stanford University (Robert E., “Fiscal Stimulus,” Daedalus p. 83, fall 2010, Academic OneFile)//HK

One simple measure of the effectiveness of fiscal stimulus--the multiplier--receives the most attention from economists and often enters public debate as well. The multiplier records the number of dollars of increase in total national output and income per dollar of stimulus spending. Much of this article reviews current thinking among economists about the size of the multiplier. A weak consensus holds that in normal times, including earlier recessions, the infrastructure multiplier is about one: each dollar of infrastructure stimulus boosts output by a dollar. Put differently, when the government buys more highways and schools, output rises by enough to permit other categories of spending--such as consumption and private investment--to remain unchanged. In times of extreme recession, such as 2009, there is widespread agreement that the infrastructure multiplier is higher--perhaps twice its normal value.

A multiplier greater than one occurs in an economy with strong feedback effects. The feedback effect stressed in elementary macroeconomics is the increase in consumption that results from higher income when production is higher. More complete macro models describe the interplay of a variety of feedback effects, some positive and some negative. The positive effects are more likely to prevail in a severely depressed economy.

Any consensus about the multiplier relating benefits spending to total output is even weaker than that of infrastructure spending. An increase in benefits has a first-round effect on spending from the fraction of the increase that recipients spend rather than save. Evidence on this fraction is truly mixed. The benefits multiplier is reduced in comparison to the infrastructure multiplier by this fraction. For example, if 30 percent of a benefits increase is consumed and the remaining 70 percent is saved, the benefits multiplier is roughly 0.3 in normal times when the infrastructure multiplier is one and 0.6 in deep recession when the infrastructure multiplier is two.

#### **Transportation investment works—sustains both supply and demand with huge payoffs**

Tyson, 10 – professor of economics at UC Berkeley (Laura, “The Case for a Multi-Year Infrastructure Investment Plan,” New America Foundation, 9/6/2010, [http://www.newamerica.net/publications/policy/the\_case\_for\_a\_multi\_year\_infrastructure\_investment\_plan)//HK](http://www.newamerica.net/publications/policy/the_case_for_a_multi_year_infrastructure_investment_plan%29//HK)

The remedy for unemployment caused by inadequate private spending is fiscal stimulus (monetary stimulus is also warranted, but that is not the focus of this piece). The 2009 fiscal stimulus package is working: it has added around 3% to the level of GDP and about 3 million jobs relative to what would have been the case otherwise, and there is more to come since about 36% of the stimulus is yet to be spent. But the package ends next year at a time when the unemployment rate will still be well above 9%. So there is a strong economic argument for additional fiscal measures targeted at job creation.

A significant and sustained increase in infrastructure investment by federal, state and local governments should be a priority. Unlike most other forms of stimulus, spending on infrastructure both increases demand when the spending occurs and increases the supply and growth potential of the economy over time. The demand-side case for infrastructure investment is well documented. According to the Congressional Budget Office, infrastructure spending is a cost-effective demand stimulus as measured by the number of jobs created per dollar of budgetary cost. Moody’s Economy.com estimates that $1 of infrastructure spending increases demand and the level of GDP by about $1.59.

The supply-side or growth case for a significant increase in infrastructure investment is also compelling. Real infrastructure spending is about the same today as it was in 1968 when the economy was a third smaller. The inadequacies of the country’s current infrastructure are displayed every day in freight bottlenecks, road congestion and airport delays, all of which reduce business productivity and make the US a less attractive location for business activity. Documenting these inadequacies, the American Society of Civil Engineers gave America’s infrastructure a failing grade of D in its 2009 report and has identified more than $2.2 trillion in outstanding infrastructure needs. And using a narrower cost-benefit approach, a 2008 CBO study concluded that a 74% increase in annual spending on transportation infrastructure alone is economically justifiable.

#### Infrastructure spending is super effective—ARRA proves

Feyrer and Sacerdote, 11 – professors of economics at Dartmouth (James and Bruce, “Did the Stimulus Stimulate? Real Time Estimates of the Effects of the American Recovery and Reinvestment Act,” National Bureau of Economic Research, February 2011, http://www.nber.org/papers/w16759)//HK

We have presented one of the first detailed analyses of employment and earnings effects from the stimulus package that uses actual employment outcomes.13 This is important because the debate about the efficacy of fiscal policy has remained mired in the same arguments that were being made in January 2010. We hope that our analysis helps to move the discussion forward. This is important because the ARRA represents the largest exercise of countercyclical fiscal policy in the post war period. Analyses of the efficacy of the ARRA are likely to set the baseline for discretionary fiscal policy going forward.

Our results are somewhat mixed, but generally support the effectiveness of the ARRA. Our point estimates for the stimulus as a whole suggest that it was somewhat less effective than anticipated by the administration, but that their estimates are well within our confidence intervals. Overall we find a cost per job between $100,000 and $400,000 depending on our specification. This implies overall Keynesian multipliers between 0.5 and 2.0. By performing a state level analysis, we are excluding impacts that cross state lines, which is likely biasing our estimates of the effectiveness down.

Perhaps most intriguing is our analysis of how the impacts on employment appear to differ by type of spending. Transfers to the states to support education and law enforcement appear to have little effect. This is consistent with a model where the states consider the grants to be temporary and therefore avoid making permanent changes based on the transfer. States may have used the money to lower borrowing or limit tax increases. Cogan and Taylor (2010) find that this is the case.

On the other hand, support for low income households appear to have been extremely effective with Keynesian multipliers of over 2 and a cost per job of under $100,000. This is consistent with low income individuals having a high marginal propensity to consume. Infrastructure spending such as highway projects had impacts that were nearly as large. This all suggests that a stimulus package that did not include state level grants for local services would have been more effective per dollar than the actual stimulus package.

### key to competitiveness

#### Infrastructure stimulus is key to revitalize the economy – its key to competitiveness

Rendell and Smith, 11 - \* former governor of Pennsylvania, chair of Building America's Future Educational Fund AND mayor of Mesa, vice chairman of the U.S. Conference of Mayors, co-chair Building America's Future Educational Fund, ( “Transportation Spending Is the Right Stimulus” 8-11, <http://online.wsj.com/article/SB10001424053111904140604576496430721692282.html>)//AH

During this time of economic uncertainty and record federal deficits, many question why America should invest aggressively in infrastructure. The answer is simple: Whether it involves highways, railways, ports, aviation or any other sector, infrastructure is an economic driver that is essential for the long-term creation of quality American jobs. Unfortunately, our position as the world leader in infrastructure has begun to erode after years of misdirected federal priorities. When it comes to transportation, Washington has been on autopilot for the last half-century. Instead of tackling the hard choices facing our nation and embracing innovations, federal transportation policy still largely adheres to an agenda set by President Eisenhower. As a result, American citizens and businesses are wasting time, money and fuel. According to the Texas Transportation Institute, in 2009 Americans wasted 4.8 billion hours sitting in traffic at a cost of $115 billion and 3.9 billion wasted gallons of gas. Meanwhile, nations around the world are investing in cutting-edge infrastructure to make their transportation networks more efficient, more sustainable and more competitive than ours. These investments have put them on a cycle of economic growth that will improve their standard of living and improve their citizens' quality of life. Building America's Future Educational Fund, a national and bipartisan coalition of state and local elected officials, of which we are members, recently issued a report on the subject, "Falling Apart and Falling Behind." It offers a sobering assessment of transportation-infrastructure investments in the U.S. as compared to the visionary investments being made by our global economic competitors. As recently as 2005, the World Economic Forum ranked the U.S. No. 1 in infrastructure economic competitiveness. Today, the U.S. is ranked 15th. This is not a surprise considering that the U.S. spends only 1.7% of its gross domestic product on transportation infrastructure while Canada spends 4% and China spends 9%. Even as the global recession has forced cutbacks in government spending, other countries continue to invest significantly more than the U.S. to expand and update their transportation networks. China has invested $3.3 trillion since 2000, for example, and recently announced another $105.2 billion for 23 new infrastructure projects. Brazil has invested $240 billion since 2008, with another $340 billion committed for the next three years. The result? China is now home to six of the world's 10 busiest ports—while the U.S. isn't home to one. Brazil's Açu Superport is larger than the island of Manhattan, with state-of-the-art highway, pipeline and conveyor-belt capacity to ease the transfer of raw materials onto ships heading to China. To get our nation's economy back on track, we must develop a national infrastructure strategy for the next decade. This policy should be based on economics, not politics. Washington must finally pass a reauthorized multiyear transportation bill; target federal dollars toward economically strategic freight gateways and corridors; and refocus highway investment on projects of national economic significance, such as New York's Tappan Zee Bridge across the Hudson, where capacity restraints impose real congestion and safety costs in an economically critical region. It is also time we create new infrastructure financing options, including a National Infrastructure Bank. Many of these new programs, using Build America Bonds, for instance, can be paid for with a minimal impact on the federal deficit. The government's continued neglect of infrastructure will consign our nation and our children to economic decline. Rebuilding America's future cannot be a Democratic or Republican political cause. It must be a national undertaking. And if it is, there will be no stopping us. Let's get to work.

#### Infrastructure stimulus boosts the economy – competitiveness, investment, employment

Rendell, 12 - former governor of Pennsylvania and co-chairman of Building America’s Future. (Ed, “The right way to fund transportation”, 3-12, http://www.politico.com/news/stories/0312/73677.html)//AH

The original Republican bill, now being revised, was too small to have any real impact on our systems or employment, didn’t adequately address the need for transit investment, weakened Buy America requirements, prohibited using gas tax funds to pay for mass-transit projects and hardly dented the down payment we need to update our crumbling infrastructure systems. We must get this bill right for all the right reasons: because it will put Americans back to work when they need it most and make the investments we need in critical infrastructure. Tom Friedman put our current predicament best when he said that flying from the Hong Kong airport to New York’s John F. Kennedy International Airport is, “like going from the Jetsons to the Flintstones.” The World Economic Forum ranked the United States 24th for infrastructure quality, down from eighth in 2005. Failure to invest in our infrastructure undermines our productivity and undercuts our competitiveness in the global economy. Worse, it’s a huge pass on the best chance we have of expanding employment by the millions. Congress will most likely point to the federal budget deficit as the reason it can’t do more. In my first year as governor of Pennsylvania, however, I confronted a $2.4 billion deficit and, later in my term, forestalled a looming deficit due to the recession. In good times and bad, we increased our state expenditures on infrastructure. Pennsylvania’s relatively strong employment performance, even during the Great Recession, is partly due to the accelerated road, transit, bridge and water-system investments we put in place. Throughout 2010, we ranked third among states in total jobs created and seventh in the rate of job growth, according to the Bureau of Labor Statistics. This approach can be taken at the federal level. A new Center for American Progress plan makes a strong case for increasing public and private infrastructure investment by $129 billion a year over 10 years. At that level, we could see real improvements in reduced congestion, more efficient goods movement, modern rail services, safer highways and water systems and state-of-the-art energy infrastructure. These investments would add an estimated 2 million jobs to the economy. This proposal includes the core federal reforms necessary to attract more private investment and, as a result, bring federal spending down to $48 billion a year. That may sound like a lot, but it’s less than a 1.4 percent increase in federal spending — or about what we spent for the Iraq War in 2011. The plan relies entirely on our infrastructure’s users and direct beneficiaries to pay for this increased investment. For decades, drivers shouldered the burden of our surface transportation improvements.

### current situation

#### **Infrastructure stimulus has a huge multiplier effect—current economic pressures and new tech and reforms—a fiated spending proposal is key to provide predictable revenue streams**

Bosworth and Milusheva, 11 – \*Senior Fellow at the Brookings Institution AND\*\*Senior Research Assistant at the Brookings Institution (Barry and Sveta, “Innovations in U.S. Infrastructure Financing: An Evaluation,” The Brookings Institution and the Nomura Foundation Macro Economy Research Conference, 10/20/2011, http://www.brookings.edu/research/papers/2011/10/20-infrastructure-financing-bosworth-milusheva)//HK

The condition of America’s infrastructure has become a subject of increased public discussion in recent years. This is the result of several factors. First, there is a perception that the existing infrastructure has become badly deteriorated due to inadequate outlays for maintenance and repair and the underfunding of new investment needs. Second, the stagnate condition of the U.S. economy in the aftermath of the financial crisis has stimulated a new search for effective means of stimulus, and public works projects attract considerable attention because those expenditures generate large Keynesian multiplier effects on the aggregate economy. Third, state and local governments, the traditional sponsors of much of the infrastructure, are faced with severe funding constraints that have stimulated a search for new means of paying for future projects. Finally, the growing interest in “green growth”–the promotion of policies to tackle environmental degradation and climate change within a framework of sustainable growth–will result in increased demand for new infrastructure investments, ranging from the retrofitting of buildings, expansion of the rail network, and development of ‘smart grids’ to improving the efficiency of electricity generation. The focus of this paper is an evaluation of some of the new approaches to the financing of infrastructure projects. They include extension of the Build America bond program that was introduced in 2009-10, proposals for an infrastructure bank, and public-private partnerships. However, a central theme of this report is that U.S. infrastructure investments are not limited by financial market constraints. State and local governments, in particular, can currently obtain long-term financing at very low rates of interest that are further subsidized through a federal income tax exemption. Instead, the more basic problem is the distorted nature of the decisionmaking process and difficulties of generating future revenue streams sufficient to pay for the initial capital investment, maintenance and operating costs. The decision-making process is perverted by an excessive focus on efforts to obtain free federal funding of infrastructure projects whose benefits are largely local, and the emphasis on new construction results in inadequate funding of operating costs and timely maintenance. Citizens and their representatives often favor expansion of the infrastructure, but they resist paying for their use of it and fail to undertake the 2 required maintenance in a timely fashion. As a result, the primary need is to develop a stronger linkage between the costs of infrastructure projects and the benefits that flow from them. That means increased reliance on user fees, congestion taxes, and special tax zones as means of promoting the more efficient utilization of the infrastructure and providing adequate funding. The paper begins by examining some evidence on basic trends in infrastructure spending and the adequacy and condition of the stock of U.S. infrastructure. We supplement that with a consideration of investments in the green economy and the experience of incorporating such spending within the 2009 federal economic stimulus program. With that assessment of needs as a background, the primary focus of the paper is on the evaluation of three new financing options for public infrastructure: Build America bonds, an infrastructure bank, and public-private partnerships.

#### **Transportation stimulus can be effective now—new methods and technologies**

Puentes, 11 – Fellow and Director, Metropolitan Infrastructure Initiative Brookings Institution (Robert, “Move It: How the U.S. Can Improve Transportation Policy,” Wall Street Journal, 5/23/2011, http://www.brookings.edu/research/opinions/2011/05/23-transportation-policy-puentes)//HK

America needs to start directing traffic.

The public sector spends north of $170 billion each year on transportation, and we'll need to spend even more to modernize our battered infrastructure.

But before we start writing more checks, we need to stop and think long and hard about transportation. Not only are we spending too little right now, but we're also not spending it wisely.

The nation lacks a clear-cut vision for transportation, and no way to target spending to make sure all those billions of dollars help achieve our economic and environmental goals. That means we have a lot of bridges to nowhere, with nobody making sure that these big investments generate enough returns to be worthwhile, or that they address any number of the large, thorny problems that are crucial to the well-being of the nation

For instance, we do a great job of building new roads—since 2000, we've added enough new lane miles to circle the globe four times. Yet border crossings, crucial to our nation's exports, are chronically congested, and there's no concerted effort to help unblock them. Meanwhile, at the government's urging, companies are gearing up to produce large numbers of electric cars, but there is no assurance that drivers will have anywhere close to enough places to recharge them.

We can't afford to do this anymore, with the economy struggling and the nation trying to achieve a host of conflicting priorities. We want to be energy independent and go green. But we also want to boost exports, which means putting more trucks on the road to chug fuel and cough out carbon. We want the mobility that comes from cars and planes. But we also want to reduce the amount of energy expended when we travel.

Clearly, we need a new approach. Transportation needs to be put squarely in the service of the American economy. We must coordinate the efforts of the public and private sectors to make it easier to move freight, find ways to cut carbon emissions, integrate new technologies into daily commutes and connect workers to jobs that are far from their homes.

The big question, of course, is how much it will all cost. And that's tough to answer right now. We have a lot of ideas for the types of new investments we want. But little attention is given to figuring out what may not be needed if we can find smarter alternatives, such as rerouting flights instead of building new airports.

With that in mind, here's a look at the national goals we want to achieve—and how transportation policy can—no, must—be rethought to achieve them.

Boosting Exports

The country needs to become more export-oriented for the future health of the economy. But right now there's no way to make sure that the nation's ports, border crossings and roadways are set up to accomplish that goal.

For one thing, there's far too little attention paid to making sure that traffic at border crossings moves swiftly. Our crossings into Mexico and Canada are routinely clogged, interrupting the flow of trade.

Consider the challenges facing Detroit—part of the largest binational trading corridor on the planet, linking the U.S. and Canadian auto industries and other sectors with highly integrated, transport-dependent, "just in time" supply chains and their smaller, more frequent shipments. Canada is our nation's largest trading partner, and Detroit's Ambassador Bridge is the No. 1 border point for commerce between the two countries.

It's a crucial corridor—but there are relatively few border crossings because of the Great Lakes. So traffic piles up at bridges and tunnels, with freight competing with passenger cars to get through tightened security checkpoints. Trucks also clog the roads of Detroit as they shuttle freight between ports and large distribution centers and warehouses.

The export problem isn't just a matter of insufficient infrastructure. States and cities routinely compete against one another for shipping activity instead of coming up with joint efforts that might benefit all the terminals in the region. Without an overall strategy, there's a duplication of efforts and a duplication of subsidies that hurts the economy, given scarce resources.

Collaboration is needed—between the federal government, states, metro areas, freight industry and shippers. We need to come up with a comprehensive plan that identifies the best ways to help the flow of freight.

The plan might identify the most important corridors for freight, for instance, and then target investments to improve safety, relieve bottlenecks and provide better access to ports. That might mean new roads leading to ports or, in some instances, truck-only lanes on existing roads.

Similarly, the U.S., Canada, and Mexico should also come together to study infrastructure needs at the land borders and along the corridors that link the two borders together.

For now, some states are coming up with innovative solutions on their own—solutions that could and should become widespread under a national transportation policy.

Back in Detroit, for instance, the national governments of the U.S. and Canada, along with lawmakers in Michigan and Ontario, are trying to build a new bridge across the Detroit River to help keep trade flowing—a plan that's awaiting final legislative approval. Meanwhile, the World Trade Bridge in Laredo, Texas, has introduced tags for electronic toll collection to speed traffic and reduce wait times.

Then, of course, there's the issue of competition between ports for shipping business. One way to ease that problem: Tell states their ports won't get any federal aid unless they work with their neighbors to boost business in the whole region.

And those agreements need to be carefully structured and policed to make sure they don't collapse—which happens all too easily. Consider the current mess involving Jasper Ocean Terminal on the Savannah River, the border between South Carolina and Georgia. In 2007, the two states agreed to develop the terminal together, and create a special entity to own and operate it.

That's good. But what came later wasn't. After the governors who signed the deal left office, the terminal became a point of contention between the states. What happened? Georgia decided it wanted to deepen another one of its own harbors, a move that South Carolina sees as a challenge to its own facilities. So, South Carolina has stopped funding the Jasper facility unless the Georgia dredging plan is scrapped. Now, I ask you: How does any of this help get us closer to our national goals?

Getting Greener

Transportation for the next U.S. economy also needs to be low carbon—to boost air quality, give us greater energy security and unleash entrepreneurial activity around green technology. Yet the U.S. has been slow to address the problem—again, in large part, because there's no guiding authority making sure all of the players talk to each other and don't work at cross purposes.

Take electric cars. The Obama administration's goal to put one million electric vehicles on the road by the year 2015 is exactly the kind of ambitious, far-reaching goal we need at this moment. But where are drivers supposed to charge them? There are only about 1,000 public charging stations around the U.S. today. While the number is increasing, drivers aren't going to feel comfortable investing in a pricey new vehicle unless they're certain they can keep it powered up no matter where they go.

There are so few charging stations because the auto industry never got together with the government and came up with standards for them. There's no agreement about what they ought to look like or how they should operate.

The public and private sector need to come together on this issue. One spur to help them: the administration's proposal, currently working its way through Congress, to reward communities that invest in electric vehicles and infrastructure through a $200 million grant program.

Another flaw that keeps us from going greener: The rules governing transportation policy continue to favor roads over transit and other alternatives to traditional highway building.

Projects using highway dollars are subject to perfunctory review and enjoy a federal funding contribution of 80% or 90% of the project's cost. Transit projects, in contrast, are subject to a rigorous bureaucratic process and a federal contribution of less than half of the project cost. So, cities have a tendency to favor building new roads over mass transit—which means more pollution and often poor solutions to current economic and social problems.

We need equal treatment of all possible transportation projects, so cities don't have to give up on, say, transit systems that fit their needs and help us go green, just because they cost more than highways.

Adding Innovations

We have tremendous technology available that could help make transportation smoother and more efficient. Traffic signals that are centrally controlled by computer can optimize the flow of traffic. Electronic toll-collection tags let drivers pay without stopping. Changeable signs can provide information about the next bus or train, or rough traffic conditions ahead. Freeway-management centers are able to spot roadway incidents, dispatch service vehicles to clear accidents and get traffic moving again.

These technologies can help address myriad problems. For one, there's congestion, which is estimated to cost the U.S. nearly $200 billion annually in lost productivity and environmental impact. For another, better information about bad weather and traffic can help drivers avoid crashes and mitigate the $230 billion annual economic impact that comes from accidents. There are also indirect economic benefits to going high-tech—like spurring growth among companies that design and produce the electronic gear.

Yet the deployment of this smart technology in our roadways and transit systems is lagging. Only one-third of metropolitan buses are electronically monitored in real time, for example, and less than 1% of bus stops are equipped with electronic displays of traveler information for the public.

Part of the reason is that there's no incentive for cities to deploy these innovations, since transportation dollars aren't distributed based on performance. You don't get bonus money for having fewer accidents or delays on your roadways, or giving your commuters better information about delays.

To be sure, transportation agencies are feeling their own budgetary pressures and fiscal challenges, but these technological fixes are relatively inexpensive. Ironically, they are often cut in shortsighted attempts to save money.

We need to change the system to reward innovation and efficiency, and have a public-private partnership to get this kind of technology deployed across the country. In a sense, we just need to encourage more of what's already going on in some places. Already, public entities buy technology from private companies and put it in the field. And public entities share their data with companies to develop new technologies, such as systems that track buses on their routes. Give municipalities ample rewards for getting efficient, such as grants and tax breaks, and this back-and-forth will happen naturally.

One effort under way at the federal level could help these technologies along. The U.S. Transportation Department is working with public and private entities to come up with tools and metrics needed to deploy wireless technologies in cars and on roadways. The goal is to help on things like crash avoidance or sending drivers information about congestion to help avoid delays.

Connecting Workers With Work

Finally, we have to make it easier for people to get to their jobs. Lower-income households depend more on transit than other households to access labor-market opportunity, due to the high costs of car ownership. Transit does a good job of getting into low-income neighborhoods, but it doesn't do so well connecting those riders to jobs, particularly lower-skilled jobs.

In some metro areas, inner-city workers are cut off from suburban labor-market opportunities. In others, low-income suburban residents spend large shares of their income on owning and operating a car. Only about one-quarter of jobs in low- and middle-skill industries are accessible via public transit within 90 minutes for the typical metropolitan commuter, compared with one-third of jobs in high-skill industries. In Los Angeles, for example, 99% of low-income neighborhoods are served by transit. However, the typical resident can get to only 36% of jobs by transit.

We need to give those lower-skilled workers more mobility and access to opportunity—which means more transportation choices. Governments need to think differently about the problem, to look at where jobs and workers are and figure out creative ways to bring them together.

For an idea of the way ahead, consider Los Angeles. Under a far-reaching plan by Mayor Antonio Villaraigosa, the city will add and extend bus lines and create corridors to connect residential and commercial areas. The Westside Subway Extension will also include a station at Century City, one of the largest employment centers in the county.

Congress could help on projects like this by working with states to speed up approvals. For example, states with very strong environmental review and planning processes—such as California—should be able to waive steps such as the draft environmental impact statement that the federal government requires.

Another important step would be a national infrastructure bank. A quasipublic entity like the Tennessee Valley Authority or Amtrak, the bank would make loans to fund transportation projects that were important to the nation as a whole. It would have to not only further policy goals—as a federal agency would—but also demand from project sponsors the same assurances and rate of return that a bank would.

It is not a silver bullet, but if designed and implemented appropriately, it would be a targeted mechanism to make critical new investments on a merit basis, while adhering to market forces and leveraging the private capital we know is ready to invest here in the U.S.

The stakes are too high—for economic recovery and fiscal responsibility—to allow spending that does not result in real returns and put us on the path to long-term prosperity. But even in this moment of fiscal austerity and restraint, we need a playbook that stimulates job creation, takes advantage of private-sector entrepreneurship and financing, and puts us on a path to the Next American Economy. Transportation is a fundamental part of that.

### shortens downturns

#### Infrastructure stimulus shortens economic downturns and raises GDP

Franco et al., 10 – managing director of Banca d’Italia (Daniele, Fiscal Policy: Lessons from the Crisis, pp. 378-379)//HK

This paper has assessed the effects of fiscal policy response during 118 episodes of systemic banking crisis in advanced and emerging market countries during 1980-2008. The results show that timely countercyclical fiscal measures can help shorten the length of crisis episodes by stimulating aggregate demand. Fiscal expansions based on measures to support government consumption are more effective than those based on public investment or income tax cuts. But these results do not hold for countries with limited fiscal space where fiscal expansions are prevented by funding constraints or limited access to markets. The composition of countercyclical fiscal responses matters also for post-crisis growth recovery, with public investment yielding the strongest impact on growth. These results suggest a potential trade off between short-run aggregate demand support and medium-term productivity growth objectives in fiscal stimulus packages adopted in distress times.

They also suggest that fiscal stimulus packages by G-20 countries may have reduced crisis length by up to one year and could have stimulated post-crisis growth by up 1 percent of GDP, compared to a scenario where fiscal policy response was not implemented. Figure 4 shows that based on the composition of the fiscal stimulus implemented by G-20 countries in 2009 and the regression results presented in the paper, post-crisis real growth rate could be higher by almost ½ percentage point for these countries. Results can be larger for emerging market economies that devoted **a higher share of the stimulus to infrastructure**. In these countries, the baseline impact is estimated at more than 1 percent, compared to less than ¼ of one percent in advanced economies that made larger use of tax cuts and increases in transfers. These results are higher if one uses the regression coefficients for countries with low initial fiscal vulnerabilities and high per capita income as discussed in the previous sections.

### at: too slow

#### Investment in transportation infrastructure succeeds in the long term- empirically proven

Blinder & Zandi 12—Alan S. Blinder - Serves at Princeton University as the Gordon S. Rentschler Memorial Professor of Economics and Public Affairs in the Economics Department. vice chairman of The Observatory Group, and as co-director of Princeton’s Center for Economic Policy Studies And Mark Zandi- Chief Economist of Moody's Analytics, where he directs the company's research and consulting activities. 10 (“How the Great Recession Was Brought to an End,” Research Paper, July 27, 2012, <http://www.economy.com/mark-zandi/documents/End-of-Great-Recession.pdf> //EH)

Funds for infrastructure projects generally do not generate spending quickly, as it takes time to get projects going. That is not a bad thing: rushing raises the risks of financing unproductive projects. But infrastructure spending does pack a significant economic punch, particularly to the nation’s depressed construction and manufacturing industries. Almost $150 billion in ARRA infrastructure spending is now flowing into the economy, and is particularly welcome, as the other stimulus fades while the economy struggles. The ARRA has also been criticized for including a hodgepodge of infrastructure spending, ranging from traditional outlays on roads and bridges to spending on electric power grids and the internet. Given the uncertain payoff of such projects, diversification is probably a plus. As Japan taught everyone in the 1990s, infrastructure spending produces diminishing returns. Investing only in bridges, for example, ultimately creates bridges to nowhere.

#### Unrestricted infrastructure stimulus is possible—economic downturn allows flexibility

Bosworth and Milusheva, 11 – \*Senior Fellow at the Brookings Institution AND\*\*Senior Research Assistant at the Brookings Institution (Barry and Sveta, “Innovations in U.S. Infrastructure Financing: An Evaluation,” The Brookings Institution and the Nomura Foundation Macro Economy Research Conference, 10/20/2011, http://www.brookings.edu/research/papers/2011/10/20-infrastructure-financing-bosworth-milusheva)//HK

Infrastructure and Fiscal Stimulus

Some observers argue that current high levels of unemployment and economic slack provide a low-cost opportunity to invest in infrastructure projects. Normally, fiscal stimulus measures need to be timely, targeted, and temporary, but given the anticipated duration of the economic downturn, the temporary aspect seems somewhat less controlling. These circumstances provide an opportunity for increased investment in public infrastructure, and specifically green economy projects, which tend to be implemented at a slower rate, but provide a bigger multiplier effect.

### ARRA proves

#### Stimulus overall was successful- especially in infrastructure spending

Jim **Feyrer** -an associate professor in the economics department at Dartmouth College, Faculty Research Fellow in the National Bureau of Economic Research **And** Bruce **Sacerdote**-Professor of economics at Dartmouth College. **12** (“Did the Stimulus Stimulate? Real Time Estimates of the Effects of the American Readjustment and Recovery Act,” January 25, 2012, <http://www.dartmouth.edu/~bsacerdo/Feyrer_Sacerdote_Stimulus_2011_02_08.pdf> //EH)

Our results are somewhat mixed, but generally support the effectiveness of the ARRA. Our point estimates for the stimulus as a whole suggest that it was somewhat less effective than anticipated by the administration, but that their estimates are well within our confidence intervals. Overall we find a cost per job between $100,000 and $400,000 depending on our specification. This implies overall Keynesian multipliers between 0.5 and 2.0. By performing a state level analysis, we are excluding impacts that cross state lines, which is likely biasing our estimates of the effectiveness down. Perhaps most intriguing is our analysis of how the impacts on employment appear to differ by type of spending. Transfers to the states to support education and law enforcement appear to have little effect. This is consistent with a model where the states consider the grants to be temporary and therefore avoid making permanent changes based on the transfer. States may have used the money to lower borrowing or limit tax increases. Cogan and Taylor (2010) find that this is the case. On the other hand, support for low income households appear to have been extremely effective with Keynesian multipliers of over 2 and a cost per job of under $100,000. This is consistent with low income individuals having a high marginal propensity to consume. Infrastructure spending such as highway projects had impacts that were nearly a large. This all suggests that a stimulus package that did not include state level grants for local services would have been more effective per dollar than the actual stimulus package. All of these conclusions are necessarily preliminary and incomplete. The empirical fiscal policy literature suggests that the effects of fiscal policy shocks can persist for years. Our results necessarily are limited to 2-3 quarters of data after the shocks. It will be some time before we can put together a full picture of the impacts of the ARRA but we think this preliminary analysis is valuable. We hope that this paper will help to set the stage for further analysis and move the ongoing debate in a new direction that is more directly informed by the data.

#### Infrastructure spending in terms of the stimulus was successful- block grants failed

Jim **Feyrer** -an associate professor in the economics department at Dartmouth College, Faculty Research Fellow in the National Bureau of Economic Research **And** Bruce **Sacerdote**-Professor of economics at Dartmouth College. **12** (“Did the Stimulus Stimulate? Real Time Estimates of the Effects of the American Readjustment and Recovery Act,” January 25, 2012, <http://www.dartmouth.edu/~bsacerdo/Feyrer_Sacerdote_Stimulus_2011_02_08.pdf> //EH)

Table 5 breaks down the stimulus spending by federal agency that disbursed the funds. As mentioned above we group the agencies into ones that represent block grants to states to maintain employees, infrastructure (Departments of Energy and Transportation) and agencies that provide support for low income families and individuals (HHS, HUD and USDA). The point estimates are extremely noisy but may suggest that infrastructure spending and low income supports are more effective at creating jobs than block grants to states.

## now key

### ARRA stimulus running out

#### Deficit spending key now—jobs from Obama’s stimulus are running out

Krugman, 10 – professor of economics and international affairs at Princeton (Paul, “March of the Peacocks,” New York Times, 1/29/2010, http://www.nytimes.com/2010/01/29/opinion/29krugman.html?)//HK

The nature of America’s troubles is easy to state. We’re in the aftermath of a severe financial crisis, which has led to mass job destruction. The only thing that’s keeping us from sliding into a second Great Depression is deficit spending. And right now we need more of that deficit spending because millions of American lives are being blighted by high unemployment, and the government should be doing everything it can to bring unemployment down.

In the long run, however, even the U.S. government has to pay its way. And the long-run budget outlook was dire even before the recent surge in the deficit, mainly because of inexorably rising health care costs. Looking ahead, we’re going to have to find a way to run smaller, not larger, deficits.

How can this apparent conflict between short-run needs and long-run responsibilities be resolved? Intellectually, it’s not hard at all. We should combine actions that create jobs now with other actions that will reduce deficits later. And economic officials in the Obama administration understand that logic: for the past year they have been very clear that their vision involves combining fiscal stimulus to help the economy now with health care reform to help the budget later.

The sad truth, however, is that our political system doesn’t seem capable of doing what’s necessary.

On jobs, it’s now clear that the Obama stimulus wasn’t nearly big enough. No need now to resolve the question of whether the administration should or could have sought a bigger package early last year. Either way, the point is that the boost from the stimulus will start to fade out in around six months, yet we’re still facing years of mass unemployment. The latest projections from the Congressional Budget Office say that the average unemployment rate next year will be only slightly lower than the current, disastrous, 10 percent.

### recession distinction

#### Fiscal stimulus is economically beneficial—current economic situation and liquidity traps

Franco et al., 10 – managing director of Banca d’Italia (Daniele, Fiscal Policy: Lessons from the Crisis, pp. 384-385)//HK

However, one may argue that times of financial crises are different from normal times. Indeed, there are some good reasons to believe that the economy reacts differently to discretionary fiscal policy in a financial crisis than during normal times. First, there are some theoretical contributions which distinguish between more classical and more Keynesian regimes on output and labour markets (e.g., Malinvaud 1985; Bénassy, 1986). A classical situation would be one, where unemployment is generated by excessive real wages while output markets are in equilibrium. A more Keynesian regime is one where unemployment and excess capacities coexist. There are disequilibria both on labour and on output markets. One can argue that in such a situation a fiscal stimulus may become more effective, replacing declining private demand for goods and so stimulating private demand for labour. One could view the public provision of private goods as a replacement for the private provision of these goods. In this case the state would take consumers’ decisions in their place and run a higher deficit that later on would have to be repaid in form of taxes by these consumers. Such a policy might have strong crowding-out effects in a situation where capacities are already exhausted, but this need not be the case when there are excess capacities in the economy.

A second argument in favour of discretionary fiscal policy is that a liquidity trap is associated with financial crises and that “the only policy that still works is fiscal policy” (both Krugman and Stiglitz advocate that).

Most importantly, one can argue that financial crisis cut off many consumers and producers from bank lending. During the current crises, the growth rate of lending to the private sector has fallen significantly. This may have two effects on the effectiveness of fiscal policy measures. First, government transfers or tax reductions may result directly in increased consumption of relatively poor, credit constrained consumers. Along these lines, Galí et al. (2007) recently calculated larger fiscal policy multipliers when more consumers spend their current income. Second, government purchases directly affect the survival of some firms.

#### Specific economic aspects of the current recession mean stimulus is cheap and effective

DeLong and Summers, 12 – \*chair of economics at UC Berkeley AND\*\*professor of government at Harvard (J. Bradford, “Fiscal Policy in a Depressed Economy,” National Bureau of Economic Research, 3/20/2012, http://www.brookings.edu/about/projects/bpea/latest-conference/~/media/Files/Programs/ES/BPEA/2012\_spring\_bpea\_papers/2012\_spring\_BPEA\_delongsummers.pdf)//HK

This paper examines the impact of fiscal policy in the context of a protracted period of high unemployment and output short of potential like that suffered by the United States and many other countries in recent years. We argue that, while the conventional wisdom rejecting discretionary fiscal policy is appropriate in normal times, discretionary fiscal policy where there is room to pursue it has a major role to play in the context of severe downturns that take place in the aftermath of financial crises. Our analysis suggests that three aspects of situations typified by the current situation in the United States alter the normal calculus of costs and benefits with respect to fiscal policy. First, the absence of supply constraints and interest behavior associated with economy being constrained by a zero lower bound mean that the likely multiplier associated with fiscal expansion is likely to be substantially greater and longer lasting than in normal times. The multiplier may well be further magnified by the impact 4 For example, see Feldstein (2002). But even in the mid-2000s there were dissents. See, for example, Alan Blinder (2004). 5 See Jeffrey Frankel and Peter Orszag (2002). 6 Alesina and Ardagna (2009).4 of economic expansion on expected inflation and hence in reducing real interest rates, an effect not present when inflation is above its target level and the zero lower bound is not a constraint. Second, even very modest hysteresis effects through which output shortfalls affect the economy's future potential have a substantial effect on estimates of the impact of expansionary fiscal policies on future debt burdens. While the data are not conclusive, we review a number of fragments of evidence suggesting that mitigating protracted output losses like those suffered by the United States in recent years raises potential future output. Third, extraordinarily low levels of real interest rates raise questions about the efficacy of monetary policy as a source of stimulus, and reduce the cost of fiscal stimulus. The paper is organized as follows. Section II presents a highly stylized example making our basic point regarding self-financing fiscal policy, and then lays out an analytical framework for assessing the efficacy of fiscal policy. It incorporates impacts on present and future output as well as the future price level. It identifies the parameters that are most important in evaluating the impact of fiscal policy changes. It analyzes necessary conditions for expansionary fiscal policy to be selffinancing. It also considers the less stringent conditions under which expansionary policy is not self-financing but nonetheless raises the present value of output. The following three sections examine evidence on the parameters of central importance--the fiscal multiplier, the extent of hysteresis, and the relationship between interest rates and growth rates. Section III argues both theoretically and empirically that the fiscal multiplier is highly context dependent, depending in particular on the reaction function of monetary policy. It concludes that at moments like the present when interest rates are constrained by a zero bound, fiscal policy is likely to be more potent than is suggested by standard estimates of “the multiplier”. Section IV examines available evidence on the extent of hysteresis effects. It argues that standard economic forecasts build in the assumption of substantial hysteresis effects in both employment and output behavior. It examines a number of fragments of evidence suggesting that this assumption is warranted, particularly in the context of financial crises. Section V takes up issues relating to interest rates and monetary policy and argues that available evidence on central bank behavior suggests that it is unlikely that in severely depressed economies expansionary fiscal policy will lead to an offsetting monetary policy response. We also rehearse a number of considerations suggesting 5 that monetary policy should not offset fiscal policy. It then discusses the long run government budget constraint when the government's creditworthiness is in question or could come into question. And it concludes with a discussion of policy implications of the analysis for the United States and the industrialized world, and directions for future research. II. A FRAMEWORK This paper focuses on policy choices in a deeply depressed demand constrained economy in which present output and spending are well below their potential level. We presume for the moment that monetary policy is constrained by the zero lower bound, and that the central bank is unable or unwilling to provide additional stimulus through quantitative easing or other means—an assumption we discuss further in Section V. The fact that most estimates of Federal Reserve reaction functions suggest that, if it were possible to have negative short-term safe nominal interest rates, they would have been chosen in recent years suggests the relevance of our analysis. 7 We focus on the impact of temporary fiscal stimulus on the government’s long run budget constraint. A very simple calculation conveys the major message of this paper: A combination of low real U.S. Treasury borrowing rates, positive fiscal multiplier effects, and modest hysteresis effects is sufficient to render fiscal expansion self-financing. Imagine a demand-constrained economy where the fiscal multiplier is 1.5, and the real interest rate on long-term government debt is 1 percent. Finally assume that a $1 increase in GDP increases tax revenues and reduces spending by $.33. Assume that the government is able to undertake a transitory increase in government spending, and then service the resulting debt in perpetuity, without any impact on risk premia. 7 See Rudebusch (2006), Rudebusch (2009), Henderson and McKibbin (1993), Taylor (2003), Taylor (2010).6 Then the impact effect of an incremental $1.00 of spending is to raise the debt stock by $0.50. The annual debt service needed on this $0.50 to keep the real debt constant is $0.005. If reducing the size of the current downturn in production by $1.50 avoids a 1% as large fall in future potential output—avoids a fall in future potential output of $0.015—then the incremental $1.00 of spending now augments future-period tax revenues by $0.005. And the fiscal expansion is self-financing. The point would be reinforced by allowing for underlying growth in the economy, positive impacts of spending on future output, and increases in the price level as a result of expansion. It is dependent on multiplier and hysteresis effects, the assumption about government borrowing costs, and the assumption that government spending once increased can again be reduced. These issues and assumptions are explored in subsequent sections. Below we develop a framework for assessing under what conditions fiscal expansion is self-financing, and whether fiscal expansion will pass a benefit-cost test. Throughout, we assume a transitory increase in government spending and assume that it doe not affect government borrowing costs. We address these issues in subsequent sections. A temporary boost to government purchases to increase aggregate demand in a depressed economy has four principal effects: First, there is the standard short-term aggregate demand multiplier. In the present period, prices are predetermined or slow to adjust and in which the level of production is demand-determined. A boost to government spending for the present period only of G percentage point-years is amplified or damped by the economy’s shortterm multiplier coefficient  and boosts production and income Yn (“n” for “now) in the present period by an amount of percentage point-years: (2.1)  Yn  G We shall discuss plausible views as to the value of  in normal times, and make the crucial point that there is a strong likelihood that  is now above its normal-time value, in Section III.7 Second, there are “hysteresis” effects: a depressed economy is one in which investment is low; in which the capital stock is growing slowly; and in which workers without employment are seeing their skills, their weak-tie networks they use to match themselves with vacancies in the labor market, and their morale decays. All of these reduce potential output. In future periods production is supply determined, and equal to potential output. Thus in future periods potential and actual output Yf will be lower by some fraction  of the depth by which the economy is depressed in the present: (2.2)  Yf Yn where the units of  are inverse years: percent reductions in the flow of future potential output per percentage point-year of the present-period output gap. We discuss the mechanisms which may make  nonzero, and evaluate its likely magnitude in Section IV. In an economy with a long-term output growth rate g and a social rate of time discount r and where r>g so that present-value calculations are possible, the net effect of these first two on the socially-discounted present value 8 of the economy’s production is: (2.3)  V     r  g      G where V is the present value of future output. Third, financing the expansion G of government purchases in the present period increases the national debt by an amount D. In an economy with a multiplier coefficient  and a baseline marginal tax-and-transfer rate , the required increase in the national debt is: 8 The change in the present value of output can, of course, be questioned as a welfare measure. In contexts like the present, however, we suspect that the social value of the leisure of the currentlyunemployed is low, and that the society attaches a high value to the extra output gained in the future by, for example, avoiding cutbacks to innovation spending or labor force withdrawal by those who after long-duration unemployment retire or apply for disability. See Krueger and Mueller (2011), Gordon (1973), Granovetter (1973), and Gordon (2010).8 (2.4)  D  (1 )G In order to maintain a constant debt-to-GDP ratio in the future periods thereafter, a fraction of this debt must be amortized. Assume for now that the real interest rate on government debt is equal to the social rate of time discount r. The taxes needed to finance these debt-amortization payments impose a marginal excess burden  per dollar: (2.5)  V     r  g  1       G where the future amortization at a constant debt-to-GDP ratio of the present-period fiscal expansion requires the government to commit recurring future-period cash flows of: (2.6)  r  g1  to this task. This paper assumes that there is a budget constraint: that the appropriate long-run real r is greater than the growth rate of the tax base g, The fourth effect is a knock-on consequence of the second. Higher future-period output from the smaller hysteresis shadow cast on the economy because expanded government purchases reduce the size of the present-period depression means that the taxes  levied to finance baseline government programs and to amortize the preexisting national debt bring in more revenue. The effect on the government’s future period net cashflows then becomes: (2.7)  r  g1  And another long-run supply-side term needs to be added to (2.5) because the hysteresis channel implies that higher present period output Yp allows the reduction of future-period marginal taxes: (2.8)  V     r  g    r  g  1       G9 The first term in (2.7) is the amount of extra future-period tax revenue the government must commit to amortize, at a constant debt-to-GDP ratio, the debt incurred to finance present-period fiscal expansion. The second term is the addition to future-period tax revenue flowing from higher future-period potential output produced by hysteresis effects. The first and most important conclusion follows immediately from (2.7): there is a future fiscal dividend from the present-period fiscal expansion G as long as: (2.9)  r  g   1   Unless the real interest rate at which the government borrows on the left-hand side is greater than the right-hand side of (2.9), fiscal expansion now improves the government’s budget balance later. 9 Arguments that economies cannot afford expansionary fiscal policy now because they should not raise their future debt-financing burdens then have little purchase. 10 For a policy-relevant multiplier  of 1.5, a hysteresis parameter  of 0.1, and a tax share  of 1/3, the second term on the right-hand side of equation (2.9) is 10%/year: if the spread between the Treasury borrowing rate r and the real growth rate of GDP g is less than 10% points, present-period fiscal expansion improves rather than degrades the long-term budget balance of the government. For a policy-relevant multiplier  of 1.0, a hysteresis parameter  of 0.05, and a tax share  of 1/3, the second term on the right-hand side of equation (2.9) is 2.5%/year: if the spread between the Treasury borrowing rate r and the real growth rate of GDP g is less than 2.5% points, present-period fiscal expansion improves rather than degrades the long-term budget balance of the government. 9 For a somewhat different argument that austerity worsens the government’s budget balance, see Denes et al. (2012). 10 This point is by no means new. See Lerner (1943), and Lerner (1951). Wray (2002) argues that Friedman (1948) proposal for stabilization policy via a money supply provided by countercyclical deficit financing and 100% reserve banking is in its essence the same idea.10 Table 2.1 Parameter Values: Baseline Case Parameter Interpretation Value  Net-of-monetary-policy-offset present-period spending 0-2.5 multiplier r Real government borrowing rate, social rate of discount .025-? g Potential GDP growth rate 0.025  Marginal tax-and-transfer rate 0.333  Reduction in output from raising additional tax revenue 0.500  Hysteresis parameter 0-0.2 For what values in the parameter space does (2.9) fail? For the base case, take the marginal baseline tax share  to be approximately one-third. The Congressional Budget Office’s long-term potential real GDP growth rate is 2.5%/year. This leaves , , and —the multiplier, the hysteresis coefficient that captures the shadow cast by the downturn on the long run, and the share of government purchases devoted to capital investment. Table 2.1 summarizes these parameters and their base-case values. Table 2.2 Critical Treasury Real Borrowing Rate  0.0 0.5 1.0 1.5 2.5  0.000 2.50% 2.50% 2.50% 2.50% 2.50% 0.025 2.50% 2.99% 3.73% 4.95% 14.29% 0.050 2.50% 3.49% 4.96% 7.40% 26.07% 0.100 2.50% 4.48% 7.43% 12.30% 49.64% 0.200 2.50% 6.45% 12.35% 22.10% 96.97%11 Table 2.2 reports the effective Treasury borrowing rate at which there is a longterm cash-flow cost to present-period expansionary fiscal policy as it depends on the share  of cyclical output shortfalls that become permanent due to hysteresis effects, and on the net-of-monetary-policy-offset multiplier . Figure 2.1 U.S. Treasury Real Borrowing Rates: 10-Year TIPS Source: U.S. Department of the Treasury and U.S. Bureau of Labor Statistics, via the Federal Reserve Bank of St. Louis’s FRED database. On January 29, 1997, the U.S. Treasury auctioned its first 10-Year Treasury Inflation Protected Securities, or TIPS at interest rate was 3.449%/year, providing the first direct market read, albeit for low volumes, for borrowers with particular niche needs, and for borrowers who were not confident of the liquidity of the market. This provided the first read on the ex ante market-expected real cost of borrowing by the U.S. Treasury. 11 On January 1, 2003, the U.S. Treasury judged the market liquid enough to begin calculating its constant-maturity series of what the yield on 11 The highest yield on a 10-year TIPS auction was 4.338%/year in January 2000. The January 2001 rate was 3.522%/year. The January 2002 rate was 3.480%/year. See U.S. Treasury (2012).12 a newly-issued 10-year TIP would be. Figure 2.1 plots the 10-year TIPS real interest rate. With even moderate values for the multiplier and even small values for hysteresis, the critical real interest rate at which a net budgetary cost to the government from expansionary fiscal policy emerges is comfortably above the real rates at which the U.S. government has been able to borrow since the first issue of TIPS. For earlier periods subtracting the past year’s inflation rate from nominal interest rates provides a proxy that does not, since the beginning of the TIPS constantmaturity series, markedly or persistently diverge from the TIPS rate. Figure 2.2 shows this admittedly inadequate proxy rate based on the 10-year nominal Treasury bond for earlier decades. Figure 2.2 U.S. Treasury Real Borrowing Rates Since 1970: 10-Year TIP and 10-Year Treasury Less Previous Year’s Inflation Source: U.S. Department of the Treasury and U.S. Bureau of Labor Statistics, via the Federal Reserve Bank of St. Louis’s FRED database.13 For the decade of the 2000s before the start of the financial crisis, both the ten-year TIPS rate and the ten-year Treasury rate minus the past year’s inflation were between 2.0% and 2.5%, but were widely viewed as depressed below their long-term sustainable levels by the global savings glut. 12 Since the financial crisis, the tenyear TIPS rate had fluctuated between 1% and 1.5% before last summer’s crash to 0—but these rates will hold only as long as the economy remains substantially cyclically depressed. Expectations of inflation were relatively stable in late 1980s and the 1990s, and were close to the then-current level of inflation. From 1985-2000 the average tenyear Treasury bond rate minus the past year’s inflation was 3.8%/year, a little more than 2% points above its average value for the 2000s, but nevertheless still in the range in which Table 2.2 reports that the extra long-run tax revenue following from expansionary fiscal policies might well outweigh the debt amortization costs. Since World War II it is only in the early 1980s, in the immediate aftermath of the Volcker disinflation, when the permanence of the reduction in inflation was uncertain, was the ten-year Treasury bond rate minus the previous year’s inflation in the range in which expansionary fiscal policy would impose any substantial financial burden on the government—if, that is, the multiplier μ has even a moderate value. 13 Equation (2.9) implies that the magnitude of the spread by which the Treasury borrowing rate r can exceed the economic growth rate g and expansionary fiscal policy still not impose a net budgetary financing burden on the government scales linearly with the hysteresis parameter : double the hysteresis parameter, and double the allowable spread between r and g. Table 2.3 reports such critical values of r-g for a value of =0.10. Even for only moderate values of the multiplier and for sensitivities of tax revenue with respect to output that are smaller than those found in 12 See Ben Bernanke (2005), “The Global Saving Glut and the U.S. Current Account Deficit” (Washington, DC: Federal Reserve) http://www.federalreserve.gov/boarddocs/speeches/2005/200503102/ 13 Moreover, the current U.S. nominal debt has a duration of four years. A depressed economy in which rates of inflation are low for the next several years means a higher real value of the outstanding debt when the economy exits the zero lower bound to short-term safe nominal interest rates. If interest rates stay at their zero nominal bound for three further years, the difference between 1%/year and 2%/year inflation over the next three years is a difference of $300 billion in the real value of the outstanding debt three years from now that then must be amortized.14 the North Atlantic today, economies far from the edge of having r in the neighborhood of g can still have fiscal expansion pay for itself. Table 2.3 Critical r-g Values as Functions of μ and , η=0.10  0.0 0.5 1.0 1.5 2.5  0.083 0.00% 0.43% 0.91% 1.42% 2.62% 0.167 0.00% 0.91% 2.00% 3.34% 7.17% 0.333 0.00% 2.00% 4.99% 9.98% 49.70% 0.417 0.00% 2.63% 7.15% 16.70% ∞ 0.500 0.00% 3.33% 10.00% 30.00% ∞ Equation (2.9) thus provides no warrant for any investor worried about the longrun fiscal stability of the United States to reduce their confidence in the wake of discretionary fiscal expansionary fiscal policies in a depressed economy. In a depressed economy, with a moderate multiplier, small hysteresis effects, and interest rates in the historical range, temporary fiscal expansion does not materially affect the overall long-run budget picture. At this point a there arises a very natural question: If the U.S. can usually (except in the early 1980s) borrow, spend on government purchases, and end up with no net increase in the burden of financing government debt, why not do so always? The principal reason is that it cannot. A multiplier μ of even 1 is, as we discuss below, a somewhat special case, likely to be found when the zero lower bound on short safe nominal interest rates applies. A policy-relevant multiplier μ close to 0 is in fact likely to be a better approximation for thinking about discretionary fiscal policy in normal times. If so, there is no stabilization-policy case for debt-financed expansionary fiscal policy. Note that the arithmetic of Table 2.2 does not in any way hinge on any claim that the U.S. economy is in or at the edge of a situation of dynamic inefficiency. Although we do not distinguish between different interest rates in our framework, the key interest rate in Table 2.2 is the government borrowing real interest rate r. The 15 key interest rate is not the private marginal product of capital Fk, the real social rate of time discount r d , or the rate of return on public capital r k . This is a point that is at least partially about the attractiveness of U.S. Treasury debt to investors. 14 If the attractiveness of government debt to wealthholders as a safe savings vehicle is sufficiently great, and if there are even minor hysteresis benefits from expansionary fiscal policy, then there is no benefit-cost analysis to conduct because there is no net financing burden of extra government purchases on taxpayers. In such a situation to sell new government debt and use the money to buy something useful in any way is a benefit. Investors then value the safety characteristics of government debt so much that the government can borrow, spend money to boost the economy, and as its debt matures refinance it, and reduce its utility cost lower and lower as the horizon before the debt is permanently retired is extended. If equation (2.9) does not hold—if the Treasury borrowing rate exceeds or will exceed the critical value—then there is a benefit-cost calculation to be done in order to assess the desirability of expansionary fiscal policy in the current situation. Equation (2.8) provides a framework for doing such an analysis.It is a guide to evaluating the effects of an attempt to boost demand, production, and employment in a depressed economy via an expansion of government purchases. The first term in (2.8), , is the simple standard net-of-monetary-policy-offset Keynesian multiplier term. The second term, /(r-g), is the private-side hysteresis term: the reduction in the long-term shadow cast by the current downturn if there is a more rapid recovery. The last two terms, [\*/(r-g) – (1-\*)] provide the impact on production of the changes in government cashflow. A reduced shadow cast by a smaller and shorter downturn allows ongoing government operations to be financed with lower tax rates. The burden of amortizing the extra debt needed to finance the fiscal expansion G requires higher tax rates. And  captures how this improvement in the fiscal situation generates a fiscal dividend. Four significant points that follow from equation (2.8). First, temporary fiscal expansion’s effects are not primarily short-run but rather long-run effects: it is not a 14 See Arvind Krishnamurthy and Annette Vissing-Jorgensen (2012a), Arvind Krishnamurthy and Annette Vissing-Jorgensen (2012).16 short-run policy, and should not be analyzed as such. Second, in a non-depressed economy temporary expansionary fiscal policy is highly likely to fail its benefitcost test (2.8): the argument that it passes the benefit-cost test in a depressed economy does not entail that it passes when the economy is not depressed. Third, even the possibility that the benefit-cost test might not be passed in a depressed economy seems to require a remarkably high fiscal burden coefficient  in the absence of a large, positive wedge between the U.S. Treasury’s borrowing costs and the social rate of time discount. And, fourth, to the contrary, right now the U.S. Treasury possesses the exorbitant privilege of borrowing cheaply by issuing a safe asset in great worldwide demand. This feature of the economy would have to be not just negated but strongly reversed for the benefit-cost test to fail. In equation (2.8), only the first multiplier term  is a short-run term. All the rest are long-run terms. Even the non-government cashflow terms: (2.10)     r  g carry the implication that temporary expansionary fiscal policy is more of a longrun than a short-run policy. The ratio of long-run to short-run benefits outside of the consequences for cashflow is: (2.11)  1:  r  g For the central case of Table 2.2, with =0.05 and =1.0 this ratio of short-term to long-term benefits is 1.7 at the critical real interest rate of r = 5.77%/year. Expansionary fiscal policy is not a policy with primarily short-run benefits, and it should not be analyzed as if pursuing it removes political-economic focus from the long run. 15 15 As with all present value calculations at moderate interest rates, a great deal of the value comes from the far distant future. If we impose the condition that we unilaterally stop our forecasting horizon 25 years into the future on the grounds that the world after 2037 is likely to be different from the world of today in an unknown unknowns way, the ratio of short-run to long-run benefits falls to 1.14.17 III. THE VALUE OF THE MULTIPLIER The recent survey of multiplier estimates by Ramey (2011) concludes that: the range of plausible estimates for the multiplier in the case of a temporary increase in government spending that is deficit financed is probably 0.8 to 1.5.... If the increase is undertaken during a severe recession, the estimates are likely to be at the upper bound of this range. It should be understood, however, that there is significant uncertainty involved in these estimates. Reasonable people could argue that the multiplier is 0.5 or 2.0... Romer (2011) summarizes the evidence as suggesting a somewhat stronger central tendency for estimates of the government-purchases multiplier: 1.5. She stresses a strong presumption that that estimate is likely to be lower than the constantmonetary-and-financial-conditions multiplier, which as we argue below is itself a lower bound to the current policy-relevant multiplier. As Romer says: “in a the situation like the one we are facing now, where monetary policy is constrained by the fact that interest rates are already close to zero, the aggregate impact of an increase in government spending may be quite a bit larger than the cross-sectional effect”. Certainly such a larger multiplier is consistent with the high tax multipliers of Romer and Romer (2007). Ramey describes four methodologies for estimating “the multiplier”: (i) structural model estimates; (ii) exogenous aggregate shock estimates (relying almost exclusively on military spending associated with wars) like Ramey and Shapiro (1998), Barro and Redlick (2011), and Ramey (2012) which are vulnerable to omitted variables associated with tax increases and to nonlinearities; (iii) structural VARS like Blanchard and Perotti (2002), Auerbach and Gorodnichenko (2012a, 2012b) and Gordon and Krenn (2010); and (iv) “local multiplier” estimates like Nakamura and Steinnson.(2011). 16 16 See also Chodorow-Reich et al. (2011), Clemens and Miran (2010), Cullen and Fishback (2006), Serrato and Wingender (2010), and a growing number of others. Romer (2011) and Mendel (2012) provide surveys of local multiplier papers Moretti (2010) estimates a local multiplier that is explicitly a supply-side economic-geography concept rather than a 18 It is far from clear that any of these methodologies shed as much light as we would wish on the policy-relevant fiscal multiplier at a time like the present, when the zero lower bound constrains interest rates and substantial frictions interfere with the functioning of credit markets. Structural model estimates are only as good as the identification of the structural model. Estimates based on changes in military spending will underestimate the impact of fiscal policy in a context like the present to the extent that (i) spending increases are associated with tax increases and Ricardian equivalence does not hold in full, (ii) supply constraints associated either with a military buildup or a high rate of resource utilization reduce output growth, and (iii) wartime spending is less productive than civilian spending or wars are associated with increased uncertainty. The identification of exogenous fiscal shocks using time-series techniques seems to us problematic. Estimates of the multiplier based on comparisons of localities that benefit from more and less federal spending abstract from any aggregate effects of spending on monetary or fiscal conditions— on future tax liabilities, confidence, or interest rates. So it is far from clear that they estimate a policy-relevant aggregate multiplier. However, the most important issue in thinking about the fiscal multiplier is the response of monetary policy to fiscal policy. Start with the assumption that real aggregate demand is a function of the fiscal policy impetus G, of the “bare” constantmonetary-and-financial-conditions multiplier, and of the real interest rate charged to firms r f . A counterfactual change in government purchases in the current period Gt will then generate a different counterfactual level of current-period output: (3.1)  Yt  (r t f )  'Gt If the monetary authority responds to fiscal policy actions via the monetary policy reaction function: (3.2)  r t f Yt The reduced-form relationship is then: demand-side macroeconomic concept. The relationship between economic-geography local multipliers and macroeconomic local multipliers is not clear to us.19 (3.3)  Yt  ' 1  Gt Thus an estimate of the multiplier over a period during which the monetary policy reaction function is characterized by a particular γ will estimate not the “bare” multiplier μ’ but rather: (3.4)    ' 1  A high value of γ—an unwillingness on the part of the monetary authority to let its judgment about what level of real aggregate demand is consistent with its price level target be overridden by the fiscal authorities—implies a low value for the estimated μ coefficient no matter how large is the “bare” multiplier μ’. A monetary authority that seeks to maximize some objective function of the output gap and of the inflation rate in a system in which inflation is a function of its past and of the present and expected future output gap alone will pick as high a value of γ as it can. Maximizing its objective function will give it a target value for the time path of the output gap. It will then use the policy tools at its disposal to attempt to hit that time path. And should shifts in fiscal policy have any effects on the time path of the output gap, it will work as hard as it can to offset them. The relevant parts of the monetary policy reaction function will then incorporate full fiscal offset. And estimates of the multiplier μ over such a period will be very small, reflecting the fact that fiscal expansions will call forth tighter monetary policy and fiscal contractions will call forth looser monetary policy. However, estimates of multiplier obtained during a period when central banks are desirous of and able to offset the impact of fiscal policies are not likely to be informative with respect to a period when these conditions do not obtain. Given the zero lower bound constraint on interest rates the Federal Reserve is limited in its ability and motivation to tighten policy in response to fiscal expansions or to ease policy in the face of fiscal contractions. Taking any multiplier estimated over any substantial fraction of the post-World War II period and applying it to today as the current policy-relevant multiplier may be misleading.20 If the Federal Reserve’s current policy is indeed one of wishing that other branches of the government would take more aggressive action to create jobs, 17 than at the moment at least the relevant piece of its monetary reaction function is not equation (3.2) for the real interest rate with a value of γ high, but is instead: (3.5)  i t  0 with the relationship between the short-term safe nominal interest rate i that the Federal Reserve is setting at “exceptionally low levels… at least until late 2014” 18 and the real interest rate r f at which firms can borrow set by: (3.6)  r t f  i t  E(t1 )  t with E(π) the expected inflation rate, and  the sum of default and risk premia over the short-term Treasury rate that firms must pay to borrow. A stronger economy is one in which there are fewer bankruptcies and, plausibly, lower risk and default premia. A stronger economy is one in which expected inflation is likely to be higher. In a situation in which short-term safe nominal interest rates are at their zero nominal lower bound, equation (5.6) predicts a real interest rate relative to borrowing firms that is lower when the economy is stronger. If under the monetary policy régime of fiscal offset the policy-relevant multiplier is near 0, at the zero nominal lower bound the policy-relevant multiplier is likely to be larger than the “bare” constant-monetary-and-financial-conditions multiplier μ’. 19 17 See Bernanke (2011). 18 Federal Open Market Committee (2012). 19 See Parker (2011), on the importance of nonlinearities and on the difficulty of picking out the depressed-economy multiplier we seek to gain knowledge of. Auerbach and Gorodnichenko (2012a, 2012b) find substantial differences in multipliers net of monetary policy offset in recessions and expansions. Hall (2012a), however, cautions that this finding “has little to do with the current thought that the multiplier is much higher when the interest rate is at its lower bound of zero… [for the] authors[’]… sample surely includes only a few years when any country apart from Japan was near the lower bound”.21 Figure 3.1 The Multiplier and the Monetary Policy Reaction Function Figure 3.1 uses the IS-MP framework advocated by David Romer (2000, 2012) to illustrate this point. The relevant interest rate to plot on the vertical axis of the figure for the product-market spending equilibrium condition is the long-term risky real interest rate at which businesses and households can borrow. In a depressed economy, the second curve needed to calculate the economy’s position is not the LM curve of Hicks (1937) that assumed a constant money supply but rather the MP curve that incorporates the monetary authority’s decision to keep the shortterm safe nominal interest rates it controls at their zero lower bound, the effects of a stronger economy on expected inflation, and the effects of a stronger economy on defaults and thus on risk and default premia. In a depressed economy at the zero nominal lower bound, this MP curve is highly likely to slope downward. Thus the “bare” constant-monetary-and-financial-conditions multiplier is not damped but rather amplified. This is in sharp contrast to what obtains in normal times, when the monetary authority interested in maintaining its credibility as a guardian of price stability commits to a very steep if not vertical MP curve, and thus a net-ofmonetary-offset policy-relevant multiplier that is small if not zero.22 Our suspicion is that much of the variation through time in at least American economists judgment about discretionary fiscal policy reflects changes in the nature of the central bank reaction function. From the time of the General Theory to the 1960s the default assumption was that interest rates would remain constant as fiscal policy changed as the central bank and fiscal authority cooperated to support demand. With the changes in macroeconomic thinking and the inflationary experience of the 1970s, the natural assumption was that the Fed was managing demand. Thus changes in fiscal policy like changes in private investment demand would be offset as the Fed pursued the appropriate balance between inflation and investment. There is a further reason for supposing that when the zero lower bound constrains interest rate movements the impact of fiscal policy will be magnified. As Christiano, Eichenbaum, and Rebelo (2009), Eggertsson (2010), and Eggertsson and Krugman (2012) point out, the impact of upward price pressure expected from expanded aggregate demand on real interest rates at the zero nominal lower bound could have substantial quantitative significance. 20 The natural conclusion is that in a depressed economy, with short-term safe nominal interest rates at their zero lower bound and with monetary authorities committed to keeping them there for a considerable period of time, the policy-relevant multiplier is likely to be larger than econometric estimates based on times when the zero nominal lower bound does not hold would suggest. A situation in which fiscal expansion is not accompanied by higher but rather lower real interest rates for firms fits a scenario often mentioned by observers but rarely modeled: that of “pump priming”. 21 The claim that private spending will flood into the marketplace and boost demand, once initial government purchases have restored the normal channels of enterprise. 22 20 Earlier the same point had been phrased in reverse, as a fear of the potentially catastrophic consequences of deflation. See Fisher (1933), Tobin (1975), DeLong (1999). Theoretical models like Tobin (1975) have the feature that for too large a deflationary shock the economy simply collapses. Since comparative statics requires comparing equilibria, no multiplier can be calculated. Nevertheless, altering policies to the point where a stable equilibrium is attained is highly desirable. 21 See Byrd L. Jones (1978). 22 In this context, it is worth noting that 1960s CEA Chair Walter Heller thought it possible that the effects of the Kennedy-Johnson 1964 tax cut via boosting spending and reducing real interest rates were large enough that it was possible that it came close to paying for itself. See Bartlett (2003, 2007).23 Adding an inertial Phillips Curve to determine the expected inflation rate in equation (3.6): (3.7)  t1  t  Yt Y \* means that equation (3.2) is replaced by: (3.8)  r t f  Yt The reduced form corresponding to equation (3.3) is then: (3.9)  Yt  ' 1 Gt And even after stimulus is withdrawn, as long as the economy is still at the zero nominal lower bound: (3.10)  Yt i  ' 1 Gt for as long a period k as the zero lower bound lasts. Thus the policy-relevant multiplier over a period in which the economy is at the zero nominal lower bound is not equation (3.4), with a large value of γ according to which the “bare” multiplier is substantially damped, but instead: (3.11)    1k' 1 according to which the “bare” multiplier is amplified. Note that this amplification effect comes through the effects of expansionary fiscal policy on “monetary conditions”, on the safe real interest rate alone—no account is taken of the likelihood that higher levels of production mean fewer bankruptcies and lower risk premia charged to borrowing businesses. 23 23 In this context it is worth noting that Kennedy-Johnson CEA Chair24 For a Phillips Curve slope parameter β of one-third, a product-market equilibrium condition IS slope α of 0.6 as in Hall (2012b), and an expected duration of the zero lower bound period of three years, this amplification effect doubles the policyrelevant multiplier relative to the “bare” constant-monetary-and-financialconditions multiplier. It is difficult to assess the empirical evidence on multipliers without reaching the conclusion that the baseline-case multiplier of 1.0 assumed in Section II is likely to be an underestimate, and perhaps a substantial underestimate, of the policyrelevant multiplier in an economy which is, like the U.S. today, at the zero nominal lower bound on safe short-term interest rates. IV. HYSTERESIS As Phelps (1972) was the first to point out, there are many reasons for believing that recessions impose costs even after they end, and that high pressure economies have continuing benefits. Because downturns and upturns are themselves caused by factors which have continuing impacts, it is not easy to identify such “hysteresis effects” or to quantify them. Below we survey some of the evidence on investment shortfalls as a source of hysteresis and then for hysteresis effects in the labor market in an effort to come to a plausible view about —the impact of a 1% point output shortfall on the subsequent path of economic potential. It would indeed be surprising if economic downturns did not cast a shadow over future levels of economic activity. There is a clear and coherent logic underlying the analytic judgments that an economic downturn does cast a substantial shadow. A host of mechanisms have been suggested. These include reduced capital investment, reduced investment in research and development, reduced labor force attachment on the part of the long term unemployed, scarring effects on young workers who have trouble beginning their careers, changes in managerial attitudes, and reductions in government physical and human capital investments as social-25 insurance expenditures make prior claims on limited state and local financial resources. Figure 4.1 Fixed Investment as a Share of Potential Output One channel through which an economic downturn casts a shadow on the future and reduces future potential output is through private investment. The financial crisis that began in 2008 brought a sharp fall in fixed investment in the American economy, especially in residential construction, from its trend average level of 16.5% of potential output to a post-2008 average of 12.5% of potential output, for a cumulative shortfall to date of 14% point-years of GDP less of cumulative investment than pre-2008 trends projected. This shortfall has two origins. The first comes from the financial stringency of the crisis. The second arises because it is hard to see why a firm would ever focus on building out its capacity rapidly if it already possessed substantial slack. Even if the economy quickly recovers to its productive potential going forward, that productive potential will be lower because of the investment shortfall of the 26 past 3.5 years. A pre-tax real rate of annual return on investment spending of 10% would suggest a reduction in potential output of 1.4% flowing from the investment shortfall that has been seen since the start of 2008, and a capital-side component of the hysteresis parameter η equal to 7%. Admittedly, not all the social project of investment comes from its addition to the capital stock: Workers learn-by-doing as they interact with the capital. Other firms observe and acquire knowledge about best practices. Moreover, a substantial amount of labor time and effort not credited to investment in the NIPA may be an essential complement of the construction of new plant and the installation of new equipment. 24 There has long been the strong association between reduced industrial capacity utilization and slow subsequent growth of industrial capacity that would be expected if reduced investment due to slack capacity were to have a powerful effect in slowing the growth of potential output. Simply regressing the two-year ahead growth of industrial capacity since the beginning of the Federal Reserve capacity utilization series in 1967 on current capacity utilization produces a slope coefficient of 1.88 with a standard error of 0.34. Under the unrealistic assumption that none of the shortfall in capacity growth is subsequently made up, the pattern of capacity utilization and capacity growth since 1967 is consistent with an η of 0.31. Since demand for industrial goods is roughly 1/3 of GDP, if a 1% shortfall in demand for two years produces a 1.88%-point reduction in capacity then a 1% shortfall in demand for one year would produce an 0.31%-point reduction in potential GDP. There is, moreover, reason to fear that the investment shortfall is not the only factor through which the current downturn casts a shadow on the long-term future of the American economy. Large recessions may create labor-market as well as capital-stock hysteresis. Reacting to the long and large increases in the unemployment rate in Western Europe from the early 1970s to the mid-1980s, Olivier Blanchard and Lawrence Summers (1986) raised the possibility that “hysteresis” links between the short-run cycle and the long-run trend might play an important role in macroeconomics: 25 that cyclical increases in unemployment from recessions “might have a direct impact on the ‘natural’ rate of unemployment” around which an economy would oscillate. 24 Certainly the productivity boom of the late 1990s made it more plausible that a high-pressure high-investment economy is one that generates substantial technological and organizational spillovers. See Brynjolfsson and Hitt (1998). 25 See Olivier Blanchard and Lawrence Summers (1986).27 Figure 4.2 Industrial Capacity Utilization and Subsequent Two-Year Growth of Capacity It is in this context that attention is drawn to the divergence between the behavior of the measured U.S. unemployment rate and the behavior of the measured U.S. adult employment-to-population ratio over the past two and a half years. Since the late-2009 business cycle trough, there has been little movement in the civilian employment-to-population ratio, but a substantial decline in the unemployment rate from 10.0% to 8.3%. 26 26 See Stehn (2011).28 Figure 4.3 Unemployment and the Employment-to-Population Ratio Such divergent movements in unemployment and the employment-to-population ratio are unusual in the United States. There may, since the late 1990s, be a developing demographic trend in the United States relating to the retirement of the “baby boom” generation leading to lower employment-to-population ratios at a constant unemployment rate. 27 But this is a slow-moving generational trend amounting to 0.05%/year. 28 And there are counteracting pressures stemming from the financial crisis. 29 27 See Elsby, Hobijn, and Sahin (2010). 28 See Daly, Hobijn, and Valetta (2011). This reduction in labor-force participation since the end of the downturn in the employment-to-population ratio in 2009 is an order of magnitude too large to be attributed to the slow-moving demographic changes in the structure of the potential labor force. There is a potential argument for an interaction effect: perhaps the older labor force of today is more likely to be induced into early retirement by the experience of unemployment. 29 There is a potential argument for an interaction effect: perhaps the older labor force of today is more likely to be induced into early retirement by the experience of unemployment. But there is also a potential argument for an offsetting labor-force participation effect: that the collapse of first housing equity and second risky financial wealth in the Great Recession should lead to a rise in labor force participation as the negative wealth shock causes people to delay retirement. There 29 The past two and a half years have seen the civilian adult employment-topopulation ratio diverge by 1.3% points from what would have been anticipated, given 1990-2009 comovement patterns and the behavior of the unemployment rate since late 2009. There would be a number of ways to map this employment shortfall given the unemployment rate onto a contribution to . The first would be to assume that the missing workers are now permanently and structurally unemployed, to hold potential labor productivity constant, and to divide a 1.3% point shortfall by a cumulative 14% point-year output gap to obtain a contribution to  of 0.093. Alternatively, allowing potential labor productivity to vary with this shift in the employment-to-population ratio at potential output and taking the labor income share of 0.6 as labor’s marginal product would lead to a contribution of 0.56. Noting that unemployment and missing labor force participation are concentrated among the less skilled and less educated might lead to using the “raw” income share unrelated to human capital of 0.3, and to a contribution of 0.28. And perhaps the divergence between the behavior of the unemployment rate over the past two and a half years and the behavior of the employment-to-population ratio will turn out to be a transitory cyclical anomaly. Empirical studies of the possibility of labor-side hysteresis are, regrettably, close to analyses that rest on one single data point or case: the rise and then persistently high level of unemployment in western Europe in the 1980s. Nevertheless, the case that high European unemployment in the 1980s and 1990s was a result of a long cyclical depression starting in the late 1970s is quite strong. 30 Blanchard and Summers’s (1986) original line of thought carried the implication that the U.S. was likely to be largely immune from permanent labor-side effects of what was originally transitory cyclical unemployment. They stressed the “insider-outsider” wagebargaining theory of hysteresis: workers who lose their jobs no longer vote in un are some signs of this at work in the increasing employment of those past retirement age since 2007. 30 The principal alternative theory was that high unemployment in Europe in the 1980s and 1990s was principally a supply-side phenomenon, driven by the interaction of a technological changedriven secular fall in the demand for low-skilled workers and rigid labor market institutions that did not allow for a decline in the relative earnings of the unskilled. See Krugman (1994). Ball (2009) points out that while this competing theory fit the contrast between the United States and western Europe, it did not fit the cross-country within-Western Europe experience at all. Siebert (1997) is more optimistic about relating a hysteresis-elevated NAIRU to labor-market rigidities.30 ion elections, and so union leaders no longer take their interests into account in negotiations and focus instead on higher wages and better working conditions for those remaining employed. Since union strength and legal obligations on employers to bargain were much weaker in the United States, insider-outsider dynamics generated by formal labor market institutions seemed to give the United States little to fear. 31 Ball (1997) 32 argued that the link between labor-market rigidities and the transformation of cyclical into structural unemployment in western Europe in the 1980s had been overdrawn. In his estimation: countries with larger decreases in inflation and longer disinflationary periods have larger rises in the NAIRU. [Measured] imperfections in the labor market [had] little direct relation to change in the NAIRU, but long-term unemployment benefits [appeared to] magnify the effects of disinflation... The implications of Ball’s (1997) attribution of the overwhelming bulk of unemployment increases in western Europe from the early 1970s to the late 1990s to hysteresis effects produced by the long disinflation of the years around 1980 are striking. In countries that pursue long, slow rather than short, sharp disinflations, the natural rate of unemployment rises, apparently by as much as the cyclical rate of unemployment rises during the disinflation. This suggests an  equal to one over the length that disinflation is actively pursued: if disinflation is actively pur 31 Indeed, Ball (2009) cites Llaudes (2005), who finds that between 1968 and 2002 the United States and Japan were the only OECD economy in which there was no statistically significant sign that the long-term unemployed exerted less downward pressure on wage and prices than the short-term unemployed. An alternative also put forward by Blanchard and Summers (1986) focuses on how the long-term unemployed become detached from the labor market. See, again, Granovetter (1973). 32 See in addition Stockhammer and Sturn (2008), who also conclude that the degree of laborside hysteresis is likely to have only weak connections with labor-market institutions but rather strong associations with the persistence of high unemployment and the failure of activist stabilization policies to quickly fill in the output gaps created by downturns. In their results, hysteresis has “strong [associations with] monetary policy, and... [perhaps] the change in the terms of trade, but weak (if any) effects of labour market institutions during recession periods. Those countries which more aggressively reduced their real interest rates in the vulnerable period of a recession experienced a much smaller increase in the NAIRU...”31 sued for three years in the average western European economy, than the average  is 1/3. 33 Figure 4.4 The Rise in Western European Unemployment in the 1980s 33 Blanchard (1997) put forward a political-economic rather than an purely economic rationale for such an extraordinarily high value of : “These factors point to a more general and more diffuse effect at work here, namely that society, in its many dimensions, also adapts to higher persistent unemployment. When unemployment and the proportion of long-term unemployed becomes high, society is compelled, mostly through the political process, to make life bearable… through unemployment benefits, safety nets, real or pseudo-training programs, governments basically make sure that people do not starve. This is the normal response…. [I]t has very much the same effect as the factors I discussed earlier, namely that, by making unemployment more bearable, it increases the natural rate of unemployment…”32 The labor market dynamics of the past two-and-a-half years raise the possibility that the United States is not, after all, largely immune from the considerations raised by Blanchard and Summers (1986). They raise the possibility that the transformation of cyclical unemployment into structural unemployment is underway as the output gap continues to remain large. This adds another channel to hysteresis, in addition to the capital formation channel. Economic forecasters’ revisions of their projections of the U.S. economy over the next decade certainly incorporate substantial hysteresis effects into their projections. Figure 4.5 CBO Revisions of End-of-2017 Potential Output Forecasts, 2007-2012 Source: U.S. Congressional Budget Office. Between January 2007 and January 2009 the U.S. economy slid into what was clearly a very deep financial crisis-driven recession, in spite of an extraordinary 33 shift to stimulative policy by the Federal Reserve supported by extraordinary interventions to stabilize financial markets by the U.S. Treasury. Over this period the U.S. Congressional Budget Office—in near-lockstep with private-sector forecasters—marked down its estimate of potential GDP for the end of 2017 by 4.2%. Figure 4.6 The Output Gap Between Real GDP and Potential Output 1995-2012 Source: U.S. Department of Commerce Bureau of Economic Analysis and U.S. Congressional Budget Office, via the Federal Reserve Bank of St. Louis’s FRED database. The fact that the expansion had not continued through 2007 and 2008 at a pace of between 2.5% and 3.0% per year, coupled with the form the downturn took and CBO’s estimates of its likely duration reduced, in CBO’s judgment, expectations of the long-run productive potential of the U.S. economy by 4.2%. Between January 2009 and January 2010 the CBO raised its estimate of end-of-2017 potential GDP by 0.4%: the recession appears to have been not as deep and the trough was reached sooner than CBO had feared in January 2009. Then over the subsequent 34 two years from January 2010 to January 2012 CBO—again, in near-lockstep with private forecasters—has marked down its forecast of potential GDP as of the end of 2017 by an additional 3%. The sluggish recovery in output and the flatlining of the employment-to-population ratio since its late 2009 trough have conveyed to the CBO staff bad news not just about the state of the current economy but about the long-run productive potential of the United States. As of the end of 2011, CBO’s estimates of potential output and the U.S. Bureau of Economic Analysis’s estimates of real GDP together gave a cumulative shortfall of U.S. GDP below potential output since the start of the recession of 18.2%-point years, with a forecast 10%-point years of additional negative output gap to come before the episode ends. Dividing the 6.8% cumulative markdown of end-of-2017 potential output by the 28.2%-point years of past, present, and expected future output gap would yield a hysteresis coefficient  in the framework of Section II equal to 0.241. This marking-down in the current downturn by forecasters of future potential output when current GDP falls below current potential estimates is part, albeit the largest part, of a more general pattern. Over the past two decades economic forecasters have tended to raise their forecasts of future potential output relative to current potential when the economy is cyclically strong, and lower them when the economy is cyclically weak. Such estimates of the general pattern over the past several decades are not precise, and are not fully relevant. Over the past twenty years, two major shocks dominate shifts in both GDP relative to potential output and in the expected future growth of potential. In the first, GDP rises relative to potential and then falls as the opportunities of the dot-com boom of the late 1990s become clear and then recede, and thus as business investment in high-tech first booms and then declines and as forecasters mark up and then mark down their estimates of potential output growth. This is, properly, not a “hysteresis” effect at all: it is not that higher output now is causing higher future potential output, but rather that higher expected future output is causing higher investment and output now to take advantage of anticipated opportunities.35 Figure 4.7 The Output Gap and CBO Potential Forecasts 1992-2012 In the second, GDP falls relative to potential as the impact of the financial crisis of 2007-8 spreads throughout the economy, and forecasters write down their forecasts of future potential output as a result. This is properly a hysteresis effect. However, even this shift in forecasts of future potential GDP may well simply reflect the fact that economic forecasters are not much better than average in keeping current euphoria or pessimism from contaminating their judgments of the long run. Nevertheless, hysteresis effects of a size larger than those assumed in Table 2.2 appear built into how forecasters view the economy. The historical macroeconomic evidence on the existence and size of hysteresis effects is distressingly thin, as is inevitably the case when attempting to generalize from few previous historical episodes. Thus the conclusions are weaker and shakier than would be wished. The question of how large a shadow is cast on future potential output by a deep cyclical downturn rests on no more than three historical cases: the Great Depression, the long western European downturn of the 1980s, and Japan’s “lost decades” starting in the 1990s. In the U.S., the Great Depression 36 of the 1930s was followed by the great boom of total mobilization for World War II, and if the Great Depression cast a shadow it was erased. 34 Our reading of the experience of western Europe since the late 1970s and Japan during the 1990s, however, is that there is strong reason to believe that hysteresis effects at least as large as those assumed in Table 2.2 are a reality. And our call for further research in this area is especially urgent. 34 See DeLong and Summers (1988). However, Field (2011) argues that in the U.S. the Great Depression was a period of unusually rapid creative destruction.37 V. CONCLUSION The analysis in Section II demonstrates that, as a matter of arithmetic, if the short run multiplier is even moderate and if there are even modest hysteresis effects, then temporary expansionary fiscal policy **will not impose future fiscal burdens**. 35 Our subsequent analysis in Sections III and IV has made the strong case that shortrun fiscal multipliers are likely to be substantial enough and that hysteresis effects are likely to be present in an environment like the present one in the United States, where the economy is operating well short of potential and where interest rates are constrained by zero lower bound. It is crucial to stress as that this result does not speak to the question of the long run sustainability of fiscal policy, or to the importance of addressing unsustainable fiscal policies. If committed spending and committed revenue plans are inconsistent, then as a matter of arithmetic adjustments will be necessary. Nothing in our analysis calls into question the widely held proposition that it is desirable for those adjustments to be committed sooner rather than later. Our analysis simply demonstrates that additional fiscal stimulus, maintained during a period when economic circumstances are such that multiplier and hysteresis effects are significant and then removed, will ease rather than exacerbate the government’s long run budget constraint. In drawing policy implications from this result, three crucial questions arise:  First, Doesn’t the argument prove too much? Surely it cannot be the case that most governments at most time can take on increased debt relying on the benefits of induced growth to pay it back?  Second, is the kind of temporary fiscal stimulus envisioned in our model feasible in the world or does temporary stimulus inevitably in reality or perception become at least quasi permanent?  Third, whatever the merits of fiscal stimulus, should not monetary policy be 35 We are not alone in this conclusion. See also Denes et al. (2012) and Cottarelli (2012) for other, somewhat different arguments that many economies now are at least near the edge of the region where stimulative deficit spending is self-financing, and fiscal austerity is self-defeating.38 relied on as an alternative and superior instrument?

### econ uq—spending cuts bad

#### Stimulus now is key to prevent another recession

**Bloomberg 6-14-12-** Bloomberg Editors(“Less Talk, More Stimulus”, Bloomberg View, June 14, 2012, [http://www.bloomberg.com/news/2012-06-14/less-talk-more-stimulus.html)//sjl](http://www.bloomberg.com/news/2012-06-14/less-talk-more-stimulus.html%29/sjl)

The cudgel to promote action is the so-called fiscal cliff, the unholy combination of more than $600 billion in tax increases and spending cuts slated to take effect in January. The nonpartisan Congressional Budget Office says that if the government fails to extend expiring tax provisions and to blunt the scheduled spending cuts, growth will slow to 0.5 percent, with the economy contracting at an annual rate of 1.3 percent in the first half of 2013 and expanding 2.3 percent in the second half. In other words, **we could be back in a recession.**

The rationale for additional government spending at this moment is compelling: Interest rates are near a historic low, and long-term unemployment is threatening the future of millions. More than 5 million of the 12.7 million people who are unemployed have been jobless for 27 weeks or more, a higher portion than at any time over the past 60 years. A new paper by former Obama economic adviser Lawrence Summers and Berkeley economist J. Bradford Delong suggests that under current conditions stimulus could ultimately be self-financing; it would put people back to work and increase the tax base, thus reducing the long-run debt burden.

#### The perception of stimulus spending boosts the stock market

**AFP 6-16-12** (AFP,“US stocks climb on stimulus hopes”, MSN, June 19, 2012, <http://news.ninemsn.com.au/article.aspx?id=8484432)//sjl>

US stocks have forged higher, joining a global rally as investors appeared to bet on fresh stimulus from the United States and Europe to boost growth and fight the eurozone crisis. In the first five minutes of trade, the Dow Jones Industrial Average was up 59.56 points (0.47 percent) to 12,711.47, extending Thursday's one per cent gain. The broad-market S&P 500 climbed 5.34 (0.40 per cent) to 1334.44, while the tech-rich Nasdaq Composite gained 5.13 (0.18 per cent) to 2,841,46. "Place your bets. Yesterday's and today's trading is all about positioning ahead of Sunday's elections in Greece and next week's Federal Reserve policy meeting," said Dick Green at Briefing.com. Green said **stocks rallied "because traders are betting that European governments will take action after the election** to prevent any adverse credit market impact from the possibility of Greece leaving the eurozone. The buying spree also was fuelled by hopes that a recent string of weak US economic data will push the Fed unleash new stimulus to boost the flagging economy at its June 19-20 meeting. On Thursday, US stocks pushed higher amid speculation of more stimulus from the Fed and rumours of central bank coordination to head off contagion in the markets.

#### The perception of massive spending cuts will wreck the economy—durable spending is key for confidence

**Bloomberg 6-19-12** (Rich Miller, “Fiscal-Cliff Concerns Hurting U.S. Economy”, Bloomberg Businessweek, June 19, 2012, [http://www.businessweek.com/news/2012-06-19/fiscal-cliff-concerns-hurting-economy-as-companies-hold-back)//sjl](http://www.businessweek.com/news/2012-06-19/fiscal-cliff-concerns-hurting-economy-as-companies-hold-back%29/sjl)

Companies are starting to delay hiring and spending out of concern that Congress won’t reach a compromise in time to avoid automatic tax increases and budget cuts that would pull billions of dollars of purchasing power out of the economy. Faced with a so-called fiscal cliff of more than $600 billion in higher taxes and reductions in defense and other government programs in 2013, U.S. companies are pulling back, though the deadline for congressional action is more than six months away. The best strategy for companies to follow when confronted with such uncertainty ahead of Dec. 31 is to “stay lean and keep your inventories taut,” Sandy Cutler, chief executive officer of industrial equipment-maker Eaton Corp. (ETN) (ETN) in Cleveland, told a conference May 31. Economists are predicting this trend will pick up through the year. “A lot of people see the fiscal cliff as a 2013 story, but you don’t board up the windows when the hurricane is there**, you board up the windows in anticipation**,” said Michael Hanson, senior U.S. economist at Bank of America Corp. in New York. Hanson sees U.S. growth decelerating to 1.3 percent in the third quarter and 1 percent in the fourth quarter as the European debt crisis and worries over the U.S. budget increasingly weigh on the economy. Gross domestic product advanced at a 1.9 percent annual pace in the first quarter.

#### these cuts would create a major recession

Bloomberg 6-19**-12** (Rich Miller, “Fiscal-Cliff Concerns Hurting U.S. Economy”, Bloomberg Businessweek, June 19, 2012, [http://www.businessweek.com/news/2012-06-19/fiscal-cliff-concerns-hurting-economy-as-companies-hold-back)//sjl](http://www.businessweek.com/news/2012-06-19/fiscal-cliff-concerns-hurting-economy-as-companies-hold-back%29/sjl) Recession Concern Things would get worse next year if Congress allows all of the scheduled spending reductions and tax increases to take effect. In that case, a recession is likely, the non-partisan Congressional Budget Office warned in a report last month. The scheduled budget cuts haven’t had much of an effect on financial markets, with investors preoccupied by the intensifying crisis in Europe. Sixty-one percent of the 234 fund managers surveyed by Bank of America last month saw the euro region’s debt troubles as the biggest concern in the world economy, more than three times as many who said that about the U.S. fiscal cliff. In a sign of investors’ equanimity, U.S. stocks have been the best-performing major equity market in 2012, with the Standard & Poor’s 500 Index (SPX) up by more than 6 percent so far this year. Such sentiment could shift if Congress doesn’t act in the next few months to avoid the year-end budget precipice, said Peter Fisher, senior managing director in New York at BlackRock Inc., the world’s largest money manager.

### econ uq—generic

#### US economy slowing—needs more stimulus

**Reuters 6-20-12**-(Mark Felsenthal and Pedro da Costa, “Fed ramps up economic stimulus, says may do more”, Reuters, June 20, 2012, [http://www.reuters.com/article/2012/06/20/us-usa-fed-idUSBRE85I1Q020120620)//sjl](http://www.reuters.com/article/2012/06/20/us-usa-fed-idUSBRE85I1Q020120620%29/sjl)

Hiring by U.S. employers has slowed sharply, factory output has slipped and consumer confidence has eroded. Europe's festering debt crisis and the **prospect of planned U.S. tax hikes and government spending cuts weigh on the outlook**. The economy grew at only a 1.9 percent annual rate in the first quarter, and economists expect it to do little better in the second **quarter**.

#### Even Federal Reserve admits US economy needs a boost

**Reuters 6-20-12-**(“Fed Extends 'Operation Twist,' Citing Concerns on Economy”, CNBC, June 20, 2012, [http://www.cnbc.com/id/47890974)//sjl](http://www.cnbc.com/id/47890974%29/sjl)

The Fed stuck to its characterization of the economy as "expanding moderately,'' but said growth in employment had slowed in recent months. It also expressed worries about weaker consumer spending. The U.S. economy appears to be faltering as growth in the emerging world slows and Europe sinks deeper into its political wrangling over sovereign debt. First-quarter U.S. gross domestic product was recently revised down to a 1.9 percent annual rate from 2.2 percent. At the same time, May jobs data confirmed that a weak labor market is faltering again, with only 69,000 new jobs created and the unemployment rate rising to 8.2 percent.

#### Condition of US economy even worse than numbers reflect

**Feldstein 12** George F. Baker Professor of Economics at Harvard University. He completed his undergraduate education at Harvard University (B.A., Summa Cum Laude, 1961), where he was affiliated with Adams House, and then attended University of Oxford (B.Litt., 1963; D.Phil., 1967). He was also a Fellow of Nuffield College, Oxford from 1964 to 1967.-(Martin, “The Economy and the Presidency”, Project Syndicate, April 2012, <http://www.nber.org/feldstein/projectsyndicateapril2012.html>)

At the moment, America's economy is limping along with slow growth and high unemployment. Output grew by just 1.5% last year, and real GDP per capita is lower now than before the economic downturn began at the end of 2007. Although annual GDP growth was 3% in the fourth quarter of 2011, more than half of that reflected inventory accumulation. Final sales to households, businesses, and foreign buyers rose at only a 1.1% annual rate, even slower than earlier in the year. And the preliminary estimate for annual GDP growth in the first quarter of 2012 was a disappointing 2.2%, with only a 1.6% rise in final sales. The labor market has been similarly disappointing. The March unemployment rate of 8.2% was nearly three percentage points above what most economists would consider a desirable and sustainable long-run level rate. Although the rate was down from 9% a year ago, about half of the change reflected a rise in the number of people who have stopped looking for work, rather than an increase in job creation and the employment rate. Indeed, the official unemployment rate understates the weakness of the labor market. An estimated 6% of all employees are working fewer hours per week than they would like, and about 2% of potential employees are not counted as unemployed because they have not looked for work in the past few weeks, even though they would like to work. Adding these individuals to those officially classified as unemployed implies that about 15% of potential labor-force participants are working less than they want. Solid increases in payroll employment at the start of the year contributed to a general sense of confidence. But the rate of increase in payroll employment fell in March to less than half of the rate recorded in previous months, **a**nd the number of workers claiming unemployment benefits recently jumped to a four-month high. Even those who are working are seeing their incomes shrink. Real average weekly earnings have fallen in recent months, and are now lower than they were 18 months ago. The broader measure of real per capita after-tax personal income has also been falling, and is back to levels last seen a year ago. Despite their declining incomes, **households raised their spending** in early 2012 at a rapid pace by cutting their saving rate to just 3.7%. Without further declines in the saving rate from this very low level, consumer spending will not continue to grow as robustly. Recent reports of declining consumer confidence reinforce the likelihood that spending will slow in the months ahead. Moreover, the housing market remains in bad shape. The most reliable index of comparable house prices has continued to decline month after month, and prices are now about 7% lower in real terms than a year ago, implying a $1 trillion loss of household wealth. With roughly 25% of all homeowners with mortgages owing more than their homes are worth, the decline in house prices reflects high rates of default and foreclosure. Falling prices, together with stricter lending standards, has spurred a shift by would-be home buyers to the rental market, causing recent declines in the sales of both new and existing homes. The weakness of America's economy is not limited to the household sector. Industrial production has been unchanged for the past two months, and utilization of industrial capacity has declined. And the monthly purchasing surveys conducted by the Institute for Supply Management now indicate weaker activity among service firms as well. Looking ahead, strong headwinds imply that it will be difficult to achieve better economic performance in the rest of the year. Higher energy prices are reducing real household spending on non-energy goods and services; weakness in Europe and Asia will hurt America's exports; state and local governments are cutting their spending; and concerns about higher taxes in 2013 will dampen both business investment and big-ticket consumer spending.

#### The U.S. economy is stalling—job creation is done for

**Bloomberg 6-14-12-** Bloomberg Editors(“Less Talk, More Stimulus”, Bloomberg View, June 14, 2012, [http://www.bloomberg.com/news/2012-06-14/less-talk-more-stimulus.html)//sjl](http://www.bloomberg.com/news/2012-06-14/less-talk-more-stimulus.html%29/sjl)

It’s not that Obama’s proposals -- a mix of tax credits for small businesses and clean energy, and spending on infrastructure and education -- are bad. It’s just that they’re shopworn and too timid to break the political stalemate in Washington. The Democratic president effectively showcased the differences between his vision and Republican candidate Mitt Romney’s plan for a rollback of regulation and $5 trillion in new tax cuts. Unfortunately, drawing these distinctions won’t do much for the U.S. economy; it’s stalling now.

As in the past two years, economic growth seems to have petered out midyear. Gross domestic product is now expected to increase just 2 percent in 2012, too little to bring down unemployment in a meaningful way. A Federal Reserve report released this week shows the blunt force trauma of the recession, which erased almost two decades of Americans’ wealth and sent the median net worth of families plummeting to $77,300 -- a level not seen since 1992. Private payrolls remain below 2001 levels, meaning not a single net private-sector job has been created in more than a decade.

It’s no wonder Federal Reserve Chairman Ben S. Bernanke practically begged lawmakers last week to take some of the burden off the Fed’s shoulders and help goose the economy.

#### Pre-election inertia will guarantee massive cuts – destroying the economy and the defense industry

**Bloomberg 6-19-12** (Rich Miller, “Fiscal-Cliff Concerns Hurting U.S. Economy”, Bloomberg Businessweek, June 19, 2012, [http://www.businessweek.com/news/2012-06-19/fiscal-cliff-concerns-hurting-economy-as-companies-hold-back)//sjl](http://www.businessweek.com/news/2012-06-19/fiscal-cliff-concerns-hurting-economy-as-companies-hold-back%29/sjl)

“The markets don’t want to wait until Dec. 31,” Fisher, a former Federal Reserve and Treasury official, told Bloomberg Television on May 30. “Congress is going to have to wake up in October when the markets start pricing in the uncertainty of a recession in 2013.” Lawmakers, for their part, **said they** don’t anticipate much from Congress until after the November election. The two parties are just too divided. Preferred Systems Solutions is among government contractors coping with delayed procurements and agency cost-cutting, said Scott Goss, president and chief executive officer of the Vienna, Virginia-based engineering and information technology provider. One intelligence agency asked Goss to lower his charges on an existing 10-year contract. Feeling ‘Squeeze’ “I’m feeling more of a pinch and squeeze than I ever have before,” Goss said. “As soon as they start these massive cuts, they’re going to impact the economy.” Defense contractors are “most fearful” of **across**-the- board reductions that could spur as many as 350,000 job losses if Congress doesn’t act, said Cord Sterling, vice president of the Aerospace Industries Association of America. In the absence of guidance from President Barack Obama’s administration about how the cuts would be carried out, companies “have to assume those go into place,” he said. The prospect of cuts already is having a “chilling effect” on the industry and Lockheed Martin Corp. (LMT) (LMT) and other companies may stop hiring and training, Robert Stevens, chief executive officer of the world’s largest defense company, said in March on Capitol Hill. Last month he said that laws requiring advance notice of firings may prompt grim warnings in September and October.

#### US economy sputtering

**Bloomberg 6-1-12-**(Christopher S. Rugaber, “US economy added 69K jobs in May, fewest in a year”, Bloomberg Businessweek, June 1, 2012, [http://www.businessweek.com/ap/2012-06/D9V4CNRO0.htm)//sjl](http://www.businessweek.com/ap/2012-06/D9V4CNRO0.htm%29/sjl)

The U.S. economy suddenly looks a lot weaker. U.S. employers created only 69,000 jobs in May, the fewest in a year, and the unemployment rate ticked up. The dismal jobs data will fan fears that the economy is sputtering. It could also damage President Barack Obama's re-election prospects. And it could lead the Federal Reserve to take further steps to help the economy. The Labor Department also said Friday that the economy created far fewer jobs in the previous two months than first thought. It revised those figures down to show 49,000 fewer jobs created. The unemployment rate rose to 8.2 percent from 8.1 percent in April, the first increase in 11 months. The Dow Jones industrial average fell more than 160 points in the first half hour of trading. The yield on the benchmark on the 10-year Treasury note plunged to 1.46 percent, the lowest on record. It suggested that investors are flocking to the safety of U.S. government bonds. The price of gold, which was trading at about $1,550 an ounce before the report, shot up $30. Investors have seen gold as a safe place to put their money during turbulent economic times. Josh Feinman, global chief economist with DB Advisors, said Friday's report raises the likelihood that the Federal Reserve will do more -- perhaps start another round of bond purchases to further lower long-term interest rates. Still, he noted that the rate on 10-year Treasury notes is already at a record low 1.46 percent. "How much lower can long-term rates go?" Feinman said. The economy is averaging just 73,000 jobs a month over the past two months -- roughly a third of 226,000 jobs created per month in the January-March quarter. Slower growth in the United States comes at a perilous time for the global economy.

#### The US requires more stimulus

**Dr. Gnuschke 12** Dr. John E. Gnuschke is Director of the Bureau of Business and Economic Research and the Center for Manpower Studies and Professor of Economics at the University of Memphis. The Bureau and the Center are the applied business, economic, and labor market research divisions of the Fogelman College of Business and Economics.Dr. Gnuschke received his PhD and MA degrees from the University of Missouri at Columbia and his BS from Utah State University.-( John E., “LOOK FOR A STRONGER ECONOMY IN 2012”, *Business Perspectives 21. 1*, 2012, [Proquest)//sjl](http://search.proquest.com.proxy.lib.umich.edu/docview/926976812%29/sjl)

We know now that the initial stimulus spending was barely sufficient to stop the accelerated declines that were taking place. **Subsequent rounds of economic stimulus will be necessary if another recession appears in 2012**. Unanticipated events in global financial markets and unanticipated increases in energy prices associated with political unrest in the Middle East are the most likely events with global implications. Clearly, the risk of another recession is not zero in 2012, but it seems to be getting lower as the new year begins.

#### US economy in decline

**WSJ 6-17-12**-(Jeffery Bartash, “U.S. economy downshifts to lower gear”, Wall Street Journal, June 17, 2012, [http://www.marketwatch.com/story/us-economy-downshifts-to-lower-gear-2012-06-17)//sjl](http://www.marketwatch.com/story/us-economy-downshifts-to-lower-gear-2012-06-17%29/sjl)

The negative signals are everywhere, most recently in the latest downbeat figures on retail spending, manufacturing production and consumer confidence. See charts of most recent economic data. This week’s light batch of data surely won’t reverse the trend. Investors will mainly focus on the ongoing crisis in Europe and the reaction of the Federal Reserve when the central bank meets on Wednesday. There’s a growing sense among economists the Fed will take additional steps to try to boost growth, a notion that most viewed as unlikely just a few weeks ago. The Philadelphia Federal Reserve’s survey of regional manufacturing executives could also be telling. In a big surprise, the index plunged last month to herald the slowdown in manufacturing. Another decline would confirm that U.S. manufacturers are struggling to cope with a global economic downturn that’s hurting American exports. First up, though, is the outcome of the Greek election on Sunday. The vote could determine if the country leaves in the euro zone and force the rest of Europe to take steps to limit the damage. Read preview of Greek election. The foggy situation overseas is among many factors holding back U.S.growth and a resolution seems unlikely anytime soon. “You can drive in fog, you just can’t drive very fast,” said economist Mark Vitner of Wells Fargo. “Hence, the 2% growth the U.S. economy has managed to eke out over the past year.” One indicator that will be closely followed is Tuesday’s report on new-home construction. Builders likely started work on homes at a faster rate in May than in April, but not by much. Although the housing market is expected to continue a gradual recovery from its worst slump in modern times, **the sector is beholden to the rest of the econom**y. Construction and sales would almost certainly decline if the economy gets any weaker. On Tuesday and Wednesday, Fed bigwigs will meet, and Chairman Ben Bernanke will hold a press conference afterward Wednesday afternoon. Just a few weeks ago, virtually no one on Wall Street expected the bank to take action. Now many believe the Fed will come off the sidelines. Some economists expect the Fed to increase bond purchases in an attempt to inject more cash into the economy and soothe jittery investors in the U.S. and around the world. Another possibility is the central bank will extend a program of swapping its holdings of short-term securities into longer-dated bonds. The effects of further Fed intervention, however, are uncertain. Interest rates are already at modern record lows and a further reduction is unlikely to induce consumers to boost spending — by far the biggest key to economic growth. Another springboard for growth, the U.S. manufacturing sector, is also unlikely to boost spending. Production has slowed along with export orders as growth declines in Europe and most overseas markets.

#### Economy faltering—on shaky ground

**Reuters 6-15-12-**(“Dip in Manufacturing Suggests a Stalled U.S. Economy”, New York Times, June 15, 2012, [http://www.nytimes.com/2012/06/16/business/economy/dip-in-manufacturing-could-suggest-stalled-economy.html)//sjl](http://www.nytimes.com/2012/06/16/business/economy/dip-in-manufacturing-could-suggest-stalled-economy.html%29/sjl)

Factory output contracted in May for the second time in three months, the Federal Reserve said on Friday, and families took a dimmer view of their economic prospects in early June, signs that the economy’s recovery is on shaky ground. The new data was the latest in a series of reports portraying a weak economy that have led analysts to cut growth forecasts while raising expectations that the Federal Reserve will offer new stimulus measures. Until recently, manufacturing had been a buttress for the nation’s economy, helping it resist headwinds from Europe’s snowballing debt crisis. But in May, factory output shrank 0.4 percent, with plants producing fewer cars and less machinery, Federal Reserve data showed. “It’s more convincing evidence that the economy is stuck in low gear,” said Joe Manimbo, a market analyst at Travelex Global Business Payments. Other reports pointed to cooling factory activity in New York State this month, along with a drop in household confidence in the economy. The fall in confidence poses a serious threat to President Obama’s chances of winning re-election in November. It could also lead consumers to cut back on spending, which would reduce economic growth. “Consumers are scared,” said Sharon Stark, managing director at Sterne Agee in Birmingham, Ala. Consumer sentiment fell in early June to a six-month low. A gauge of household confidence in the economy’s future also dropped to its lowest since December. The Thomson Reuters/University of Michigan’s index on consumer sentiment slipped to 74.1, falling short of even the most pessimistic forecast in a Reuters poll. Economists at Capital Economics reckon the decline in consumer sentiment is consistent with growth in consumer spending slowing to a mere 1 percent annual rate in the second quarter, down from 2.7 percent in the first three months of the year.

#### US economy slowing

**AFP 6-17-12-**(“US Fed to assess need for economic stimulus after string of weak data”, GMA Network, June 17, 2012, <http://www.gmanetwork.com/news/story/262186/economy/moneyandbanking/us-fed-to-assess-need-for-economic-stimulus-after-string-of-weak-data>)

The plodding US economy, meager job growth and market tensions over Europe's debt crisis will hang over Federal Reserve policymakers when they meet in a few days. A recent string of weak data on the economy, from rising jobless claims to easing inflation as gasoline prices retrench, has raised speculation that the Fed may act to boost growth.

#### US economy undoubtedly needs a boost

**The Guardian 6-18-12**-(Dean Baker, “What Ben Bernanke and the Federal Reserve can do to save the US economy”, The Guardian, June 18, 2012, [http://www.guardian.co.uk/commentisfree/2012/jun/18/ben-bernanke-federal-reserve-us-economy)//sjl](http://www.guardian.co.uk/commentisfree/2012/jun/18/ben-bernanke-federal-reserve-us-economy%29/sjl)

The fact that the economy can use an additional boost should not be in dispute. The rate of job creation in the last two months understates the underlying growth path, since it is essentially a payback from the stronger growth due to an unusually mild winter. Even the 165,000-a-month average rate of job creation for the last five months is far too slow. With the economy needing roughly 100,000 new jobs a month just to keep pace with labor force growth, it would take us more than 12 years to make up our 10 million jobs deficit at this point. If there is a clear need for more rapid growth, the data also show there is no downside risk of excessive inflation. The consumer price index fell 0.3% in May. It has risen by just 1.7% over the last year. (The core index rose 0.2% last month and is up 2.3% over the last year.)

### econ uq—consumer spending

#### Growth is declining now – consumer spending is the key factor

WSJ 6-19**-12** (Fannie Mae’s Economic and Strategic Research Group, “Global Political Economic Risks Rise at Mid-Year: U.S. Economy Slows”, Wall Street Journal, June 19, 2012, [http://www.marketwatch.com/story/global-political-economic-risks-rise-at-mid-year-us-economy-slows-2012-06-19)//sjl](http://www.marketwatch.com/story/global-political-economic-risks-rise-at-mid-year-us-economy-slows-2012-06-19%29/sjl)

Despite a downward revision to economic growth in the first quarter, **moderate growth is expected to continue for the remainder of 2012**, according to Fannie Mae's FNMA +1.15% Economic & Strategic Research Group. However, risks to the economic outlook have tilted to the downside. Factors such as a decelerating trend in hiring, potential contagion in the euro zone from fiscal issues in Greece, and the potential of a massive fiscal drag in the U.S. indicate that the balance between upside and downside risks has diminished. For all of 2012, growth is projected to come in at 2.2 percent. Consumers remain key to the overall outlook, as attitudes appear to be reaching a plateau after a few months of improvement early in the year. Loss of momentum in labor market conditions, sluggish income growth, and decreasing saving rates suggest that consumers may need to moderate spending unless income picks up.

#### Consumer demand is low

**Bloomberg 6-1-12-**(Christopher S. Rugaber, “US economy added 69K jobs in May, fewest in a year”, Bloomberg Businessweek, June 1, 2012, [http://www.businessweek.com/ap/2012-06/D9V4CNRO0.htm)//sjl](http://www.businessweek.com/ap/2012-06/D9V4CNRO0.htm%29/sjl)

The average work week was shortened to 34.4 hours. It suggested that companies are seeing less consumer demand. The average hourly wage ticked up two cents, to $23.41. It has increased only 1.7 percent in the past year, trailing the rate of inflation. Businesses are facing a growing threat from Europe's financial crisis, which has worsened in recent weeks. The crisis is driving up borrowing costs for Spain and Italy and spreading to the banking system. Greece could be forced to exit the euro, which could push the region into a sharp recession. That could limit U.S. growth. "Business sentiment has turned sours," said Ellen Zentner, an economist at Nomura Securities. "Companies are concerned about contagion from Europe." Zentner said the warm winter accelerated some hiring that normally would have taken place in the spring. The construction industry, one of the most weather-sensitive industries, added jobs in December and January but cut back sharply in April and May.

### econ uq—at: quantitative easing

#### Quantitative easing not even close to enough to save put the economy back on track

**The Guardian 6-18-12**-(Dean Baker, “What Ben Bernanke and the Federal Reserve can do to save the US economy”, The Guardian, June 18, 2012, [http://www.guardian.co.uk/commentisfree/2012/jun/18/ben-bernanke-federal-reserve-us-economy)//sjl](http://www.guardian.co.uk/commentisfree/2012/jun/18/ben-bernanke-federal-reserve-us-economy%29/sjl)

The Fed already owns close to $3tn in mostly long-term debt. It could buy another $1tn or so, in the hope of putting somewhat more downward pressure on long-term rates. In an optimistic scenario, perhaps this would lower the 10-year treasury rate by 15-20 basis points. That would allow for some additional mortgage refinancing, and perhaps be a modest spur to investment. It would also help to lower the value of the dollar, which would increase our net exports, although the improvement on the trade balance will likely take six months to a year to be felt. The alternative route would be to pick up an idea that Bernanke tossed out three years ago. He could target a longer-term rate. For example, he could announce that he would set a target of 1.2% for 10-year treasury bonds for the next year (compared to around 1.5% at present). This would mean that the Fed would buy as many Treasury bonds as necessary to bring yields down to this level. This would have a similar, but likely, somewhat more powerful effect as another round of quantitative easing. In an optimistic scenario, it could lower 30-year mortgage rates by 20-30 basis points, allowing for a rather greater impact on mortgage refinancing and investment. In neither case will the Fed action turn around the economy. The refinancing process itself will create jobs and provide some boost to the economy. In an optimistic scenario, Fed action could spur 5-10 million refinanced mortgages over the course of a year. If we assume an average saving of 1.5 percentage points on a $180,000 mortgage, this frees up $13.5bn to $27bn in mortgage payments to be spent on other items. That is between 0.1% and 0.2% of GDP. That might translate into 200,000 to 400,000 jobs. That's not getting us to full employment, but it is a step in the right direction.

#### Quantitative Easing not enough and creates long-term problems

**Feldstein 6-20-12** George F. Baker Professor of Economics at Harvard University. He completed his undergraduate education at Harvard University (B.A., Summa Cum Laude, 1961), where he was affiliated with Adams House, and then attended University of Oxford (B.Litt., 1963; D.Phil., 1967). He was also a Fellow of Nuffield College, Oxford from 1964 to 1967.-(Martin, “Martin Feldstein: The Fed Shouldn't Bother With More Easing Because It Doesn't Help The Economy”, Business Insider, June 20, 2012, [http://www.businessinsider.com/martin-feldstein-fed-easing-2012-6)//sjl](http://www.businessinsider.com/martin-feldstein-fed-easing-2012-6%29/sjl)

But Martin Feldstein, Harvard professor was on Bloomberg TV saying that the monetary policy tools have little real effect on "actual economic activity". He says it helps the bond and stock market and potential mortgage borrowers but it isn't making much of an impact: "The people who say why are we taking the risk of building up the Fed's balance sheet, putting a lot more liquidity? They will at the meeting at the Fed this week say, maybe enough is enough. Let's not continue with these policies of quantitative easing. ...The Fed has been saying we will do whatever is necessary. We will move if the economy gets soft. Well the economy has been getting very soft in recent day. **So in some ways it's going to be hard for them to say well we promised we would act if the economy got soft**. We know have a string of bad news but we're not going to do anything. So i think they're more likely than not to do something, not a big thing, something to check the box. My own judgement is they shouldn't be bothering." Feldstein is cautious about the risks of additional QE in the future when the economy starts to heat up because he thinks the Fed's exit strategy, namely raising interest rates, will be a political landmine. "If the unemployment rate is still very high, it's going to be hard for the Fed to actually use that exit strategy."

### no fed constraint

#### **Stimulus multipliers are especially high now—no Taylor rule inhibition**

Hall, 10 – professor of economics at Stanford University (Robert E., “Fiscal Stimulus,” Daedalus p. 83, fall 2010, Academic OneFile)//HK

Sometimes, as in 2009 and 2010, the stabilization principles call for a negative interest rate. If unemployment is high and inflation is low, a great deal of expansion is desirable. But the Fed is incapable of making its interest rate negative, for the reason that the interest rate the Fed controls is the rate at which banks borrow and lend reserves. Banks have the right to convert reserves to hundred-dollar bills in unlimited amounts. The rate that the bills pay is zero, so if the reserves had a negative rate--if banks had to pay to hold reserves--they would simply convert reserves to bills.

The Taylor rule (so named for economist John Taylor) calls for the Fed to raise the interest rate when a fiscal stimulus goes into effect. The higher rate would offset part of the expansionary effect of the stimulus. But if the interest rate is pinned at zero when the Taylor rule asks for a negative rate, the Fed will keep it at zero unless the fiscal stimulus is so effective as to raise the interest rate--dictated by the rule--to a positive level. In 2009, the Taylor rule yielded a deeply negative rate, but in the absence of practical fiscal policy that would raise the rate above zero, the best the Fed could do in the face of fiscal expansion was to keep the rate at zero. Consequently, the Taylor rule ceased to inhibit fiscal expansion. Thus, in an economy where the central bank is governed by a Taylor rule (or a central bank that raised interest rates for any reason during economic expansion), the bank's reaction to the expansionary effect of fiscal stimulus blunts the effect. The infrastructure multiplier is lower in an economy with a responsive central bank than in an economy with a central bank that keeps the interest rate constant.

A number of investigators have studied the elevation of the infrastructure multiplier when the interest rate is pinned at zero. All have concluded that it is substantially larger than the value of around one that is the weak consensus for the multiplier in normal times. The range of estimates for the zero-interest-rate multiplier is wide, even within the same study, because it is sensitive to the timing of the stimulus and the duration of the period when the interest rate will remain pinned at zero. That said, a value for the zero-interest-rate multiplier of around two is representative of recent research.

#### Infrastructure spending now is key to maximum economic growth—ARRA proves

Wilson, 11 – senior economist, Economic Research Dept. of the Federal Reserve Bank of San Francisco (Daniel J., “Fiscal Spending Jobs Multipliers: Evidence from the 2009 American Recovery and Reinvestment Act,” Federal Reserve Bank of San Francisco, October 2011, <http://www.frbsf.org/publications/economics/papers/2010/wp10-17bk.pdf>)//HK

This paper analyzed the employment impacts of fiscal stimulus spending, using statelevel data from the American Recovery and Reinvestment Act (ARRA) enacted in February 2009 and instrumenting for actual ARRA spending using pre-ARRA factors that went into the ARRA’s allocation formulas. Cross-state IV results indicate that ARRA spending had a positive and statistically significant impact on total nonfarm employment at the one-year mark after the legislation was enacted. It also had a positive and significant impact on employment in the subsectors of state and local government, construction, manufacturing and, depending on which measure of stimulus spending one uses, the education and health sectors. Further analyses show that ARRA spending began having a statistically significant effect on total employment around July or August of 2009, but not before. Moreover, there is no evidence of correlation between employment changes and predicted ARRA spending, conditional on controls, in months prior to the ARRA’s enactment.

Based on my preferred measure of spending, announced funds, the results imply that its first year ARRA spending yielded about eight jobs per million dollars spent, or about $125,000 per job. Extrapolating from that marginal local effect to the national level, the estimates imply ARRA spending created or saved about 2.0 million jobs, or 1.5% of pre-ARRA total nonfarm employment, in that first year. The estimated employment effect is estimated to have grown further over time, reaching 3.4 million (based on announced funds) by March 2011. The estimates are moderately larger if one measures ARRA spending by obligated funds or actual outlays. Despite the use of a very different methodology, these estimates are in line with the range of estimates of the ARRA’s impact generated by studies using the macroeconometric modeling approach.

It should be emphasized that the stimulus effects estimated in this paper correspond to the effects of one particular stimulus program enacted in a unique economic environment. There are at least two reasons why the ARRA’s spending effects are not likely to be generally applicable to the question of the effects of fiscal stimulus in other contexts. First, the ARRA was unusual relative to previous stimulus programs in the U.S. and elsewhere in that it focused heavily on infrastructure spending and fiscal aid to state governments. These types of spending may well have different multipliers than federal government consumption expenditures. Second, the ARRA was enacted in a unique, and in many ways unprecedented, economic environoment. The U.S. economy was in the midst of its most severe economic downturns since the Great Depression. The resulting underutilization of resources could have made fiscal stimulus more effective than it would be in a more normal environment (see, for example, the results of Auerbach and Gorodnichenko finding that the fiscal multiplier is higher in downturns). Furthermore, monetary policy during the 2007-2009 recession and subsequent recovery was arguably stuck at the zero lower bound, or at least heavily restrained in its accommodative abilities. A number of theoretical studies have found that fiscal multipliers should be larger when monetary policy is less accommodative.

#### Current stagnation prevents the fed from constraining stimulus’ effects

Woodford, 10 - Political economy professor at Columbia (Michael, “Simple Analytics of the Government Expenditure Multiplier,” National Bureau of Economic Research, January 2010, http://www.nber.org/papers/w15714)//HK

One case in which it is especially plausible to suppose that the central bank will not tighten policy in response to an increase in government purchases is when monetary policy is constrained by the zero lower bound on the short-term nominal interest rate. This is a case in which it is plausible to assume not merely that the real interest rate does not rise in response to fiscal stimulus, but that the nominal rate does not rise; this will actually be associated with a decrease in the real rate of interest, to the extent that the fiscal stimulus is associated with increased inflation expectations. Hence government purchases should have an especially strong effect on aggregate output when the central bank's policy rate is at the zero lower bound.22 This is also a case of particular interest, since calls for fiscal stimulus become more urgent when it is no longer possible to achieve as much stimulus to aggregate demand as would be desired through interest-rate cuts alone.

In practice, the zero lower bound is most likely to become a binding constraint on monetary policy when financial intermediation is severely disrupted, as during the Depression or the recent financial crisis." A simple extension of the model proposed above allows us to see how this can occur. Suppose that the interest rate that is relevant in condition (2.1) for the intertemporal allocation of expenditure is not the same as the central bank's policy rate, and furthermore that the spread between the two interest rates varies over time, owing to changes in the eliiciency of financial intermediation." If we let it denote the policy rate, and it + At the interest rate that is relevant for the intertemporal allocation of expenditure, then (3.12) takes the more general form K \_ Gt = Et[K+1 \_ Gt+1] \_ Â°7(it \_ Et7rt+1 \_ Tim), (4-1) where rf" 5 - log B - A, is the real policy rate required to maintain a constant path for private expenditure (at the steady-state level). lf the spread A, becomes large enough, for a period of time, as a result of a disturbance to the financial sector, then the value of rf" may temporarily be negative. In such a case the zero lower bolmd on it will make (4.1) incompatible, for example, with achievement of the steady state with zero inflation and government purchases equal to G in all periods.

## at: stimulus bad

### at: chinese deficit

#### Government spending doesn’t result in Chinese debt – even if it did, there would be no impact

Harvey 11 – Professor of Economics @ TCU (John, “The Big Danger In Cutting The Deficit,” March, http://www.forbes.com/2011/03/18/deficit-cut-danger-budget-jobs-leadership-managing-employment\_2.html)//AH

There is also a great deal of confusion regarding the role of China in financing the national debt. First, as already mentioned, there was never any economic reason to sell Treasury bills to China. If China and everyone else on the planet decided tomorrow that they didn't want any more, there is no reason why that must act as a constraint on federal spending. We could simply sell the debt directly to the Federal Reserve for the necessary cash (as stated earlier, that's not strictly permitted under current rules, but there's no economic reason not to do it). Second, if China were to suddenly want to "cash out," which for a variety of reasons it is exceedingly unlikely to do, we could easily pay it back with the dollars that we are legally permitted to create. It was already explained above why this is not inflationary, besides which the new money would be in China. And if it caused the dollar to depreciate (which is far from a certainty), then that would increase our exports and decrease our imports--one of the many reasons China would be reluctant to do it! But third and most fundamentally, the debt owned by China is a function of our trade deficit with that country, not of the federal budget deficit. Even if the latter were in surplus, we would still owe as much to China as we do right now. When we import more from China than we export to it, it ends up with a surplus of cash. For example, in December of 2010, we sold roughly $10 billion in goods and services to China while purchasing $30 billion. This gave the country net earnings of $20 billion. Because it had already bought all the U.S. goods and services it wanted, it used the earnings to buy U.S. financial assets. The fact that we had a budget deficit only served to make a particular class of assets abundantly available. Had the U.S. budget been in surplus and we weren't selling new Treasury bills, China would have purchased something else, perhaps the stock of U.S. companies (which might have given it more real control than people assume it has now). As it stands, we can solve our China debt "problem" overnight by buying that debt back with new cash. There is absolutely no reason to do this, but we could. Of course, China would then need to buy something else with those dollars, presumably U.S. private-sector assets. To reiterate, debt to China, private or public, is a function of the trade deficit and has absolutely nothing directly to do with the budget deficit. It will not go away if we balance the budget; it will only change forms. Do we want China owning Treasury bills or Wal-Mart ( WMT - news - people )? As an aside, the trade deficit with China is actually a much more fundamental problem than the budget deficit. Putting hard-working Americans out of work by eagerly buying products from a dictatorship that follows minimal environmental, health and safety standards and then calling what that country does "capitalism" is an insult to the memory of Adam Smith.

### at: deficit

**Stimulus now would solve debt**

**Bloomberg 6-14-12-** Bloomberg Editors(“Less Talk, More Stimulus”, Bloomberg View, June 14, 2012, [http://www.bloomberg.com/news/2012-06-14/less-talk-more-stimulus.html)//sjl](http://www.bloomberg.com/news/2012-06-14/less-talk-more-stimulus.html%29/sjl)

The rationale for additional government spending at this moment is compelling: Interest rates are near a historic low, and long-term unemployment is threatening the future of millions. More than 5 million of the 12.7 million people who are unemployed have been jobless for 27 weeks or more, a higher portion than at any time over the past 60 years. A new paper by former Obama economic adviser Lawrence Summers and Berkeley economist J. Bradford Delong suggests that **under current conditions stimulus could ultimately be self-financing**; it would put people back to work and increase the tax base, thus **reducing the long-run debt burden.**

#### Despite deficit, output and investment means gains are net positive

Corden 11 is an Australian economist. He is mostly known for his work on the theory of trade protection, including the development of the dutch disease model of international trade. (W. Max “Ambulance Economics: the pros and cons of fiscal stimuli” Center for economic policy research feb 12 2011 [http://www.springerlink.com.proxy.lib.umich.edu/content/n88181r14055k5h2/fulltext.pdf)//BM](http://www.springerlink.com.proxy.lib.umich.edu/content/n88181r14055k5h2/fulltext.pdf%29//BM)

1.1 The Basic Theory: The Main Effects and How the Future is Affected I begin with a simple model that is more fully expounded in Corden (2010). The country has a floating exchange rate and starts with an actual or expected output gap. We can think of this gap as being substantial, representing even a depression. The cause is a breakdown in the credit system and the inability of expansionary monetary policy to revive the economy. Hence fiscal policy comes to the rescue. One might call this the story of 2008–09. I shall analyse the effects of a fiscal expansion taking the form of expenditure on infrastructure, which is financed by the sale of bonds on the world or the domestic market. One can also allow for other forms of public expenditure or reductions in taxation. The main point is that there will be a budget deficit, which will increase the public debt. The increased expenditure relative to the recession situation will give rise to a familiar multiplier process, that will revive domestic output and employment and also consumption. As is familiar from Keynesian theory, there will be leakages from the income stream into taxation, imports and savings. The increased tax revenue that results will reduce the extra debt incurred. Assuming that the current account has to stay in its initial balance as extra foreign finance is not available, the leakage into imports will lead to exchange rate depreciation, which will raise exports and reduce imports somewhat, so that any net leakage on that account will end. But there will be a series of leakages into savings that will finally add up to the original net stimulus in the form of the original budget deficit minus the extra tax revenue. Thus the debt incurred will finally be equal to the increase in savings brought about by the fiscal stimulus. Let me label as Period 1 the present period when there would have been a recession (or even Great Depression) if there had not been the fiscal stimulus, while Period 2 is “the future”. No one would deny that in Period 1 there has been a gain as a result of the stimulus, reflected in higher consumption in that period. But what about Period 2? Here it is usual to emphasize the liability for taxpayers which has been created as a result of the debt incurred in Period 1. Hence it seems that there is a gain now (Period 1)) and a cost or loss later (Period 2). I term the emphasis on the later loss “the Conservative Allegation”. Consider now the Period 2 loss. There are actually two qualifications. Firstly, if additional government expenditure in Period 1 has taken the form of capital investment, perhaps in infrastructure, it may yield some benefits in Period 2. This depends on how efficient the investment is. Secondly, the higher savings that have resulted from the original government spending, followed by the multiplier process that raised incomes in Period 1, will enable residents to buy financial assets equal in value to the extra debt. As savers they have more financial assets and as taxpayers they have more liabilities. If they were the same persons these two effects would cancel out. Only the net gain from Period 1 investment would be left. The main point is that, in the absence of the stimulus policy, output in Period 1 would just be lost. This would be the result of the output gap. There is clearly a gain from this extra output. Some of it goes to Period 1 consumers and some is available in Period 2 through the higher savings out of the higher incomes of Period 1. In addition there is a loss to taxpayers in Period 2 owing to the extra debt, and a possible gain through the fruits of Period 1 public investment.

#### Immediate Stimulus combined with long-term deficit reduction is key to save the U.S. economy

**Dr. Orszag 5-30-12** Orszag is vice chairman of global banking at Citigroup and former director of the Office of Management and Budget under President Obama. He has a doctorate from the London School of Economics-(Peter, “U.S. Needs More Stimulus Now, Real Deficit Cuts Later”, Investors.com, May 30, 2012, <http://news.investors.com/article/613108/201205301825/us-needs-stimulus-now-spending-cuts-later.htm?p=full)//sjl>

 Bracing for more economic shocks from Europe, **the** U.S. urgently needs **a barbell fiscal policy. That is,** more immediate stimulus and more deficit reduction that is designed to take effect over time. Unfortunately, policymakers are failing on both sides, mostly ignoring the need for additional stimulus while also becoming enthralled with the wrong kind of future deficit reduction. History shows we are capable of setting up future deficit cuts and sticking to it — as long as the delayed measures are specific and gradual. But it is also possible to set up future budget cuts that have little chance of actually happening and therefore lack credibility. A good illustration of how to do future deficit reduction the wrong way is the Sustainable Growth Rate formula for Medicare, enacted in 1997 to constrain payments to doctors. The SGR places a broad cap on payments without addressing the reasons those payments are rising. If the cap is exceeded, payments are supposed to be simply cut across the board. It's much easier to slap a cap on spending than to make policy changes to constrain that spending. It generally doesn't work, though. Not surprisingly, Congress has repeatedly waived the SGR cap by legislating "doc fixes," temporary patches that cancel the scheduled payment reductions. Although this hasn't fully restored physician payments to what they would have been, the SGR has had much less effect than if it had been fully implemented. This same cap-and-punt approach is at the heart of several bills that the House Budget Committee is addressing this week. Two of these, the Spending Control Act and the Balancing Our Obligations for the Long Term Act, would impose a cap on total government spending as a share of gross domestic product, plus a number of other specific areas of spending. These would be enforced with automatic across-the-board spending cuts (with some specific areas exempted). Like the SGR, these actions avoid making specific policy changes. And the spending cuts are so implausibly large that the automatic cuts will inevitably be waived when the time comes. The Balancing Our Obligations for the Long Term Act, for its part, would limit federal spending to 20% of GDP in 2030, 2040 and 2050. The Congressional Budget Office's alternative fiscal scenario projects spending in 2040 to amount to 37% of GDP. Anyone think we can simply waive our hands and get from 37% to 20%? While it's true the Republican budget plan put forth earlier this year by Wisconsin Rep. Paul Ryan would theoretically get us below this 20% of GDP threshold by 2040, it would do so only by taking the cap-and-punt approach to a new level. The heart of the Ryan plan is to put caps on key types of federal spending and just hope for the best. Look, **for example, at how Ryan would trim the cost of Medicare and Medicaid, which are the primary drivers of our long-term deficits. He would change Medicare into a premium-support program, in which the federal government would make fixed payments to each beneficiary. Looks good on paper for the government ledger, but the Congressional Budget Office has estimated that this plan would lead to massive increases in total health-care spending because personal costs would rise much faster than government costs would fall.** (The overall increase occurs because reductions in health spending from increased cost sharing are modest and because, under the Ryan plan, administrative costs are higher and negotiating leverage with hospitals is less.) As for Medicaid, Ryan would turn it into a block-grant program. That would cap federal government spending, but leave state governments to pick up the slack. Neither approach is likely to be sustainable unless policy makers also adjust the health-care payment system to constrain costs. Ryan would adopt the same approach for revenue. He would cut tax rates dramatically while promising that revenue would be maintained at 19% of GDP by scaling back on tax breaks. But he doesn't identify which tax exemptions he would eliminate. The whole Ryan budget is thus effectively a super-SGR, with simplistic caps but no specific measures that could make those caps plausible. The fiscal cliff the nation will reach at the end of this year — as tax cuts expire, broad spending reductions come due and we again come up against the debt limit — provides an opportunity for both parties to do better. The coming debate should focus on substantial expansion of stimulus, via automatic stabilizers, with specific and credible, but delayed, deficit reduction.

#### **Stimulus spending solves immediate economic concerns that outweigh and solve deficit reduction**

Gale, 10 – co-director of the Urban-Brookings Tax Policy Center (William G., “Five Myths About Cutting the Deficit,” The Washington Post, 11/29/2010, http://www.brookings.edu/research/opinions/2010/11/29-deficit-myths-gale)//HK

The Rivlin-Domenici plan proposes higher near-term deficits as a means of economic stimulus, to be followed by cuts down the line. Some may see this as Washington-style "business as usual" - always putting off cuts until tomorrow - but it makes sense economically. With the recovery stalling, spending more and taxing less now to get the economy going is perfectly consistent with the need for medium- and long-term fiscal discipline. A strong economy can do the budget a lot of good by boosting tax revenues and reducing spending on unemployment benefits and other need-based programs. As always, there is a balancing act between immediate and longer-term concerns. Fiscal responsibility requires that we spend stimulus funds wisely on projects with the biggest bang for the buck. According to the Congressional Budget Office, these would include infrastructure spending, aid to the states, higher unemployment benefits, hiring credits and a payroll tax holiday. The other key to a responsible stimulus package is timing. Short-term stimulus cannot become long-term policy. Congress should explicitly legislate an end date for any new stimulus and couple it with a medium-term deficit-reduction package. Together, these policies would do more to spur the economy and curb the deficit than either would alone.

#### Debt isn’t a reason to reject stimulus projects

Corden 11 is an Australian economist. He is mostly known for his work on the theory of trade protection, including the development of the dutch disease model of international trade. (W. Max “Ambulance Economics: the pros and cons of fiscal stimuli” Center for economic policy research feb 12 2011 <http://www.springerlink.com.proxy.lib.umich.edu/content/n88181r14055k5h2/fulltext.pdf>)//BM

It is well known that most or all developed countries have a long-term potential public debt problem for demographic reasons. Most or all countries need pension and health reforms that have not yet taken place, but that will be needed if public solvency is not eventually to be at risk. Some countries had even before the crisis very high ratios of public debt to GDP, notably Japan and Italy. Fiscal stimuli and related policies that are likely to be pursued for two to 3 years will clearly intensify this problem. This problem becomes even more evident when ratios of prospective budget deficits relative to GDP for the next few years are calculated. For example, for the United States this ratio was 2.9% in 2007, and (in March 2009) was forecast for 2010 at nearly 9%. (and since then higher figures have been cited). For the United Kingdom it was expected to rise from 2.7% in 2007 to 11% in 2010. An excellent IMF document, namely International Monetary Fund (2009), discusses in detail this whole issue of the outlook for public finances of the various forms of fiscal stimulus and other interventions and effects resulting from the crisis. It is full of useful facts and estimates, which I do not reproduce here. I will just note two important conclusions. Firstly, one needs to get the fiscal effects of the current crisis in perspective relative to the pre-existent long-term problems. These effects of the crisis will only last for a few years, and hence are much less important than the long-term effects of the well known demographic changes. For the 12 advanced countries that are members of the G20 group, the report calculates the “net present value of impact on fiscal deficit” of crisis and of agerelayed (demographic) spending. (See Table 11, p. 45 of International Monetary Fund, 2009). Of course these are only estimates, but—to sum up—for the group as a whole the burden of the crisis is only about 5% of the total (age-related plus crisis) burden. The reason is that the demographic effects will last for a long period while the crisis effects are a matter of a few years. Looking at figures for particular countries, the figure is 6.4% for the US, 7.9% for the UK, and about 5% for Australia, Germany and Spain. For Japan it is 15%. The other conclusion, strongly supported in various IMF documents, is that concern with the adverse long-term effects on public debt of fiscal stimulus policies should not lead such policies to be ended or modified prematurely. Taking all effects discussed in this paper into account there is highly likely to be a net benefit from fiscal stimulus policies. In particular the IMF has urged that countries should not switch to fiscal consolidation—which of course is eventually needed because of the demographic effects—until the current crisis is clearly past. Thus, premature departure from fiscal stimulus should be avoided. Every country is a special case, and it may well be that Australia is ahead of the pack. But one should remember the adverse effects of premature fiscal tightening in the US that led to the 1937 recession, and also several short episodes of fiscal tightening in Japan, which always led to recessions, discussed in Koo (2008).

### at: taxation

#### Benefits from stimulus outweighs costs of taxation—stimulating employment is key to prevent global war

Corden 11 is an Australian economist. He is mostly known for his work on the theory of trade protection, including the development of the dutch disease model of international trade. (W. Max “Ambulance Economics: the pros and cons of fiscal stimuli” Center for economic policy research feb 12 2011 <http://www.springerlink.com.proxy.lib.umich.edu/content/n88181r14055k5h2/fulltext.pdf>)//BM

The principal future cost not taken into account in the preceding analysis is that of the need to increase taxation because of the bigger public debt stock. The fiscal stimulus has provided the community as a whole with the extra financial resources to pay this tax— namely through the extra savings that the stimulus made possible. The extra economic cost consists only of the administrative and possible distortion costs (such as disincentive costs if based on income tax) of extra taxation. One might also add a political or “perception” cost. Taxpayers will forget that they owe their extra financial assets to the savings that they made only because of the rise in their incomes resulting from the stimulus. These resources, of course, are only “extra” relative to the true counterfactual, namely a period of deep recession in Period 1. But people may forget this, and may take their financial resources as given, and thus resent the taxes. I would put heavier weight on the future (Period 2) benefits from a fiscal stimulus which are not mentioned in the previous section. These are the benefits from avoiding a depression in Period 1. Here we need only think of the Great Depression. What harm did it do that lasted into later years? First, prolonged and severe unemployment lead to a loss of human capital, in the form of work experience and the confidence that goes with it. Secondly, the Great Depression led to popular support for anti-capitalist (or anti-free market) policies that in some countries went well beyond the need for them—an argument that should appeal to conservatives— and finally it led to social unrest, xenophobia, and finally to Hitler and the second world war.

### at: neoclassicism

#### **Prefer higher infrastructure multipliers—superior Keynesian theories**

Hall, 10 – professor of economics at Stanford University (Robert E., “Fiscal Stimulus,” Daedalus p. 83, fall 2010, Academic OneFile)//HK

The financial press equates the term Keynesian to advocacy of fiscal stimulus to offset recessions, while among economists, Keynesian refers to the adoption of some principles of behavior of the aggregate economy that are not neoclassical. There are plenty of Republican Keynesian economists these days. Even libertarians--numerous among economists if not in the population in general--can be Keynesian. The popular and professional meanings interact. Because Keynesian principles lead to higher estimates of multipliers, fiscal stimulus is more effective in a Keynesian than in a neoclassical world.

It is useful to start with the neoclassical analysis of the effect of infrastructure stimulus in order to illustrate its limitations and the need for Keynesian features. The neoclassical model gives prices and wages free rein to cushion against shocks and prevent unemployment. An increase in infrastructure spending raises the interest rate, which causes workers to choose longer hours of work. The future tax increase that will finance the spending also raises hours of work because workers choose to offset some of the loss of purchasing power due to higher taxes by raising their earnings. Investment and consumption fall because of the tax and interest-rate effects. Total output rises, but by only a fraction, about 30 percent, of the increase in infrastructure spending. The multiplier is just 0.3. Displacement of private spending by public spending is a substantial issue, though it is not complete, as some economists have claimed. The critique that appears in The Wall Street Journal whenever fiscal stimulus is under consideration is on point in a neoclassical economy: stimulus spending drives up the interest rate and displaces private investment.

What is wrong with the neoclassical model? First, it neglects unemployment. It has taken a long time, but modern economics finally has a theoretically respectable and empirically reasonable view of unemployment. Adding unemployment to the neoclassical model has the expected effect of raising the multiplier. A primary reason for the low neoclassical multiplier is that, in the neoclassical economy, stimulus results in more output because people feel that they are worse off under the burden of taxation and because a higher interest rate rewards immediate work by increasing the amount of deferred consumption from an hour of current work. Neither of these effects is strong, according to a large body of research on household behavior. Factoring in unemployment, governed by a model that emphasizes employers' incentives for job creation, adds a powerful third force. A stimulus draws workers out of unemployment and puts them to work. The multiplier is substantially larger with this important modification, at around 0.6.

The second reason that the neoclassical model delivers a low multiplier is that it lacks an amplification mechanism based on sticky or rigid prices. Sticky prices are the hallmark of modern thinking that calls itself Keynesian. (In fact, to distinguish itself from older ideas, this vibrant modern school calls itself New Keynesian.) Amplification works in the following way: At all times, the economy is held back because of pervasive market power. The suppliers of productive inputs--labor and capital--receive inefficiently low rewards because businesses extract profits derived from market power prior to passing on their revenue to labor and capital suppliers. At all times, the economy produces less than it could. But when a stimulus expands the economy and drives up the rewards to labor and capital while prices do not respond because they are sticky, the price/cost margin contracts. In effect, the economy becomes more competitive. Rewards to labor and capital improve and the economy expands more than it would in the neoclassical model, where prices are flexible. Without invoking an unreasonable extent of price stickiness, a model that includes both unemployment and sticky prices can deliver a multiplier around one.

Are prices sufficiently sticky to generate substantial amplification? Research on this topic has been intense in the past decade. The Great Recession has generated a raft of new evidence on how prices respond to slack, as the economy had unprecedented slack in 2009. In a flexible-price economy, prices should fall in times of slack, as merchants cut prices to take business away from their rivals and to take advantage of the lower cost of inputs. But prices hardly fell at all as the economy collapsed. Table 2 presents data for categories of output that declined from the end of 2007 to the end of 2009. The most striking example of a sticky price is in the category of business equipment: although output declined at 9.1 percent per year, the price actually rose slightly.

Although prices seem to be quite sticky, research has not so far been able to document that market power increased during this or earlier contractions. Evidence that the economy becomes less competitive in a recession is only circumstantial.

We teach college freshmen quite a different version of the Keynesian explanation of the multiplier. There is no mention of unemployment, variable market power, or interest rates. Instead, when the government spends more on infrastructure, income rises, consumers spend more, income rises further, and so on. The multiplier expresses the cumulation of this process; it depends on the feedback operating through the propensity of consumers to spend more when their incomes rise. A high propensity to consume is not required for a modern model, based on the two key elements of unemployment and amplification, to generate a reasonable multiplier. Some investigators have included fairly high values of the propensity to consume in their models, but the mechanism described in freshman economics has little to do with the numerical value of the multiplier in most models in use today.

### at: no consumer spending

#### **Stimulus boosts consumption—empirics disprove their theories**

Galí et al., 05 – professor of economics at MIT (Jordi, “Understanding the Effects of Government Spending on Consumption,” National Bureau of Economic Research, August 2005, http://www.nber.org/papers/w11578)//HK

1 Introduction

What are the eﬀects of changes in government purchases on aggregate economic activity? How are those eﬀects transmitted? Even though such questions are central to macroeconomics and its ability to inform economic policy, there is no widespread agreement on their answer. In particular, though most macroeconomic models predict that a rise in government purchases will have an expansionary eﬀect on output, those models often diﬀer regarding the implied eﬀects on consumption. Since the latter variable is the largest component of aggregate demand, its response is a key determinant of the size of the government spending multiplier.

The standard RBC and the textbook IS-LM models provide a stark example of such diﬀerential qualitative predictions. The standard RBC model generally predicts a decline in consumption in response to a rise in government purchases of goods and services (henceforth, government spending, for short). In contrast, the IS-LM model predicts that consumption should rise, hence amplifying the eﬀects of the expansion in government spending on output. Of course, the reason for the diﬀerential impact across those two models lies in how consumers are assumed to behave in each case. The RBC model features inﬁnitely-lived Ricardian households, whose consumption decisions at any point in time are based on an intertemporal budget constraint. Ceteris paribus, an increase in government spending lowers the present value of after-tax income, thus generating a negative wealth eﬀect that induces a cut in consumption.

1 By way of contrast, in the IS-LM model consumers behave in a non-Ricardian fashion, with their consumption being a function of their current disposable income and not of their lifetime resources. Accordingly, the implied eﬀect of an increase in government spending will depend critically on how the latter is ﬁnanced, with the multiplier increasing with the extent of deﬁcit ﬁnancing. 2

What does the existing empirical evidence have to say regarding the consumption eﬀects of changes in government spending? Can it help discriminate between the two paradigms mentioned above, on the grounds of the observed response of consumption? A number of recent empirical papers shed some light on those questions. They all apply multivariate time series methods in order to estimate the responses of consumption and a number of other variables to an exogenous increase in government spending. They diﬀer, however, on the assumptions made in order to identify the exogenous component of that variable. In Section 2 we describe in some detail the ﬁndings from that literature that are most relevant to our purposes, and provide some additional empirical results of our own. In particular, and like several other authors that preceded us, we ﬁnd that a positive government spending shock leads to a signiﬁcant increase in consumption, while investment either falls or does not respond signiﬁcantly. Thus, our evidence seems to be consistent with the predictions of models with non-Ricardian consumers, and hard to reconcile with those of the neoclassical paradigm.

#### Government spending increases consumer spending twofold

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Panel B shows that private consumption appears to be crowded out in expansions and to be stimulated in recessions by government spending shocks. If we take the ratio of government spending to private consumption for the U.S. (≈ 3.5), a dollar increase in government spending in recessions can increase consumption up to $2.8 with a 90 percent confidence interval of (1.4, 4.2). Although some may consider this multiplier as too large to be plausible, note that it applies to a very deep recession and that the average response over three years is about $2. Also observe that the linear model predicts that the maximum response of consumption to a dollar increase in government spending would be approximately $1, which is not small economically but in statistical terms is marginally significantly different from zero. Although we do not have data to explore further the sources of these consumption multipliers, Bachmann and Sims (2011) argue that an important ingredient for stimulating consumption in recessions is the response of consumer confidence to government spending shocks. Bachmann and Sims note that government spending shocks may have pure sentiment effects (i.e., one can think of “animal spirits” shifted by changes in government spending) and news effects when changes in government spending provide signals about future changes in output and productivity. In the U.S. context, Bachmann and Sims find that it is the latter effect that stimulates confidence and hence consumption.

#### No offense—no evidence of substantial negative consumer responses to spending

Galí et al., 05 – professor of economics at MIT (Jordi, “Understanding the Effects of Government Spending on Consumption,” National Bureau of Economic Research, August 2005, http://www.nber.org/papers/w11578)//HK

In the present section we start by summarizing the existing evidence on the response of consumption (and some other variables) to an exogenous increase in government spending, and provide some new evidence of our own. Most of the existing evidence relies on structural vector autoregressive models, with diﬀerent papers using alternative identiﬁcation schemes. Unfortunately, the data does not seem to speak with a single voice on this issue: while some papers uncover a large, positive and signiﬁcant response of consumption, others ﬁnd that such a response is small and often insignificant. As far as we know, however, there is no evidence in the literature pointing to the large and signiﬁcant negative consumption response that would be consistent with the predictions of the neoclassical model. Blanchard and Perotti (2002) and Fat·s and Mihov (2001) identify exogenous shocks to government spending by assuming that the latter variable is predetermined relative to the other variables included in the VAR. Their most relevant ﬁndings for our purposes can be summarized as follows. First, a positive shock to government spending leads to a persistent rise in that variable. Second, the implied ﬁscal expansion generates a positive response in output, with the associated multiplier being greater than one in Fat·s and Mihov (2001), but close to one in Blanchard and Perotti (2002). Third, in both papers the ﬁscal expansion leads to large (and signiﬁcant) increases in consumption. Fourth, the response of investment to the spending shock is found to be insigniﬁcant in Fat·s and Mihov (2001), but negative (and signiﬁcant) in Blanchard and Perotti (2002). Here we provide some complementary evidence using an identiﬁcation strategy similar to the above mentioned papers. Using U.S. quarterly data, we estimate the responses of several macroeconomic variables to a government spending shock. The latter is identiﬁed by assuming that government purchases are not aﬀected contemporaneously (i.e. within the quarter) by the innovations in the other variables contained in a VAR. 8

### at: ricardian equivalence

#### Ricardian equivalence is false—the government doesn’t borrow any money to finance spending, it prints its own

Harvey 11 – Professor of Economics @ TCU (John, “The Big Danger In Cutting The Deficit,” March, http://www.forbes.com/2011/03/18/deficit-cut-danger-budget-jobs-leadership-managing-employment\_2.html)//AH

I have been a professional economist for almost 25 years, but never have I been more concerned about the state of our macroeconomy. Yet it's not so much the current rate of unemployment or GDP growth that has me scared to death; it's the so-called solutions being pursued in Washington. Consider this for a moment: As of January 2011, we had 13.9 million unemployed people in the United States (and note that it takes very little to count as "employed"). Recommended cuts in the federal budget have ranged from tens of billions to hundreds of billions of dollars. In practice, what do these represent? They are at the very least a reduction in the wages of Americans who are currently working, if not outright job loss. This makes them functionally equivalent to a tax increase. Ask yourself this question: How would raising taxes by tens to hundreds of billions of dollars right now lower unemployment and speed recovery? You're right, it wouldn't. In fact, it's not difficult to see that it would make it much worse. Unemployment is not reduced by cutting incomes and destroying more jobs. But that's the policy currently being pursued with great enthusiasm in Washington, and the two parties differ only in degree. We are on the road to economic suicide. The gun is loaded, cocked and aimed squarely at the American worker. The economic illogic of these recommendations runs deep. In the most recent State of the Union address, President Obama likened the federal budget to that of a household. This is a false analogy, the application of which has led us to believe that cutting government expenditures in the midst of the second-worst contraction is economic history is a good idea. It is an invalid comparison on at least two levels. First, households do not print their own money. If you want to buy a big-screen TV and don't have the ready cash, you are forced to find someone willing to loan you the funds. You could try issuing your own currency and bringing it to the store, but I suspect you would not find yourself leaving with a TV (if you do, please let me know where you shop!). The federal government can do this, however. There is no logical reason it needs to "borrow" money from anyone (least of all China, since dollar bills are one of the few things we still make in this country!). The idea that we need to borrow to finance federal budget deficits is a fiction or, as Paul Samuelson called it, a myth. We use it to indirectly constrain Washington in order to make it consider its choices more carefully. But there is no economic logic to it, only political. The Treasury could finance any project by issuing debt that the Federal Reserve then immediately purchased with brand-new cash (though they are presently not permitted to do this, they can come pretty close), meaning that not a single penny is taxed or borrowed from U.S. citizens or companies, China or anywhere else. Nor is this inflationary. If it were, first of all, simply having borrowed the money from China would have already caused inflation. Second, inflation is a far more complex phenomenon than is allowed for in the popular press or in introductory economics courses. The way a modern financial system works, simply creating money does not lead to price increases in the same way it might in a world where gold was the only currency, for example. In the latter, discoveries of gold would increase the money supply regardless of people's wishes. If (and this is a very important "if") the economy were already operating at full capacity, with all willing workers employed, then, indeed, as it spent the newfound gold, inflation would follow, since no more goods or services could be produced. However, first, we are not at full employment (far from it), so a discovery of gold like this would actually have the effect of increasing production and employment, and second, our monetary system doesn't work that way in the first place. The primary tool by which our central bank introduces new money into the economy is the purchase of government debt from the public. This is a voluntary transaction, in the sense that no one who owns that debt is forced to sell it. Thus, it is impossible to create a situation analogous to the discovery of gold mentioned before. Money doesn't get dumped on us and thereby cause inflation. Instead, it is created when agents make portfolio management decisions.

### at: crowd-out

#### **Recessionary stimulus checks crowd-out—increased output**

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5. Concluding remarks During the Great Recession, countries around the world adopted expansionary fiscal policies aimed at counteracting the large negative shocks to their economies. These actions occurred in spite of skepticism among many economists about the potential of fiscal policy to stimulate economic activity. In the United States, at least, the stage for this active course for fiscal policy was already set by earlier policy developments, which showed a marked increase in fiscal policy activism earlier in the decade (Auerbach and Gale, 2009).

The results in this paper and those in our earlier one suggest that fiscal policy activism may indeed be effective at stimulating output during a deep recession, and that the potential negative side effects of fiscal stimulus, such as increased inflation, are also less likely under these circumstances. These empirical results call into question the results from the new Keynesian literature, which suggests that shocks to government spending, even when increasing output, will crowd out private economic activity. While there has been some recent progress 23 providing a rationale for large multipliers when economies confront a binding zero lower bound on interest rates, our findings apply to more general recessionary conditions, and thus present a challenge for the development of new models that, like the simple traditional Keynesian model, can encompass positive fiscal multipliers for private activity.

#### The private sector is reliant on government stimulus – it can’t generate employment and investment alone

Harvey 11 – Professor of Economics @ TCU (John, “Why the Private Sector NEEDS the Government to Spend Money” 4-28, http://www.forbes.com/sites/johntharvey/2011/04/29/why-the-private-sector-needs-the-government-to-spend-money/)//AH

That leaves investment and government spending as the real engines of growth, and this is why I highlighted them in green. They are the forces that drive the business cycle rather than follow it. Businesses and the government together determine whether or not we are in rapid expansion or the depths of depression. This chart illustrates the point: US GDP If you can’t see it clearly, just select this link: US GDP Growth and Causes since 1950 It compares quarterly US GDP growth rates (green) from 1950Q1 to 2011Q1 to the average of the growth rate of investment plus that of government spending (red; the government contribution is weighted by 1.6 to represent it’s relative weight over the time period–in other words, government spending is 1.6 times as large as investment, so it should count more heavily). It’s a very tight fit in terms of when they peak and valley. Note that the scales on each axis are different, but I tried to line up the zeros (which turned out to be a royal pain–I’m not sure I quite nailed it). Note that this means that if there were no government sector, then the job of driving economic activity would be left to investment alone. This is similar to the situation we faced before WWII, when the government was tiny compared to the rest of the economy. The problem is, firms can build new capacity (i.e., invest) relatively quickly so that, ironically, at the very moment we have our greatest ability to produce goods and services, investment falls, layoffs occur, and we slip into recession. This is an absolutely critical point. It is covered in much more detail here: What Causes the Business Cycle Productivity increases have meant that, since the early 20th century, the private sector alone has been unable to generate sufficient opportunities for employment to hire everyone who is willing to work–despite our ability to produce plenty of output for them. Capitalism can do a decent job in terms of allocating resources, creating new technologies, developing innovative products, et cetera (not that it always does, of course, but that’s a different discussion). But what it is incapable of doing is generating sufficient employment for all those willing to work. It will do so in spurts, but that’s it. We are just too damn productive which means that we don’t need to hire everyone who wants a job in order to create sufficient output for them. This is the key issue we face. The severity of this problem has been greatly diminished by the fact that WWII, which effectively ended the Great Depression (and left us with far more debt that we have today, incidentally), led to growth in the government sector that only slightly reversed itself once peace came. This created an automatic counterbalance to the fluctuations in investment that I am saying are so important. Consider the following: when the economy slumps, this lowers tax revenues (because people have less money) and raises, without any legislation being necessary, government spending (because, with the lower level of economic activity, more people qualify for unemployment and income assistance). Since investment is a major driver of the business cycle, look at what happens: fall in investment => fall in GDP => increase in government spending The last entry at least partially compensates for the first, which makes recessions less severe and lengthy. This has dampened, if not eliminated, the effect of the private sector’s instability since WWII. And it works in reverse, too: rise in investment => rise in GDP => decrease in government spending Hence, as the economy grows, so the government budget tends toward balance (as it did at the end of our longest peacetime expansion in the 1990s). But, and this is terribly important for today, the line of causation does not run in the opposite direction!!! It is not true that lowering government spending has a tendency to increase investment. Unfortunately, this appears to be the basis of a great deal of policy in Washington today (assuming there is any economic logic to it at all). Taking discretionary action to cut spending now will be an absolute disaster. We haven’t even started doing that with any gusto yet, and look at the results from 2011Q1. And, just today, President Obama signed a bill that cut $38 billion from the government budget, while the house passed one reducing government spending by $6.2 trillion over the next decade. This is absolute insanity. What do these people think is going to happen? Something that appears to be completely lost in this discussion is that every cut in government spending represents a reduction in someone’s income. It has the same effect as an increase in taxes. How is this going to excite entrepreneurs about investing? Interest rates are already ridiculously low and workers come at a bargain-basement price (as they always do when unemployment is high). And yet look at investment over the past few years (even before the run up in oil and commodity prices had hit epidemic levels): US Investment and Unemployment Here is a link to see it in more detail (note that I went back to 2000 to give a bit more context–the Great Recession started in December 2007): US Investment and Unemployment To be sure, there has been some recovery in investment (the blue line), but it has also backtracked and we are a long, long way from the levels that were generating around 4.5% unemployment (the red line) back in early 2007. We can’t really do much more to realistically lower firms’ costs, and that’s not the problem anyway–businesses know damn well that investing right now would be a complete waste of time (as were QEI and QEII, incidentally, because they were aimed at lowering borrowing costs–that was never the problem). Sales aren’t going to be brisk when 13.5 million of your customers are unemployed and many more underemployed or discouraged. That is the major obstacle to economic recovery. The government’s plan? More layoffs and wage reductions. This is supposed to encourage entrepreneurs to take the risks about which they are reluctant at the moment. If that seems illogical to you, it’s because it is. It’s sheer lunacy. What we saw from 2011Q1 is just a taste. It’s going to get much worse. The private sector needs the injections of income that will create profits for those entrepreneurs and induce them to invest. Instead, we are about to further impoverish their potential customers.

#### Public sector investment is the only way to spur full employment

Harvey 11 – Professor of Economics @ TCU (John, “The Big Danger In Cutting The Deficit,” March, http://www.forbes.com/2011/03/18/deficit-cut-danger-budget-jobs-leadership-managing-employment\_2.html)//AH

The second fundamental difference between a household budget and that of the federal government is that the former does not have the means or responsibility to stimulate the macroeconomy to the point that it employs all willing workers. This is an absolutely key point that has been almost entirely ignored. As technology allows us to become increasingly productive, it creates a cruel irony. On the one hand, we develop the capacity to produce more sophisticated and efficient products for all of us to enjoy. On the other, we are able to do so by employing fewer and fewer people. Those without jobs, even though they are willing to work, must go without despite the fact that we have the capacity to meet their demand. If the government did not act to supplement this, then we would find ourselves in a constant state of poverty amid the capacity for plenty--just as we did in the Great Depression (and as we do to a lesser extent right now). The market can't correct this on its own. We have no right to expect entrepreneurs to hire more workers than they need or consumers to buy more televisions than they want. Entrepreneurs' goal is to find low-cost ways to satisfy consumer demand, not generate a jobs for all those who want one. The federal government, however, is in a perfect position to do this, and when it does so it is a net gain for everyone. Say it takes an unemployed worker and makes him a soldier. As already explained, paying him requires neither a borrowing nor additional taxation (indeed, the latter would be counterproductive, just as cutting expenditures is right now). The government could create new money and the result would be an increase in income for everyone, including those in the private sector. Those who had already been employed would give up nothing. They'd be able to enjoy the same number of goods and services as before, since we were never at full capacity. Plus, they'd now have all that and protection against foreign aggression. The soldier would obviously be better off, since he'd now have money in his pocket and be able to buy the goods and services society was always able to produce. And entrepreneurs would get higher sales, which they obviously like, and might even find it necessary to hire more workers to meet the new demand. All net gains, every single one, because the economy was at less than full employment--a place where the market system tends to leave us. A secondary lesson here is that not only can the federal government spend in deficit forever, but it must do so if the private sector is to reach its full potential. Deficits raise the level of private wealth while surpluses, representing as they do an excess of government taxation over spending, necessarily drain wealth from private citizens and firms. It is no coincidence that the Clinton surpluses coincided with massive increases in private-sector debt. It's simple math. The government is not a household, and you cannot apply the same logic without disastrous consequences. We went through this same debate in the 1930s, and it was only settled by Pearl Harbor, when suddenly deficits that put our present one to shame were viewed as absolutely right and just--and the economy hardly collapsed then or in the postwar era.

#### The private sector creates unemployment because it lacks demand

Harvey, 11 – Professor of Economics @ TCU (John, “How to Destroy the US Economy? Balance the Budget,” 6-5, <http://blogs.forbes.com/johntharvey/2011/06/05/how-to-destroy-the-us-economy/>)//AH

How the Private Sector Creates Unemployment This is probably the single most overlooked issue when it comes to discussing the debt and deficit. One cannot truly understand the role of the federal budget without an explicit recognition of the following structural problem: the private sector does not generate sufficient demand to make it profitable to hire everyone who is willing to work. Consumers do not want more, more, more. They reach a point, as do firms, when they are satisfied, where they don’t want another big-screen TV, house, car, evening out, et cetera. This tends to happen at the end of economic expansions (the Roaring Twenties, for example), which is why they then become recessions. (For more on the latter, see: Why Do Recessions Happen? A Practical Guide to the Business Cycle.) Once the recession is underway, not only do incomes fall, but households and firms will opt to spend an even smaller percentage of these smaller incomes. Downturns, therefore, can be very difficult to escape by relying on the private sector alone. Note that meanwhile, there has been no change whatsoever in our ability to produce goods and services! There was no technological reason, for example, for the suffering during the Great Depression. We had the ability to continue to produce output at the 1920s level; what was missing was sufficient demand to hire everyone willing to work. As a consequence, living standards collapsed. That’s where the system breaks down, as it did in October 1929 and December 2007.

## at: inflation

### at: causes inflation

#### Government spending doesn’t lead inflation – current under-employment means that printing new money solves and is normal means

Harvey 11 – Professor of Economics @ TCU (John, “The Big Danger In Cutting The Deficit,” March, http://www.forbes.com/2011/03/18/deficit-cut-danger-budget-jobs-leadership-managing-employment\_2.html)//AH

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The gun is loaded, cocked and aimed squarely at the American worker. The economic illogic of these recommendations runs deep. In the most recent State of the Union address, President Obama likened the federal budget to that of a household. This is a false analogy, the application of which has led us to believe that cutting government expenditures in the midst of the second-worst contraction is economic history is a good idea. It is an invalid comparison on at least two levels. First, households do not print their own money. If you want to buy a big-screen TV and don't have the ready cash, you are forced to find someone willing to loan you the funds. You could try issuing your own currency and bringing it to the store, but I suspect you would not find yourself leaving with a TV (if you do, please let me know where you shop!). The federal government can do this, however. 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Second, inflation is a far more complex phenomenon than is allowed for in the popular press or in introductory economics courses. The way a modern financial system works, simply creating money does not lead to price increases in the same way it might in a world where gold was the only currency, for example. In the latter, discoveries of gold would increase the money supply regardless of people's wishes. If (and this is a very important "if") the economy were already operating at full capacity, with all willing workers employed, then, indeed, as it spent the newfound gold, inflation would follow, since no more goods or services could be produced. However, first, we are not at full employment (far from it), so a discovery of gold like this would actually have the effect of increasing production and employment, and second, our monetary system doesn't work that way in the first place. The primary tool by which our central bank introduces new money into the economy is the purchase of government debt from the public. This is a voluntary transaction, in the sense that no one who owns that debt is forced to sell it. Thus, it is impossible to create a situation analogous to the discovery of gold mentioned before. Money doesn't get dumped on us and thereby cause inflation. Instead, it is created when agents make portfolio management decisions. To make this more clear, consider a brief example of how inflation really works. Recall the worst episode of inflation in U.S. economic history, that of the 1970s and early 1980s. What happened, of course, was that the OPEC oil cartel cut supply in order to drive up prices. The increases went well beyond oil, because of the central role played by energy in our economy. The money supply most certainly did increase, but in response to these events and not as a causal factor. Businesses (especially banks) and households freely offered to sell Treasury bills to get the cash they needed to pay the higher prices caused by the OPEC oil embargo. The Federal Reserve, recognizing that these were legitimate and even desperate needs, accommodated by buying them, and the money supply rose. This is not to say that increases in the money supply cannot cause inflation. However, not only are the conditions under which they would do so uncommon, but one of the key ones would be that we were already operating at or near full employment. That hardly describes where we are today. Creating new money--which we do all the time, of course, as the money supply is constantly growing--is not in and of itself inflationary, particularly in a time of high unemployment. Thus, the federal government's budget is unlike your household one, because it issues its own currency. It can fund spending without taxes or borrowing, and without causing inflation. Those who argue otherwise are either operating with economic models developed in the 18th or 19th century or they are buying into President Obama's State of the Union address analogy (or have an ulterior motive). But it simply isn't true.

#### Deficit spending doesn’t lead to inflation, austerity does

Green, 12– Broker, Economics @ Santa Barbra, As Editor/Publisher of Popular Economics (Harlan, “Where is the Inflation” Feb 15, http://populareconomicsweekly.blogspot.com/2012/02/where-is-inflation.html)//AH

If we would listen to the Europeans advocating austerity measures to punish Greece and Italy in particular for their profligacy, then inflation is right around the corner, according to the Germans, at least. Germany’s Finance Minister Wolfgang Schaubele is the most hawkish in advocating that the Greeks won’t get the next installment of their rescue package unless they shave off 130M euros in spending cuts to bring down their some 400M euros in debt. Herr Schaubele is the principal advocate of what Paul Krugman calls the “confidence fairy”. The confidence fairy is the myth that too much debt causes the loss of confidence in a sovereign currency, driving up interest rates and inflation, even during recessions. It is the rationalization extreme fiscal conservatives use to justify their ideology that all debt is bad (though it is their wealthy supporters who do the most lending), and so debtors must be punished for their borrowing. That is behind Herr Schaubele’s attempts to drive Greece out of the euro by insisting on such draconian austerity measures that Greece cannot possibly fulfill. Herr Schaubele’s efforts have succeeded instead in pulling several EU countries back into recession, as prices and output are falling, which is what one would expect, because such austerity measures cause a huge drop in incomes, and so any stimulus to grow economies. Great Britain, Ireland, Italy the Netherlands, and Spain are just a few countries suffering from its effects. “We doubt that the euro zone will be able to avoid further contraction in the first quarter and very possibly the second as well in the face of tighter credit conditions, a further tightening in fiscal policy in many countries, the ongoing pressures facing consumers (high and rising unemployment, and still squeezed purchasing power) and limited global growth,” said Howard Archer, chief European economist at IHS Global Insight, said in a Marketwatch interview. Economists have been discussing the dangers of inflation since the beginning of economics, but don’t really spell out that there are at least 2 kinds of inflation. There is consumer inflation measured by such as the Consumer Price Index, and there are many commodity price indexes that measure asset inflation. Consumer price inflation was nonexistent in December at the headline and core levels. The consumer price index in December was unchanged for the second month in a row with lower energy costs playing a key role. Excluding food and energy, the core CPI decelerated to a modest 0.1 percent increase after gaining 0.2 percent in November, and is up just 2.2 percent year-over-year. For the U.S., commodity prices are best measured by the U.S. Producer Price Index for producer goods, which at the producer level in December was tugged down by gasoline and food costs but the core was warmer than expected. Producer prices edged down 0.1 percent after rebounding 0.3 percent the prior month. The two are not necessarily related, because producers cannot always pass on their costs to consumers, though economists still take sides. The so-called monetarists, or neo-classicists tend to be fiscal, small government conservatives that believe all economic activity depends on the size of the money supply. And government should not be in the business of boosting the money supply with stimulus, which only causes more inflation. Whereas Keynesians, or neo-Keynesians, believe that there is really no danger of inflation as long as unemployment is high, which happens during recessions. That’s because consumers who power some 67 percent of aggregate demand cannot create inflationary pressures as long as personal incomes, wages and salaries and the like are stagnant. In fact, Keynesians maintain from their Great Depression experience that the overall money supply doesn’t increase during recessions, but is hoarded, causing deflationary pressures. And deflation is the hardest to root out, as Japan found out since their bubbles burst in 1990. In fact, corporations are the largest hoarders of cash (some $2 trillion to date), so don’t expect much hiring from them.

### inflation good—investment

#### Inflation is good – it stimulates investment and reduces debt burdens

Baker, 10 - economist and Co-Director of the Center for Economic and Policy Research (Dean, “Feel No Pain: Why a Deficit In Times of High Unemployment Is Not a Burden” http://129.132.57.230/serviceengine/Files/ISN/121973/ipublicationdocument\_singledocument/7884a664-f053-4506-9a14-35332c859dc1/en/2010-09\_FeelNoPain.pdf)//AH

Suppose the Federal Reserve Board were to buy and hold the additional bonds issued to finance a larger stimulus package. For example, suppose the government borrowed an additional $800 billion (beyond what is currently projected) in both fiscal years 2011 and 2012 to pay for more stimulus. The Fed could simply buy up these bonds by issuing more reserves. There is little need to fear that this injection of more reserves into the banking system would lead to inflation in the current situation, since the economy has an enormous amount of unemployed labor and idle resources. Furthermore, it would be beneficial to the economy if the Fed’s actions did lead to somewhat more inflation. A higher rate of inflation would reduce the real interest rate, making firms more willing to invest. If inflation rose to a 3.0-4.0 percent range, then it would mean that firms could expect to sell products they produce in 4-5 years at prices that are far higher than current prices. (A 4 percent inflation rate implies that prices will be 20 percent higher in 5 years, before taking into account compounding.) If firms know that they will be able to sell their output at much higher prices in the near future, then it will be far more profitable to invest today. In the same vein, a higher rate of inflation will reduce debt burdens. If wages rise in step with inflation, and inflation averages 4.0 percent over the next 5 years, then wages will be approximately 20 percent higher 5 years from now. This will reduce the burden of mortgages or other debts where the size of the monthly payment remains fixed. In addition, if house prices rise in step with inflation, then a higher rate of inflation will translate into additional home equity (as the value of homes rises, the size of mortgages will remain unchanged). For these reasons, any inflation that resulted from the Fed’s decision to buy large amounts of debt at present would be a plus for the economy rather than something to be feared. If inflation threatened to get out of control, then it would be a serious problem, but there is little possibility that this could happen given the depth of the downturn. Furthermore, inflation does not just begin skyrocketing overnight in developed economies. Inflation increases gradually in response to excess demand. If there was evidence that tight labor markets or bottlenecks in production were creating inflationary pressures, then the Fed would have plenty of time to reverse course and adopt policies to slow the economy. In short, the decision to buy large amounts of debt at present holds little risk

### inflation good—housing

#### Inflation incentivizes increased investment, boosts housing market—no adverse effects—data proves

**The Guardian 6-18-12**-(Dean Baker, “What Ben Bernanke and the Federal Reserve can do to save the US economy”, The Guardian, June 18, 2012, http://www.guardian.co.uk/commentisfree/2012/jun/18/ben-bernanke-federal-reserve-us-economy)//sjl

If there is a clear need for more rapid growth, the data also show there is no downside risk of excessive inflation. The consumer price index fell 0.3% in May. It has risen by just 1.7% over the last year. (The core index rose 0.2% last month and is up 2.3% over the last year.) Of course, many of us have argued that higher than normal inflation would be desirable, in any case. It would reduce real interest rates in a world where the Fed has already pushed the nominal federal funds rate as low as it possibly can. That would provide businesses with more incentive to invest. Higher inflation should also help to lift house prices, **helping homeowners to rebuild equity.** However, even if the Fed is unwilling to accept the idea that it should promote higher inflation, as Chairman Ben Bernanke used to recommend back in his days as economics professor, it should at least be confident that the data show no reason to be concerned about inflation exceeding its target.

#### Housing market key to economic recovery

**Dr. Bernanke et al. 12-** Harvard University, Massachusetts Institute of Technology, Harvard College, Head of Federal Reserve(Ben S., “The U.S. Housing Market: Current Conditions and Policy Considerations”, Federal Reserve System, January 4, 2012, [http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf)//sjl](http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf%29/sjl)

The ongoing problems in the U.S. housing market continue to impede the economic recovery. House prices have fallen an average of about 33 percent from their 2006 peak, resulting in about $7 trillion in household wealth losses and an associated ratcheting down of aggregate consumption. At the same time, an unprecedented number of households have lost, or are on the verge of losing, their homes. The extraordinary problems plaguing the housing market reflect in part the effect of weak demand due to high unemployment and heightened uncertainty. But the problems also reflect three key forces originating from within the housing market itself: a persistent excess supply of vacant homes on the market, many of which stem from foreclosures; a marked and potentially long-term downshift in the supply of mortgage credit; and the costs that an often unwieldy and inefficient foreclosure process imposes on homeowners, lenders, and communities. Looking forward, continued weakness in the housing market poses a significant barrier to a more vigorous economic recovery. Of course, some of the weakness is related to poor labor market conditions, which will take time to be resolved. At the same time, there is scope for policymakers to take action along three dimensions that could ease some of the pressures afflicting the housing market. In particular, policies could be considered that would help moderate the inflow of properties into the large inventory of unsold homes, remove some of the obstacles preventing creditworthy borrowers from accessing mortgage credit, and limit the number of homeowners who find themselves pushed into an inefficient and overburdened foreclosure pipeline. Some steps already being taken or proposed in these areas will be discussed below. Taking these issues in turn, the large inventory of foreclosed or surrendered properties is contributing to excess supply in the for-sale market, placing downward pressure on house prices and exacerbating the loss in aggregate housing wealth. At the same time, rental markets are strengthening in some areas of the country, reflecting in part a decline in the homeownership rate. Reducing some of the barriers to converting foreclosed properties to rental units will help redeploy the existing stock of houses in a more efficient way. Such conversions might also increase lenders' eventual recoveries on foreclosed and surrendered properties. Obstacles limiting access to mortgage credit even among creditworthy borrowers contribute to weakness in housing demand, and barriers to refinancing blunt the transmission of monetary policy to the household sector. Further attention to easing some of these obstacles could contribute to the gradual recovery in housing markets and thus help speed the overall economic recovery. Finally, foreclosures inflict economic damage beyond the personal suffering and dislocation that accompany them. These deadweight losses compound the losses that households and creditors already bear and can result in further downward pressure on house prices. Some of these foreclosures can be avoided if lenders pursue appropriate loan modifications aggressively and if servicers are provided greater incentives to pursue alternatives to foreclosure. And in cases where modifications cannot create a credible and sustainable resolution to a delinquent mortgage, more-expedient exits from homeownership, such as deeds-in-lieu of foreclosure or short sales, can help reduce transaction costs and minimize negative effects on communities

### at: inflation causes unemployment

#### No correlation between inflation and unemployment

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One serious problem with this view is that the correlation between unemployment (or other measures of economic “slack”) and inflation is actually very weak. The charts below show inflation and unemployment in the United States over the past several decades. If “slack” and “tightness” drove inflation, we would see a clear, negatively sloped line: Higher inflation would correspond to lower unemployment, and vice versa. But the charts show almost no relation between inflation and unemployment. From 1992 to 2001, inflation and unemployment declined simultaneously. More alarming, from 1973 to 1975, and again from 1978 to 1981, inflation rose dramatically despite high and rising levels of unemployment and other measures of “slack.”’

### solves debt

#### Inflation reduces debt—models, simulations, and empirics prove

Aizenman and Marion, 09 - \*Professor of Economics at UC Santa Cruz AND\*\* Professor of Economics at Dartmouth (Joshua and Nancy, “Using Inflation to Erode the U.S. Public Debt,” University of California Santa Cruz, November 2009, http://www.scn.rain.com/~neighorn/PDF/Using\_Inflation\_to\_Erode\_Debt\_Nov27\_09.pdf)//HK

IV. Conclusion A lesson to take from the model and the simulations is that eroding the debt through inflation is not farfetched. The model predicts that a moderate inflation of 6 percent could reduce the debt/GDP ratio by 20 percent within 4 years. That inflation rate is only slightly higher than the average observed after World War II. Of course, inflation projections would be much higher than 6 percent if the share of publicly-held debt in the U.S. were to approach the 100 percent range observed at the end of World War II. Hence, while moderate inflation may help reduce today's debt burden, it is a much less powerful tool for addressing long-term fiscal challenges. The current period shares two features with the immediate post-war period. It starts with a large debt overhang and low inflation. Both factors increase the temptation to erode the debt burden through inflation.

## indicts

### at: cochrane

#### Cochrane’s analysis is incorrect – its unrealistic and has no empirical basis

Seidman, 11 - Professor of Economics University of Delaware Laurence (Laurence, “Keynesian Fiscal Stimulus: What Have We Learned from the Great Recession?” 2011‐11, http://www.lerner.udel.edu/sites/default/files/imce/economics/WorkingPapers/2011/UDWP2011-11.pdf)//AH

It is illuminating to examine in detail a recent representative exposition of opposition to Keynesian fiscal stimulus by John Cochrane of the University of Chicago who has published op ed articles in the Wall Street Journal as well as technical articles in scholarly journals. His article in the January 2011 issue of the European Economic Review is entitled “Understanding Policy in the Great Recession: Some Unpleasant Fiscal Arithmetic.” He begins the article this way: “I offer an interpretation of the macroeconomic events in the great recession of 2008-2009 and the subsequent outlook, focused on the fiscal stance of the U.S. government and its link to potential inflation. What happened? How did the policies work? Are we headed for inflation or deflation? Will the Fed be able to fight deflation, and follow an ‘exit strategy’ when it’s time to fight inflation? Will large government deficits lead to inflation? If so, what will that event look like?” Note that this paragraph focuses entirely on prices—inflation or deflation--without mentioning real output, employment, or unemployment. But the Great Recession witnessed a plunge in real output and employment and a sharp and sustained rise in unemployment, with little change in the modest inflation rate of the U.S. economy. Cochrane’s entire paper, like his initial paragraph, focuses mainly on prices and largely ignores real output, employment, and unemployment. A section of Cochrane’s paper is entitled “fiscal stimulus.” He begins the section with a revealing paragraph: “Starting in February 2009, the U.S. government engaged in a large ‘fiscal stimulus’ designed to raise aggregate demand, with multi-trillion dollar deficits projected to last many years. The question here is, will these deficits actually ‘stimulate’ as promised, within the fiscal-monetary framework I am exploring?” But the key issue is not whether the fiscal stimulus package would stimulate the economy in Cochrane’s fiscal-monetary framework. What matters is whether the package would raise real output and employment in the actual economy. If Cochrane’s fiscal-monetary framework is unrealistic, it doesn’t matter what the package would do in his framework. Cochrane ignores the simple straightforward Keynesian explanation of how tax cuts and government spending increases are supposed to raise real output and employment when the economy is in recession—namely, that tax cuts and transfers enable consumers to spend more, and in response to this additional demand, producers find it profitable to raise production, employment, and investment in plant and equipment. Instead, Cochrane launches into an explanation in his framework which focuses entirely on rational agents’ expectations of future debt and inflation. He assumes, without any empirical evidence, that actual people will think, “I won’t spend any of this year’s tax cut because I have to save it all in order to be ready to pay the higher future tax that will be made necessary by this year’s tax cut.” He says: “The main argument for real fiscal stimulus is that people disregard future taxes. But is there a voter left in the country who is unaware that taxes are likely to rise?” The real issue, however, isn’t whether people think taxes are likely to rise in the future. The issue is whether, upon receiving a tax cut in a recession, the typical person will decide he must save it all. Cochrane offers no empirical evidence about how the typical person actually thinks and behaves upon receiving a tax cut in a recession. Finally, Cochrane comments on Milton Friedman’s famous “helicopter drop.” He begins with an important correct statement: “A helicopter drop is at heart a fiscal operation. It is a transfer payment. To implement the drop, the Treasury would borrow money, issuing more debt, and write checks. Then the Federal Reserve would buy the debt, so that the money supply increased. Even a drop of real cash from real helicopters would be recorded as a transfer payment, a fiscal operation.” But what, according to Cochrane, would be the impact of such a helicopter drop on an economy in recession? Cochrane’s answer is, “no effect at all.” How does he reach this conclusion? He says: “Suppose a helicopter drop is accompanied by the announcement that taxes will be raised the next day, by exactly the amount of the helicopter drop. In this case, everyone would simply sit on the money.” Why does Cochrane say the announced tax increase would occur “the next day?” Because he is surely correct that many people would wait just one day to see if it’s true before spending their tax cut. From this Cochrane hopes the reader will leap to the conclusion that when taxes are cut in a recession, people will save the entire tax cut to get ready to pay more taxes sometime in the future. But he offers no empirical evidence that people think and behave this way when they receive an actual tax cut in an actual recession.

### at: barro

#### Barro’s analysis fails – he uses data from the wrong timeframe to measure effects of stimulus

Seidman, 11 - Professor of Economics University of Delaware Laurence (Laurence, “Keynesian Fiscal Stimulus: What Have We Learned from the Great Recession?” 2011‐11, http://www.lerner.udel.edu/sites/default/files/imce/economics/WorkingPapers/2011/UDWP2011-11.pdf)//AH

A Fundamental Error in Estimating the Recession Magnitude of the Keynesian Multiplier The Keynesian multiplier is the ratio of the increase in real output to the increase in government spending or tax cut that generates it. Suppose the economy is at full employment and full capacity utilization when the government increases spending or cuts taxes (supported by a monetary stimulus). With hardly any unemployed labor or capital available, real output hardly increase so the multiplier is near zero. By contrast, suppose the economy is in a severe recession with high unemployment and low capacity utilization. Then the increase in spending or tax cut would cause employers to hire unemployed workers and utilize idle machines, thereby increasing real output; hence, the multiplier would be positive. Moreover, the newly employed would enjoy an increase in income enabling them to raise their consumption spending, inducing producers of consumer goods to hire unemployed workers, utilize idle machines, and raise real output, thereby making the multiplier larger. What matters for fiscal stimulus to combat a recession is the size of the multiplier in a recession when unemployment is high and capacity utilization low, not the size of the multiplier in a fully employed economy. Picture an aggregate supply aggregate demand diagram in which the supply curve is initially flat but then curves upward to become steep at the full employment level of output Y\*. When the economy is in severe recession at a low value of real output Y with high unemployment a low capacity utilization, a shift right of aggregate demand (D) can raise real output with only a slight bidding up of wages, costs, and prices, so the aggregate supply (S) curve is relatively flat. But when output is at full employment Y\*, a shift right of aggregate demand curve mainly bids up wages, costs, and prices, with hardly any increase in real output so the aggregate supply curve is steep. Thus, when the economy is in a severe recession, a shift right of the D curve by magnitude ΔD causes a relatively large increase in real output ΔY—hence, the multiplier is large-- but when the economy is at full employment, a shift right of the D curve by the same magnitude ΔD causes a relatively small increase in real output ΔY—hence, the multiplier is small. Thus, it is a fundamental error to estimate the value of the multiplier in a fully employed economy and then assume this value holds when the economy is in a severe recession. Yet Robert Barro makes exactly this error. He tries to estimate a value for the multiplier using data from a fully employed economy and then asserts that this multiplier value would hold when the economy is in a severe recession. Barro summarizes his research in a truly revealing article in a 2009 Economists’ Voice article entitled “Voodoo Multipliers.” Barro begins his article by saying that, according to Keynesians: “If the government buys another airplane or bridge, the economy’s total output expands by enough to create the airplane or bridge without requiring a cut in anyone’s consumption or investment. The explanation for this magic is that idle resources—unemployed labor and capital—are put to work to produce the added goods and services. If there is a social cost, it is only that people who used to be unemployed have less leisure because they are working.” He then writes: “So where is the flaw in the argument? The theory (a simple Keynesian macroeconomic model) implicitly assumes that the government is better than the private market at marshaling idle resources to produce useful stuff. Unemployed labor and capital can be utilized at essentially zero social cost, but the private market is somehow unable to figure any of this out. Implicitly, there is something wrong with the price system. Keynes thought that the problem lay with wages and prices that were stuck at excessive levels. But this problem could be readily solved by expansionary monetary policy…” Barro seems oblivious to the problem confronting expansionary monetary policy in a severe recession when interest rates are already very low. He ignores Samuelson’s 1948 quote given above that you can force money on the system in exchange for government bonds but you can’t make the money circulate against new goods and new jobs, and you can tempt businessmen with cheap rates of borrowing but you can’t make them borrow and spend on new investment goods. Moreover, he ignores the recent literature of macroeconomists who admit there is a serious “zero-bound” problem confronting monetary policy in a severe recession. With interest rates already very low and consumers and businesses pessimistic, many macroeconomists recognize that it is doubtful that monetary stimulus alone can generate a recovery. Barro ignores all this and simply asserts that even in a severe recession: “A much more plausible starting point is a multiplier of zero. In this case, the real GDP is given, and a rise in government purchases requires an equal fall in the total of other parts of GDP—consumption, investment, and net exports…I think this perspective, not the suppose macroeconomic benefits from fiscal stimulus, is the right one to apply to the many new and expanded government programs that we are likely to see this year and next.” Barro continues: “Aside from theory, what is true about multipliers in the data? Because it is not easy to separate movement in government purchases from overall business fluctuations, the best evidence comes from large changes in military purchases that are driven by shifts in war and peace. A particularly good experiment is the massive expansion of U.S. defense expenditures during World War II. This case works well because the United States from 1941 to 1945 did not suffer from the massive destruction of property and life that led to large declines in real GDP in many other countries during WWII. In any event, the usual Keynesian view is that the WWII expansion provided the stimulus that finally got the U.S. economy out of the great Depression.” His last sentence is correct. There was a dramatic reduction in the U.S. unemployment rate from 1939 to 1942 driven by the sharp rise in military and related spending in preparation for a possibly entry into a world war. An analysis confined to 1939 to 1942 might be therefore be useful. Instead, Barro focuses on 1943-44. He writes: “I have estimated (in my book, Macroeconomics, A Modern Approach) that World War II raised U.S. real defense expenditures by $540 billion (1996 dollars) per year at the peak in 1943-44, amounting to 44% of trend GDP. I also estimated that the war raised real GDP above trend by $430 billion per year in 1943-44. Thus, the multiplier was 0.8 (430/540). The other way to put this is that the war lowered components of GDP aside from military purchases.” But by 1942 the U.S. economy was at full employment with a very low unemployment rate. Barro continues: “In an earlier study in the Journal of Political Economy, I got a similar regression-based estimate for the multiplier effect on real GDP from temporary defense purchases—for a sample from 1942 to 1978, the coefficient was 0.71, with a standard error of 0.06.” Why does Barro choose to begin his sample in 1942? By omitting 1939-42 when the U.S. economy moved from high unemployment to full employment, Barro confines his World War II data to the period when the U.S. economy was already at full employment. Unfortunately, Barro is not the only economist who claims to estimate the magnitude of the multiplier in a recession by using data generated in a fully employed economy. There is a large recent literature that regresses the change in real output against the change in government spending or taxes for all quarters in the sample. But only a small fraction of the quarters in the sample are recession quarters, so these studies mainly estimate the value of the multiplier when the economy is not in recession. What matters for Keynesian counter-cyclical fiscal policy, however, is that value of the multiplier when the economy is in recession, not the value of the multiplier in a full employment economy.

# stimulus bad

## stimulus fails/ defense

### mismanagement

#### Governments mismanage projects-no incentive to do it correctly

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Although some have occasionally identified public choice insights in the writings of Hayek and other Austrians, I think that it is fair to say that the public choice school is a separate though complementary intellectual development. Just how complementary it is will be evident once the following list of public choice insights has been outlined.

A central claim concerns “the rationally ignorant voter,” by which I mean the voter who deems it to be in his interest not to stay informed. Since learning the various candidates’ positions on a host of issues is costly and the chances of an election turning on a single voter’s ballot are miniscule, many voters rationally choose not to be very informed about the issues. When one couples this with Bryan Caplan’s argument that public opinion generally favors policies that not only make voters feel good or moral or more American (for example, raising the minimum wage to fight poverty or attributing a rise in gasoline prices to the greed of oil corporations), but also make for policy outcomes that most economists and more educated voters view as pernicious (for example, increasing the incidence of unemployment among the least skilled workers or passing “excess profit tax” legislation that reduces the supply of domestically produced oil),[[30]](http://www.heritage.org/research/reports/2011/02/ten-mostly-hayekian-insights-for-trying-economic-times%22%20%5Cl%20%22_ftn30) it is hard to feel much confidence in the policy that is generated in a democracy. From this perspective, politicians who seek to be re-elected are justified in supplying voters with the policies they want even though they are unsound.

A second claim has to do with the effects of concentrated benefits and diffused costs on policymaking. Politicians frequently pay lip service to “the public good,” but if a politician is to be successful (that is, stay in office), he or she will typically support policy that is aimed at benefiting the well-organized and informed few rather than the unorganized and uninformed many. As a result, legislation tends to favor special interests over the public good, and once a policy is in place, it is nearly impossible to get rid of it.

Public choice theorists believe that politicians, like everyone else, act in their own self-interest. If consumers maximize utility, firms maximize profits, and politicians maximize votes, what do bureaucrats maximize? The answer is troubling: Bureaucrats have an incentive to maximize the size of the bureaucracy under their control. Governments don’t shrink; they grow. Never has the triumph of hope over reality been better illustrated than by the steady stream of politicians who promise to pay for new programs by “reducing waste and inefficiency” in the existing government.

In their wonderfully titled 1977 book Democracy in Deficit,[[31]](http://www.heritage.org/research/reports/2011/02/ten-mostly-hayekian-insights-for-trying-economic-times%22%20%5Cl%20%22_ftn31) James Buchanan and Richard Wagner made the point that democratic politics leads naturally to deficits. Politicians typically insist that they intend to constrain the growth of government spending, but in reality they seldom are able to overcome (and, given the ignorance of the electorate, seldom need to do so) the natural incentives of increasing government spending and decreasing taxes. Can anyone remember a politician who campaigned successfully with a platform of raising taxes?

The past 30 years have demonstrated this to be one of the few areas in which bipartisan endorsement of a basic principle has been nearly complete. For a case study of how difficult it is for politicians to actually cut government spending, even when they have a mandate to do so, one need only consult William Greider’s classic 1981 piece “The Education of David Stockman.”[[32]](http://www.heritage.org/research/reports/2011/02/ten-mostly-hayekian-insights-for-trying-economic-times%22%20%5Cl%20%22_ftn32) While constantly mouthing the rhetoric of balanced budgets, Ronald Reagan offered up instead tax cuts and substantially smaller cuts in government spending and won two terms.

When George H. W. Bush tried to balance the budget by raising taxes, he was excoriated by his own party and served only one term. After that, the policy of cutting taxes but leaving government spending intact became canonized in certain Republican circles under the cynical “starve the beast” philosophy. For a while, it seemed as if the only difference between the two major American parties was that the Democrats favored tax and spend, while the Republicans favored don’t tax and spend. This changed in 2008, when the Democrats began following the Republican mantra in spades. It seems that no one these days, with the exception of Libertarians and Ron Paul, speaks about a smaller government, period.

Another central concept in the public choice literature is the notion of rent-seeking. Firms can compete successfully in two ways: directly, by producing a better product at a lower cost than their rivals, or indirectly, by getting the government to grant them an advantage over their rivals through the granting of subsidies or the imposition of licensing restrictions, taxes, tariffs, or quotas on their competitors. Given an expected level of added profits from getting the government to intervene, a firm would be justified in spending up to that amount in lobbying the government to do so. Such rent-seeking behavior is a waste of resources but takes place all the time. Gordon Tullock once asked: “[W]hy is the level of rent-seeking as small as it is?” Perhaps it is time for him to recalculate his estimates.

**We said above that the best regulator for market behavior is the carrot of profits and the stick of losses. No equivalent regulator exists when the government undertakes a project. Indeed, if a government program does not achieve its goals, the solution always seems to be: We just need to spend more money.**

Finally, it is evident that many government programs introduce moral hazard into the marketplace, undermining initiative and the taking of responsibility for actions. From welfare programs for the poor to welfare programs for the rich (the socialization of losses under the bailout programs being the most recent example of the latter), ubiquitous government intervention makes all of us more likely to seek a handout.

The list of ills that public choice theorists have identified leads one to a general three-step principle that, if followed, can help to minimize the impact of government intervention.[[33]](http://www.heritage.org/research/reports/2011/02/ten-mostly-hayekian-insights-for-trying-economic-times%22%20%5Cl%20%22_ftn33) In capsule form:

Negotiation (as occurs in market exchange) is always preferable to adjudication.

If negotiation fails, adjudication that clarifies rights is always preferable to regulation or legislation.

Only if both negotiation and adjudication fail should one turn to regulation or legislation.

Unfortunately, too often, regulation and legislation are the first and only step.

In conclusion, if we combine the last two insights, we see that the Austrian economists and the public choice theorists deliver a one-two punch: We usually do not have the necessary knowledge to intervene effectively in the economy, and the political process is such that, even if we did, we still likely would get bad policy together with an ever-growing government sector.

That is why the Austrian economists and the public choice theorists favor smaller government. Especially in today’s environment, their insights bear repetition.

#### Stimulus money does not boost economic growth-Money is empirically mismanaged

[**Epstein**](http://reason.com/people/jim-epstein/all) **11** - Ph.D. and MA in Economics from the University of Paris Reason.tv journalist quotes Veronique de Rugy,[Reason columnist](http://reason.com/people/veronique-de-rugy/all) and [senior research fellow at the Mercatus Center](http://mercatus.org/veronique-de-rugy) (Jim, "[Why Obama's Stimulus Failed: A Case Study of Silver Spring, Maryland](http://reason.com/blog/2011/12/08/why-obamas-stimulus-failed-a-case-study), Reason.com, 12/8/11, <http://reason.com/blog/2011/12/08/why-obamas-stimulus-failed-a-case-study>)//AP

High, persistent unemployment and a sluggish economy underscore what all but the most-dedicated supporters of Barack Obama know to be true: The president's 2009 stimulus program was a massively expensive bust.

Understanding why the stimulus failed is an important step in understanding how the government can—and cannot—goose economic recovery. To get a better sense of how and where the stimulus went wrong, Reason.tv focused on Silver Spring, Maryland, a suburb of Washington, D.C., that's home to a large number of government contractors and other recipients of money earmarked for the sorts of "shovel ready" projects that were going to bring the economy back to life.

President Obama's top economic advisor Larry Summers [laid out ground rules](http://www.hks.harvard.edu/news-events/news/testimonies/summers-testimony-house-budget-committee) for how stimulus dollars should be spent: The funds must be "targeted" at resources idled by the recession, the interventions must be "temporary," and they needed to "timely," or injected quickly into the economy.

None of that turned out to be true. "Even if you were to believe that government spending can trigger economic growth," says Veronique de Rugy, [Reason columnist](http://reason.com/people/veronique-de-rugy/all) and [senior research fellow at the Mercatus Center](http://mercatus.org/veronique-de-rugy), "the money is never spent in a way that's consistent with the conditions laid out by the Keynesians for it to be efficient."

Reason.tv identified four basic ways in which the stimulus was doomed almost before it was put into operation.

Government Contracts: More of the Same

According to proponents, an effective stimulus program must put idle resources back to work. A particularly bad way to go about this is to give money to big government contractors to do more of what they're already doing.

Yet that's what happened in downtown Silver Spring, where $138 million dollars in stimulus grants and contracts went to 46 organizations. Just three firms took home a majority of the money. These three firms—[Synergy Enterprises](http://www.seiservices.com/), [Senior Service America](http://www.seniorserviceamerica.org/site/index.html), and [Social & Scientific Systems](http://www.s-3.com/)—were major government contractors before the stimulus was signed. In fact, these firms received a combined $71 million in stimulus funds. Over that same period, they got $702 million in other government contracts, according to [USASpending.gov](http://usaspending.gov/).

So the stimulus money was like icing on the cake. Take [Palladian Partners](http://www.palladianpartners.com/home/), a communications firm in Silver Spring that's received $97.5 million dollars in government contracts over the past 12 years. The National Insitutes of Health (NIH), which is Palladian's biggest client, tacked [$363,760 stimulus dollars](http://www.recovery.gov/Transparency/RecipientReportedData/Pages/Recipient.aspx?duns=961413028) on to an existing contract, and then followed it with two more awards totaling $431,333. Palladian was to spend the money collecting and disseminating information about how the NIH was spending stimulus money.

Palladian was well paid for its work, but with the project 80 percent complete, its main activities have included building a [website](http://recovery.nih.gov/), and publishing 29 short articles for the site. The stimulus grant went to hire two new employees, neither of whom was unemployed before coming to Palladian. That's no way to jumpstart the economy.

Infrastructure: Money for Nothing

President Obama [said](http://www.whitehouse.gov/the-press-office/remarks-president-and-vice-president-signing-american-recovery-and-reinvestment-act) the stimulus bill would put nearly 400,000 people back to work rebuilding America. But over the next two-and-a-half years, the U.S. construction industry shed about 900,000 jobs or 14 percent of the building workforce.

In Maryland, the "specialty trades," a subset of the construction industry that handles big infrastructure projects, has lost 8 percent of its total, which amounts to 8,000 jobs. Maryland's Department of Transportation says stimulus money for transit projects has steadily paid the salaries of only about [600 construction workers](http://www.mdot.maryland.gov/Planning/Economic_Recovery/Documents_2/FactSheet_December_12312010.pdf) since the middle of 2009.

Why didn't Maryland's $771 million stimulus dollars for transit infrastructure have a bigger impact on the state's economy?

Partly because Gov. Martin O'Malley cut infrastructure spending more than enough to offset any gains from the stimulus. Maryland’s Transportation Trust Fund generally pays for highway repairs by collecting a special gas tax and other user fees. After the stimulus money was available, Governor O’Malley raided the trust fund by diverting $861 million over the next three years to help balance the state's budget, according to information provided by Maryland's Department of Legislative Services. After you account for the $771 million in stimulus money, state funding for transit infrastructure saw a net decrease of $90 million. That sort of scenario played out in all sorts of ways in all sorts of states: Stimulus dollars were used to cover general expenses rather than to increase overall spending.

The Green Jobs Fiasco

The stimulus bill set aside $500 million for a program to train and recruit people for the new green economy. The program promised to place 80,000 people in so-called green jobs. The grant period is more than half over, and the program has placed only 8,000 people in jobs, according to a [report](http://www.eenews.net/assets/2011/10/04/document_gw_03.pdf) by the Department of Labor's Inspector General.

In downtown Silver Spring, a union-backed organization called the [International Transportation Learning Center](http://www.transportcenter.org/) got $5 million in stimulus dollars partly to recruit thousands of new workers and train them in new "green job" skills. But because transit workers already face low unemployment and low turnover and the new jobs weren't materializing, the group is instead using the entire grant to teach new skills to workers who already have jobs.

"The spirit of the stimulus shouldn't be to get people who already have jobs to get more money to do the same thing, just bigger," says de Rugy. Under stimulus theory, she says, "government spending should be going to places where unemployment is very high, going to people who are poached from unemployment lines."

Weatherizing Homes: Not So Shovel Ready

According to the Keynesian theory that undergirds it, stimulus spending must be spent quickly to be effective. By Barack Obama's own testimony, one of the most "shovel-ready" stimulus programs was supposed to be a $5 billion program to weatherize 590,000 homes around the country.

But the weatherization program started off as a slow-moving, dismal failure. According to a February 2010 [report](http://energy.gov/sites/prod/files/igprod/documents/OAS-RA-10-04.pdf) by the Department of Energy's Inspector General, only 8 percent of the weatherization money had been tapped in the program's first year.

In Silver Spring, Gov. O'Malley [held a press conference](http://ww2.gazette.net/stories/06242009/montnew182542_32527.shtml) at the home of Sonja and Richard Lowery in June 2009. It was the first home in Maryland to get weatherized with stimulus money. The program was underway. And then it nearly ground to a halt. In the first year, Maryland weatherized only 279 homes, or 4 percent of its goal.

The main holdup was a concession to organized labor that the ["prevailing wage" rules](http://en.wikipedia.org/wiki/Davis%E2%80%93Bacon_Act) apply to programs funded by stimulus dollars. That meant weatherization workers had to earn at least the average wage in their area for the particular work they were hired to do. Before workers could be paid, Maryland (and every other state) spent months conducting surveys to determine [average wages and benefits for workers weatherizing homes](http://www.dol.gov/whd/recovery/dbsurvey/weatherMD.htm) in every county.

Today Maryland is racing to spend the remainder of its weatherization money before it’s forced to forfeit what’s left in early 2012.

"The main lesson of the stimulus is that creating jobs is a very complex process," says de Rugy, "and certainly it can't be directed by a top down institution that pretty much fails at everything it does."

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#### Stimulus fails – perception and rational mistakes

Cochrane, 10 - professor of Finance at the University of Chicago Booth School of Business (John H. “Fiscal Stimulus, RIP” November 9, 2010, http://faculty.chicagobooth.edu/john.cochrane/research/papers/stimulus\_rip.html)//AH

Before we spend a trillion dollars or so, it’s important to understand how it’s supposed to work. Spending supported by taxes pretty obviously won’t work: If the government taxes A by $1 and gives the money to B, B can spend $1 more. But A spends $1 less and we are not collectively any better off2. “Stimulus” supposes that if the government borrows $1 from A and gives it to B we get a fundamentally different result, and we all are $1.50 better off. But here’s the catch: to borrow today, the government must raise taxes tomorrow to repay that debt. If we borrow $1 from A, but tell him his taxes will be $1 higher (with interest) tomorrow, he reduces spending exactly as if we had taxed him today! If we tell both A and B that C (“the rich”) will pay the taxes, C will spend $1 less today. Worse, C will work less hard, hire a bunch of lawyers, lobby for loopholes, or move to Switzerland. A will hire a lobbyist to get more stimulus. All this is wasted effort, so we’re worse off than before! The question for the “multiplier” is not whether it is greater than one, it’s how on earth it can be greater than zero? (Conversely, so far my arguments for the ineffectiveness of spending apply equally to tax cuts. But tax cuts can cut rates, which improves incentives.) These statements are a theorem not a theory. I’m explaining (in very simple terms) Robert Barro’s (1974) famous “Ricardian Equivalence” theorem. “Theorem” means that if a bunch of assumptions, then borrowing has exactly the same effect as taxing. That doesn’t mean it’s true of the world, but it means that if you want to defend stimulus, you have to tell us which of the “ifs” you disagree with. That discipline changes everything. Thoughtful stimulus advocates respond. Well, maybe people don’t notice future taxes. Does the man or woman on the street really understand that more spending today means more taxes tomorrow? That’s an interesting position, but at this point, most of the battle is lost. Stimulus is no longer an “always and everywhere” law, it’s at best a “if people don’t notice that deficits today mean taxes tomorrow” idea. This qualification has deep implications. First, it means that a “stimulus” policy can only work by fooling people. Is wise policy really predicated on fooling people? Also, people are unlikely to be fooled over and over again. If that’s how stimulus works, you can’t use it too often. Second, it means that stimulus will work sometimes and not other times. Are American voters right now really unaware that larger deficits mean higher future taxes? Or is the zeitgeist of the moment exactly the opposite: Americans are positively aghast at the future taxes they think they’ll be paying? If you think people can be “irrational” they can be irrational in both directions. They can pay too much attention to future taxes corresponding to current deficits, and stimulus can have a negative effect! When I compare tea party rhetoric to the actual reforms needed to cure America’s deficits, I think there’s a good chance we’re in this range. Third, if this is the reason that stimulus works, then the current policy attempt, consisting of stimulus now, but strong promises to address the deficit in the future, can have no effect whatsoever. If you think stimulus works by fooling people to ignore future tax hikes or spending cuts, then loudly announcing such tax hikes and spending cuts must undermine stimulus! Augustinian policy, “give me chastity, but not yet,” will not work. Casanova is needed. Well, maybe some other Barro assumption is wrong. Yes, there are many. (“Liquidity constraints” are a common complaint, keeping people from acting based on their estimation of the future.) But if you take any of them seriously, the case for stimulus becomes similarly circumscribed. Each specifies a channel, a “friction,” something fundamentally wrong with the economy that matters some times more or less than others, that restricts what kinds of stimulus will work, and that can be independently checked. And in many cases, these “frictions” that falsify Barro’s theorem suggest much better direct remedies, rather than exploitation by fiscal stimulus.Relaxing Barro’s assumptions can also lead to negative multipliers. For example, Barro assumed perfectly-efficient “lump-sum” taxes. In fact, we have proportional taxes with lots of loopholes. In the real economy, raising tax rates is an inefficient process, as is spending money. Recognizing this fact leads to my guess of a negative multiplier. So the biggest impact of Barro’s theorem is not whether it is “right” or “wrong” as a description of the world. The biggest impact is that, if you are at all intellectually honest, it forces you to deal with why it is wrong. Many proponents do not do this; they just cite one assumption they don’t like, on the basis of intuition rather than real evidence, and go back to simplistic always-and-everywhere mulitipliers. There is a deeper problem with stimulus. Even if nobody notices future taxes, A was going to do something with the money. Suppose, for example, A was a small business owner, and he was going to buy a forklift3. The government borrows the money instead, and gives it to B who buys a car. Now the composition of spending has changed towards more “consumption.” But does the economy really care if B buys a car rather than A buying a forklift? Barro’s theorem gives conditions in which nothing changes, including the split between consumption and investment. But his real point is deeper: Borrowing does not alter the “intertemporal budget constraint,” society’s overall wealth. These two stories capture the central logical errors of Keynesian economics, and central advance of “equilibrium” or “inetertemporal” thinking that destroyed it and revolutionized macroeconomics in the 1970s. Some other big names in this effort are Friedman (1957), Lucas (1975), with Sargent (1979), Kydland, Prescott (1982). They pointed out two big mistakes in Keynesian economics: First, Keynesian economics treats each moment in time in isolation. People’s consumption depends on their current income, not their future prospects. Investment decisions depend on current sales and interest rates, not whether companies expect future sales to be any good. Modern macroeconomics extends across time. It recognizes that what people expect of the future is central to how they behave now. Now, maybe people don’t “perfectly” or “rationally” evaluate the future. But that’s a far cry from saying they don’t consider the future at all! And budget constraints – the fact that debt today must be paid off – are independent of your feelings. Second, the “plans” of Keynesian economics4 ; how much we suppose people want to consume, invest, etc.; don’t automatically add up to their income, unlike the “demands” of regular economics that must do so. Keynesian economics ignores budget realities at each moment in time as well as the “intertemporal budget constraint” emphasized by Barro. For these and other reasons, Keynesian ISLM models have not been taught in any serious graduate school since at least 1980, except as interesting fallacies or history of thought. I include my own graduate education at very liberal Berkeley starting in 1979. Even sympathetic textbooks, like David Romer’s Advanced Macroeconomics, cannot bring themselves to integrate Keynesian thinking into modern macro. The “new Keynesian” economics, epitomized by Mike Woodford’s Interest and Prices has nothing to do with standard Keynesian thinking5 . Not a single policy simulation from a Keynesian model has appeared in any respectable academic journal since 1980. Not one. The whole business was simply discredited as being logically incoherent 30 years ago.

#### Fallacies in stimulus theory prove it has no net positive effect on output

Cochrane 09 Myron S. Scholes Professor of Finance University of Chicago Booth School of Business (John H. “Fiscal Stimulus, Fiscal Inflation, or Fiscal Fallacies?” feb 27 2009 http://faculty.ses.wsu.edu/rayb/420/fiscal\_stimulus.pdf)//BM

Most fiscal stimulus arguments are based on fallacies, because they ignore three basic facts.

First, if money is not going to be printed, it has to come from somewhere. If the government borrows a dollar from you, that is a dollar that you do not spend, or that you do not lend to a company to spend on new investment. Every dollar of increased government spending must correspond to one less dollar of private spending. Jobs created by stimulus spending are offset by jobs lost from the decline in private spending. We can build roads instead of factories, but fiscal stimulus can’t help us to build more of both1 . This form of “crowding out” is just accounting, and doesn't rest on any perceptions or behavioral assumptions.

Second, investment is “spending” every bit as much as is consumption. Keynesian fiscal stimulus advocates want money spent on consumption, not saved. They evaluate past stimulus programs by whether people who got stimulus money spent it on consumption goods rather than save it. But the economy overall does not care if you buy a car, or if you lend money to a company that buys a forklift.

Third, people must ignore the fact that the government will raise future taxes to pay back the debt. If you know your taxes will go up in the future, the right thing to do with a stimulus check is to buy government bonds so you can pay those higher taxes. Now the net effect of fiscal stimulus is exactly zero, except to raise future tax distortions. The classic arguments for fiscal stimulus presume that the government can systematically fool people.

The central question is whether fiscal stimulus can do anything to raise the level of output. The question is not whether the “multiplier” exceeds one – whether deficit spending raises output by more than the value of that spending. The baseline question is whether the multiplier exceeds zero.2

A cure should have something to do with the diagnosis. The classic argument for fiscal stimulus presumes that the central cause of our current economic problems is this: We, the people and our government, are not doing nearly enough borrowing and spending on consumer goods. The government must step in force us all to borrow and spend more. This diagnosis is tragically comic once said aloud.

#### Keynesian theory is inadequate- we face no constraints on supply

Cochrane 09 Myron S. Scholes Professor of Finance University of Chicago Booth School of Business (John H. “Fiscal Stimulus, Fiscal Inflation, or Fiscal Fallacies?” feb 27 2009 http://faculty.ses.wsu.edu/rayb/420/fiscal\_stimulus.pdf)//BM

My first fallacy was “where does the money come from?” Well, suppose the Government could borrow money from people or banks who are pathologically sitting on cash, but are willing to take Treasury debt instead. Suppose the government could direct that money to people who are willing to keep spending it on consumption or lend it to companies who will spend it on investment goods. Then overall demand for goods and services could increase, as overall demand for money decreases. This is the argument for fiscal stimulus because “the banks are sitting on reserves and won’t lend them out” or “liquidity trap.”

In this analysis, fiscal stimulus is a roundabout way of avoiding monetary policy. If money demand increases dramatically but money supply does not, we get a recession and deflation. If we want to hold two months of purchases as money rather than one months’s worth, and if the government does not increase the money supply, then the price of goods and services must fall until the money we do have covers two months of expenditure. People try to get more money by spending less on goods and services, so until prices fall, we get a recession. This is a common and sensible analysis of the early stages of the great depression. Demand for money skyrocketed, but the Fed was unwilling or, under the Gold standard, unable, to increase supply.

This is not a convincing analysis of the present situation however. We may have the high money demand, but we do not face any constraints on supply. Yes, money holdings have jumped spectacularly. Bank excess reserves in

particular (essentially checking accounts that banks hold at the Federal Reserve) have increased from $2 billion in

August to $847 billion in January. However, our Federal Reserve can create as much more money as anyone might desire and more. There is about $10 trillion of Treasury debt still outstanding. The Fed can buy it. There are trillions

more of high quality agency, private debt, and foreign debt outstanding. The Fed can buy that too. We do not need to send a blank check to, say, Illinois’ beloved Governor Blagojevich to spend on “shovel-ready” projects, in an attempt to reduce overall money demand. If money demand-induced deflation is the problem, money supply is the answer.

Some people say “you can’t run monetary policy with interest rates near zero.” This is false. The fact of low interest

rates does not stop the Fed from simply buying trillions of debt and thereby introducing trillions of cash dollars into the economy. Our Federal Reserve understands this fact with crystal clarity. It calls this step “quantitative easing.” If Fed ignorance of this possibility was the problem in 1932, that problem does not face us now.

#### The most recent data concludes stimulus fails

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The weak economic recovery in the U.S. and the even weaker performance in much of Europe have renewed calls for ending budget austerity and returning to larger fiscal deficits. Curiously, this plea for more fiscal expansion fails to offer any proof that Organization for Economic Cooperation and Development (OECD) countries that chose more budget stimulus have performed better than those that opted for more austerity. Similarly, in the American context, no evidence is offered that past U.S. budget deficits (averaging 9% of GDP between 2009 and 2011) helped to promote the economic recovery. Two interesting European cases are Germany and Sweden, each of which moved toward rough budget balance between 2009 and 2011 while sustaining comparatively strong growth—the average growth rate per year of real GDP for 2010 and 2011 was 3.6% for Germany and 4.9% for Sweden. If austerity is so terrible, how come these two countries have done so well? The OECD countries most clearly in or near renewed recession—Greece, Portugal, Italy, Spain and perhaps Ireland and the Netherlands—are among those with relatively large fiscal deficits. The median of fiscal deficits for these six countries for 2010 and 2011 was 7.9% of GDP. Of course, part of this pattern reflects a positive effect of weak economic growth on deficits, rather than the reverse. But there is nothing in the overall OECD data since 2009 that supports the Keynesian view that fiscal expansion has promoted economic growth. For the U.S., my view is that the large fiscal deficits had a moderately positive effect on GDP growth in 2009, but this effect faded quickly and most likely became negative for 2011 and 2012. Yet many Keynesian economists look at the weak U.S. recovery and conclude that the problem was that the government lacked sufficient commitment to fiscal expansion; it should have been even larger and pursued over an extended period. Enlarge Image Getty Images This viewpoint is dangerously unstable. Every time heightened fiscal deficits fail to produce desirable outcomes, the policy advice is to choose still larger deficits. If, as I believe to be true, fiscal deficits have only a short-run expansionary impact on growth and then become negative, the results from following this policy advice are persistently low economic growth and an exploding ratio of public debt to GDP. The last conclusion is not just academic, because it fits with the behavior of Japan over the past two decades. Once a comparatively low public-debt nation, Japan apparently bought the Keynesian message many years ago. The consequence for today is a ratio of government debt to GDP around 210%—the largest in the world. This vast fiscal expansion didn't avoid two decades of sluggish GDP growth, which averaged less than 1% per year from 1991 to 2011. No doubt, a committed Keynesian would say that Japanese growth would have been even lower without the extraordinary fiscal stimulus—but a little evidence would be nice. Despite the lack of evidence, it is remarkable how much allegiance the Keynesian approach receives from policy makers and economists. I think it's because the Keynesian model addresses important macroeconomic policy issues and is pedagogically beautiful, no doubt reflecting the genius of Keynes. The basic model—government steps in to spend when others won't—can be presented readily to one's mother, who is then likely to buy the conclusions. Keynes worshipers' faith in this model has actually been strengthened by the Great Recession and the associated financial crisis. Yet the empirical support for all this is astonishingly thin. The Keynesian model asks one to turn economic common sense on its head in many ways. For instance, more saving is bad because of the resultant drop in consumer demand, and higher productivity is bad because the increased supply of goods tends to lower the price level, thereby raising the real value of debt. Meanwhile, transfer payments that subsidize unemployment are supposed to lower unemployment, and more government spending is good even if it goes to wasteful projects.

#### Empiricism goes our way – studies only indicate stimulus fails

Foster, 9 - Ph.D., Norman B. Ture Senior Fellow in the Economics of Fiscal Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation (James D., “KEYNESIAN POLICIES STIMULATE DEBATE AND DEBT, NOT EMPLOYMENT” JAMES D. FOSTER, 2009,  [http://www.ifo.de/portal/pls/portal/docs/1/1191496.PDF](http://blog.heritage.org/2012/03/06/wapo-admitting-keynesian-stimulus-failed/))//AH

Casual empiricism suggests Keynesian stimulus policy does not work, and the theory behind the policy falls apart upon inspection. What does empirical research indicate? Empirical insights on Keynesian effectiveness One approach to testing the efficacy of debt-based fiscal stimulus turns to the data to see what stories it tells. Unfortunately, few have attempted this task in recent years. This may be due to the emergence, development and parameterization of a new consensus model in macroeconomics, the so-called New Keynesian model (Blanchard 2008;Woodford 2009). Also, most of the developed world (other than Japan) has been relatively immune to significant business cycle swings, thus dampening the demand for research on countercyclical fiscal policies in industrial nations. Part of the reason may also be the strong consensus prior to recent events that Keynesian stimulus was ineffective and that studies reporting statistically insignificant results confirming the consensus view are rarely published. Perhaps Robert J. Barro’s analysis of fiscal stimulus efficacy is the most well known and controversial. Barro argues that the clearest evidence of fiscal policy effects is likely to be found when spending ramps up rapidly during wars (Barro 2007). Examining the US fiscal policy in the periods surrounding World War II, the Korean War and the Vietnam War, Barro’s analysis suggests a fiscal multiplier of 0.8, meaning that the increase in output was a fraction of the increase in government spending. Barro further suggests that the wartime multiplier is likely to be much greater than the peacetime multiplier, and that a peacetime multiplier is likely to be near zero, so every extra dollar of government spending actually replaces a dollar of private spending leaving output unaffected. Paul Krugman among others has criticized Barro’s results, noting that the wars themselves and the often attendant wage and price controls would have diminished the effectiveness of fiscal policy (Krugman 2009). However, none of his critics have as yet provided an empirical analysis challenging Barro’s results.

#### Stimulus fails – macroeconomic research proves – their models don’t include scarcity

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Crude, old-style Keynesianism has thus returned with a vengeance. In truth, it never really left. Despite all the talk by government poli­cymakers and central bankers and their macroeconomic advisers that they have painstakingly developed and learned to deploy sophisticated new tools of "stabilization policy" in the last twenty-five years, their tool shed is, in actual practice, completely bare of all but the blunt and well-worn instruments of deficit spending and cheap money. For their part, the mandarins of academic macroeconomics have revealed the total intellectual bankruptcy of their discipline and the laughable irrelevance of their formal models by abandoning all scholarly reserve and decorum and stridently promoting and endorsing the long dis­credited policies of old-fashioned Keynesianism. The amazing, knee-jerk resort to simplistic Keynesian remedies by the macroeconomics establishment in the current crisis is tantamount to the admission that there has been absolutely no progress in the postwar era in understand­ing the causes and cures of business cycles. This reveals a deeper and more chilling truth: contemporary stabilization policy is implicitly based on one of the oldest and most naive of all economic fallacies, one that has been repeatedly demolished by sound economic thinkers since the mid-eighteenth century. This fallacy is that there exists a direct causal link between the total volume of money spending and the levels of total employment and real income. In this book, Hayek provides an incisive critique of this fallacy in its Keynesian form and demonstrates the dire consequences of pursuing policies based on it. But the book contains much more than a critique of fallacious theories and policies: it holds the recipe for a solid and steady recovery from our current depression (and yes, always the straight-talker, Hayek uses this forbidden word). In brief, Hayek argues that all depressions involve a pattern of resource allocation, including and especially labor, that docs not correspond to the pattern of demand, particularly among higher-order industries (roughly, capital goods) and lower-order industries (roughly, consumer goods). This mismatch of labor and demand occurs during the prior inflationary boom and is the result of entrepreneurial errors induced by a distortion of the interest rate caused by monetary and bank credit expansion. More importantly, any attempt to cure the depression via deficit spending and cheap money, while it may work temporarily, intensifies the misallocation of resources relative to the demands for them and only postpones and prolongs the inevitable adjustment. The reason why this is not perceived by Keynesians is because of an implicit assumption that Hayek identified in Keynes's writings. Keynes wrongly assumed that unemployment typically involves the idleness of resources of all kinds in all stages of production. In this sense Keynesian economics left out the vital element of the scarcity of real resources, the pons a si nor um of undergraduate economic principles courses. In Keynes's illusory world of superabundance, an increase in total money expenditure will indeed increase employment and real income, because all the resources needed for any production process will be available in the correct proportions at current prices. However, in the real world of scarcity, as Hayek shows, unemployed resources will be of specific kinds and in specific industries, for example unionized labor in mining or steel fabrication. Under these circumstances, an increase in expenditure will increase employment, but only by raising overall prices and making it temporarily profitable to re-employ these idle resources by combining them with resources misdirected away from other industries where they were already employed- When costs of production have once again caught up with the rise in output prices, unemployment will once again appear, but this time in a more severe form because of the misallocation of additional resources. The government and central bank will then once again face the dilemma of allowing unemployment or expanding the stream of money spending. This sets up the conditions for an ever-accclcrating monetary and price inflation punctuated by periods of worsening unemployment as was the case during the Great Inflation of the 1970s and early 1980s.

#### Stimulus is unfalsifiable and costly – disincentivizes employment

Smith, 11 – Forbes contributor (Kyle, “Keynesian Stimulus: Costly, Unproven And Unfalsifiable”, 11-22, <http://www.forbes.com/sites/kylesmith/2011/11/22/keynesian-stimulus-costly-unproven-and-unfalsifiable/print/>)//AH

As the Keynesian argument slips back into the hibernation in which it spent the 70 years between the New Deal and the New New Deal, the after-action assessments are piling up. True, Lord Keynes’ acolytes say with a sorrowful look, the Obama administration has been an economic failure, but that is only because our ideas were never actually tried. The 2009 stimulus, of course, should have been much larger than merely $800 billion. The failure of that amount, or four or five times that amount, would simply have meant that the spending was too modest. Keynesian stimulus is like religious faith–unfalsifiable. If the stimulus had worked? “Told ya so.” If didn’t work? “Told ya so,” again. The notion of Keynesian stimulus as a cure to a deep recession is at best a very costly unproven theory. An excellent example of this faith-based economics can be seen in the Nov. 24 New York Review of Books essay by Ezra Klein, “Obama’s Flunking Ecomomy: the Real Cause.” Klein says journalists’ and Democrats’ efforts to find someone in the administration to blame for the economy’s continued woes are a distraction: No one in the White House, Klein thinks, could possibly be to blame because they were all Keynesians (albeit ones who differed on the political practicalities involved), and Keynesianism — understood to mean borrowing and spending your way out of a slump — is the One True Religion. Klein writes that the administration made the mistake of underestimating the financial crisis, noting that at the end of 2008 the Bureau of Economic Accounts estimated that the economy was contracting at an annual rate of 3.8 percent but “it wouldn’t be until this year that we learned the economy was really contracting at a rate of nine percent.” It does not follow that only a Keynesian jolt could cause recovery, nor does the situation lack for irony when leading economic thinkers opine that the only way out of a recession caused by profligacy in taking on debt is to take on vastly more of it. In general, the lower the bottom, the greater the strength of the bounce back: Inventories get depleted. Things wear out and must be replaced. Pantries empty. Demand builds. That’s the natural state of the economy. But the continuing policy of Obamanomics has been to toss onto the bottom a series of cushiony soft market-distorting subsidies–the stimulus that delayed layoffs, Cash for Clunkers, federal mortgage support, repeated extension of unemployment benefits so as to create a disincentive to accept job offers. Meanwhile, a host of new regulatory initiatives and fanciful (perhaps farcical) beliefs about the market readiness of clean-energy technologies redirected capital away from where it would most productively be used to compliance and rent-seeking. Yet the neo-Keynesians argue, as Klein does, that “the combination of stimulus, TARP, and aggressive monetary policy quickly broke the recession.” But we don’t know that, and can’t know that. Subsequence is not the same thing as causation, yet Klein blithely goes on, “We went from losing 800,000 jobs a month in January 2009 to losing 39,000 jobs a month in January 2010. By March 2010–the same month Obama signed his health care bill into law–we were adding jobs again. It looked like we were on a steady path back to recovery.” Following this, the depletion of the stimulus led to a “wobble” in summer 2010 that heralded four straight months of job losses, and “though employment picked up in the fall and the monthly jobs report never again turned negative, the economy proved unexpectedly stuck at what PIMCO CEO Mohamed el-Erian calls ‘stall speed’–it’s neither getting worse nor getting much better.” Yet Klein seems unaware that he contradicts himself later in the piece when he writes that “the stimulus didn’t really begin spending its money until 2010.” It could not therefore have been responsible for the steady improvement in 2009, and could not have much been responsible for the improvement in early 2010. According to recovery.gov, stimulus recipients (stimulees?) took in only $8 billion in award money in the first quarter of 2010. While the recovery sputtered, the stimulus was spending more on such grants, not less: $24 billion in the second quarter of 2010, $26 billion in the third quarter, another $26 billion in the fourth. As the stimulus heated up, the economy cooled off Moreover, despite the characteristic Keynesian compulsion to fudge numbers, it is simply a myth that stimulus and TARP funds dried up, causing a parched economic climate deprived of the nurturing rains of federal largesse. Federal spending was $2.73 trillion in 2007, $2.98 trillion in 2008, $3.52 trillion in 2009, $3.46 trillion in 2010 and $3.6 trillion in 2011. More and more, the Keynesians sound like sweaty gamblers begging to be allowed back at the card table to cover mounting losses with ever-larger bets. Should we keep giving them our money to do so?

#### Keynesianism is flawed

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President Obama’s former head of the Council of Economic Advisers has taken [to the pages of the New York Times](http://www.nytimes.com/2011/07/03/business/economy/03view.html) to warn us against pursuing “fiscal austerity just now,” particularly not spending cuts.

Christina Romer’s views are Keynesian. She doesn’t use that word, but she is focused on juicing “demand” with optimally-targeted and well-managed government “investments.”

Economics has numerous schools of thought, but Romer’s writing reflects nothing but the most simplistic Keynesian framework. The fact that the [huge Keynesian stimulus of recent years that she supported has coincided with the slowest economic recovery](http://www.cato-at-liberty.org/biggest-keynesian-stimulus-slowest-recovery/) since World War II seems to be of little concern to her.

She also doesn’t seem to be interested in how government spending actually works in the real world. She assures us that “government spending on things like basic scientific research, education and infrastructure...helps increase future productivity.”

That view has a veneer of exconomic authenticity, but it leaves many issues unaddressed:

Most federal spending is on transfers and consumption, not investment. The debt crisis we face is driven mainly by entitlements, which is consumption spending. Romer’s talk of investment spending is a rhetorical bait-and-switch.

Romer doesn’t distinguish between average and marginal spending. If some federal investment spending has created positive net returns, that doesn’t mean that additional spending would. Governments already spend massive amounts on education, for example, so the marginal return from added spending is probably very low.

If the government investments that Romer touts are so valuable, then why hasn’t the government done them already? After all, [federal, state, and local governments in this country already spend 41 percent of GDP](http://www.cato.org/pub_display.php?pub_id=13261).

If science, education, and infrastructure investments have the high returns that Romer seems to think they do, then why does the government need to be involved? Private firms seeking higher profits would be all over such investments.

Romer mentions that the “social returns” on some investments might be higher than purely private returns. However, that doesn’t mean that the government should automatically intervene. For one thing, the government suffers from all kinds of management failures and other pathologies.

Romer also ignores that the government imposes substantial deadweight losses on the economy when it commandeers the resources it needs for its “investments.”

So my reading assignment for Romer is [www.DownsizingGovernment.org](http://www.downsizinggovernment.org/) so she can get a better understanding of how federal programs actually operate.

And readers interested in all the economics of government spending that Romer doesn’t tell you about can consult Edgar Browning’s [excellent book, Stealing From Each Other](http://www.amazon.com/Stealing-Each-Other-Welfare-Americans/dp/0313348227/ref%3Dcm_cr_pr_product_top).

#### Keynesianism fails-Green spending proves

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With unemployment high, economic recovery elusive, and gasoline prices near record levels, the term Great Recession has joined the economic infamy list that is only topped by the 1930s Great Depression. Enter Barack Obama as the new-age FDR, ready to lead us back to prosperity with his newly unfurled election-year “to do” list for Congress.

But this is not your grandfather’s New Deal. While premised on the fallacious Keynesian notion that government spending brings prosperity, Obama’s fare has a distinct environmentalist dogma. FDR had the New Deal; Obama’s is a Malthusian New Deal. Like FDR’s seventy years ago, green Keynesianism is also at odds with wealth creation and true recovery.

Obama’s mantra can be traced all the way back to a 1798 tract, An Essay on the Principle of Population, in which Thomas Malthus laid out a dystopian vision of human population growth outrunning agricultural productivity, requiring war, disease, and other “misery or vice” to reduce the number of mouths to feed. Mankind was forever destined to subsistence living in his view.

Fortunately, economic freedom and human ingenuity intervened. People turned out to be the solution, not the problem. Agricultural productivity soared, and Malthus was refuted.

But the idea of the earth’s limited “carrying capacity” graduated from Malthus’s agriculture to mineral resources, including oil and gas. Terms such as “peak oil” took root in the 1970s and intensified in the 1990s forward.

So here is the rub. Obama’s so-called growth plan is top heavy on a fallacious neo-Malthusian limits-to-growth thinking. Yet the supposedly depleting energies that Obama policy is trying to phase down (or phase out as is the case with coal) are booming—and their “green” substitutes are a predictable bust.

Think back to when the newly elected Obama picked advisors and department heads collectively called the “green dream team.” These neo-Malthusians engineered the 2009 stimulus plan’s $79 billion for ‘green’ initiatives, according to the nonprofit Environment California. Such went to wind, solar, conservation, **and transportation projects that would otherwise be uneconomical, as judged by self-interested consumers**.

Since then, tens of billions of dollars more have gone to the politically correct, market incorrect energy initiatives.

Yet wind, solar, and batteries are inferior job creators. A July 2011 Brookings study found that between 2003 and 2010, the government green-job expansion was 20 percent below that of the overall economy. And the real story has been in the last two years when the artificial, transitory Malthusian job plan imploded, as evidenced by green layoffs at Solyndra,Ener1, Range Fuels, and Beacon Power Corp, among other firms. Worst still, taxpayers were stuck with the bill.

Don’t forget what Obama did not get: a House-passed cap-and-trade bill to limit emissions of carbon dioxide and other greenhouse gases. Obama’s initial budget estimated $646 billion in auction revenues from carbon permits, but Jason Furman, deputy director of the National Economic Council, warned that the back-door tax could be “two-to-three times” greater—as much as $1.9 trillion over ten years.

The bill that was mercifully killed in the Senate would have cost the average American household $890 in 2020, according to the Congressional Budget Office.

Cap-and-trade is dead, but the green dream lives on in the out-of-control budget deficit. Obama’s current Congressional to-do list includes even more fiscal support for the green energy sector, including extending a 30 percent tax credit to investments in clean energy manufacturing.

Compare the above to the real energies that consumers prefer and that taxpayers do not have to subsidize. Here, this administration has also been doing its utmost (within election-year political constraints) to stifle production from our traditional and abundant domestic energy resources.

Thwarting homegrown oil and gas has not been easy for Obama. The U.S. has an enormous bounty of untapped economically recoverable wealth — an estimated 273 trillion cubic feet of natural gas and 1.7 trillion barrels of oil. Hydraulic fracturing can develop these reserves and boost our economy, without compromising the environment.

The Barnett shale, for example, supports 100,000 jobs in northern Texas alone, while natural gas production in the Marcellus has doubled this to Pennsylvania’s economy. North Dakota’s Bakken Shale play has turned the state almost overnight into an oil Mecca. Yet the hostility of many Obama administration officials to “fracking” technology is another instance of Malthusian governance at odds with consumers, taxpayers, and the general economy.

Lifting unnecessary restrictions on new oil and gas production would immediately boost economic output, and not just in the energy sector. An analysis from PricewaterhouseCoopers found that every new oil and gas job supports an additional three jobs across the rest of the economy.

And so we are left with the irony of an Administration working to make the most attractive, taxpayer-free energies more expensive in the name of saving us from ourselves. “We have met the enemy and he is us” applies to Obama, not to citizens who want plentiful, affordable, reliable energy.

**The Malthusian New Deal has failed to create sustainable jobs and has left government budgets further in the red**. Americans are not ready to settle for diminished standards of living in pursuit of a false green dream. Developing our abundant natural resources, not artificially imposing scarcity, must be a pillar of the economic recovery to come.

### ricardian equivalence

#### Ricardian equivilance means stimulus is pointless

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2. If a government borrows to finance a deficit, the wise far-seeing taxpayers will anticipate that taxes will have to go up in the future to repay this debt. They will then save additionally to prepare for this event. This is the theory of Ricardian equivalence. Thus, cutting taxes now while raising them later will not make them richer. Hence total spending will not change. There is therefore no point in a fiscal stimulus. I am over-simplifying a little here, but such Ricardian equivalence is a favourite idea of some modern macroeconomic theorists. It is described and discussed, for example (without being approved) in the textbook by Mankiw (1994, pp 423–30). David Ricardo had the idea but did not regard the key assumption as realistic. The Japanese case of the nineties does not support it: household savings as a percentage of GDP actually declined while public debt was accumulating. The US “Reagan” episode of 1982–1987 is very relevant here. Substantial tax cuts led to a big budget deficit. But over the period the household savings ratio actually fell. I analysed this episode in Corden (1994, pp 196–97). Let me quote my conclusion: Hence this episode did not give support to the Ricardian equivalence theorem. It is likely that the low concern for the future—and the confidence that something, such as high productivity growth, will turn up—influenced both the elected rulers of the United States and the savings behaviour of the private sector. Hence there was both public and private profligacy, rather than that the profligacy of the former was offset by the prudence of the latter. (p 197)

#### Ricardian equivalence means stimulus is ineffective

Sumo 08 the Senior Windows Administrator of The University of Chicago Booth School of Business. (Vanessa “Ricardian Equivalence” Region Focus Winter 2008 <http://search.proquest.com.proxy.lib.umich.edu/docview/201418252>)//BM

A government sometimes spends beyond its revenues in an effort to rouse a slumping economy. Commissioning roads and bridges, for instance, increases demand for construction workers, services, and supplies. That translates into higher incomes and purchases of other goods and services that, in turn, put more spending power in other people’s wallets. The same argument applies to a policy of cutting taxes or tax rebates. Lower taxes mean that people can take home a bigger chunk of their income, which might encourage them to spend more. But an alternative view in economics — Ricardian equivalence — suggests that such deficit spending is no free lunch. Named by Robert Barro of Harvard University (its main proponent) after 19th century economist David Ricardo, the theory of Ricardian equivalence claims that people will tend to save rather than consume the extra income arising from such spending. This is because people understand that whatever amount a government overspends today has to be repaid in the future in the form of higher taxes, thus unraveling a government’s efforts to stimulate the economy. If a tax cut today merely postpones a tax increase until tomorrow, then there would be little reason for people to loosen their purse strings now. To understand this logic, suppose that a government has a balanced budget and wants to inject billions of dollars through a tax cut that would give every household $1,000. If a government’s expenditures are already equal to its revenues, it must finance this policy by borrowing money and promising to pay back the principal and interest several years from now. Recognizing that this will show up as a future tax liability, forward-looking households will likely put away the $1,000 in the bank and let it earn interest. The proceeds of this saving should be just enough to pay for an anticipated rise in taxes.

**Ricardian equivalence is empirically proven**

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A long-forgotten theory suggesting that stimulus spending is doomed to failure draws attention nearly 200 years later Stimulus is supposed to be the key to recovery, and governments around the world are embracing it as never before. But a long-forgotten theory dating back almost 200 years is increasingly weighing on the minds of policy makers: Ricardian equivalence. Named after the writings of David Ricardo in the early 1820s, the theory suggests that stimulus spending is doomed to failure because taxpayers tend to save their stimulus dollars rather than spend them. Their reluctance to spend, according to Ricardo, stems from a basic lack of faith in the government's ability to manage stimulus, and a belief that they will eventually be hit by big tax increases to pay off bulging deficits. Lately, discussion about Ricardian equivalence is spilling from its normal confines in academia to the offices of Bay Street and Wall Street economists. It even drew a mention last month by Bank of Canada Governor Mark Carney, who warned in a speech that "Ricardian effects on consumption" are among the risks to the global recovery. The Ricardian chatter signals policy makers' and economists' nagging fear that fiscal stimulus will fall flat or even backfire, undermining the global recovery before it has a chance to blossom. The risk is that despite the hundreds of billions being spent, "the money from Uncle Sam goes into the coffee can instead of being used to buy more coffee," explains David Rosenberg, chief economist and strategist at Gluskin Sheff + Associates Inc. "People see today's stimulus as tomorrow's tax hike." Last year, U.S. taxpayers saved essentially all the money they got through a federal tax cut. And the recent spike in the U.S. personal savings rate is all Mr. Rosenberg needs to believe Mr. Ricardo had a point. In May, the total Obama administration stimulus was worth $163-billion (U.S.) at annual rates, while consumer spending increased only by $25-billion that month, at annual rates. At the same time, the personal savings rate jumped to a 16-year high of 6.9 per cent of disposable income, up from 5.6 per cent in April and 4.3 per cent in March. The stimulus, Mr. Rosenberg argues, "does seem like such a complete waste of time" because for every new government dollar, consumer spending rises just 8 cents. Canadian savings rates have risen, too, but there is not much concern that Ricardian equivalence will render stimulus obsolete here. Canada entered the recession with a strong government balance sheet, so it won't have to use huge tax hikes or spending cuts to bring its budget into balance again in the long run, said economist Nicholas Rowe at Carleton University. In addition, monetary policy has been far more effective in Canada than in the United States in injecting some life into the economy, so recovery here is not as dependent on fiscal stimulus as it is in the United States, he said. Canadian recovery is, however, very dependent on American households spending their stimulus. So if Ricardian equivalence does play out south of the border, the impact could be more than theoretical. Though updated and modernized by economist Robert Barro in 1974 (and also known as the Barro-Ricardo equivalence proposition), the Ricardo theory has never held much sway among economists. In fact, Ricardo ultimately rejected the idea. But many economists have tried, over the centuries, to disprove the theory, and none have succeeded in doing so. The idea behind the theory - that consumers will not spend their stimulus because they think they will need the money as a cushion against future rough times - is more widely accepted than the Ricardian theory. The hoarding concern is even greater these days, amid rising concern that government-financed pensions won't be able to withstand the crisis and individual households will have to make up the shortfall. Now, with President Barack Obama's administration signalling its intention to eventually raise taxes to offset the mounting deficit, taxpayers are almost being encouraged to stash away their stimulus, argues Derek Holt, senior vice-president of economics at Scotia Capital Inc. "Every theory has its day in the sun and, at this point in time, especially in the United States, it's holding true," Mr. Holt said. And loud talk about the need for fiscal and monetary "exit strategies" at a time when recovery has not yet taken hold only serves to highlight the reasons why households should start saving more, and could encourage people to do so. Even if the Ricardian connection between hoarding and the announcement of exit strategies is tenuous, it's not worth taking the risk, adds Avery Shenfeld, chief economist at CIBC World Markets. "There's no point waking up a hibernating Barro by talking too much, too soon, about a budget tightening ahead," he said. WHO WAS DAVID RICARDO? \* Born in London in 1772, the third child of 17, to a family who had relocated from Holland. Died in 1823. \* At 14, began working for his father at the London Stock Exchange, and quickly proved he had a knack for the trade. \* At the urging of his friend James Mill (father of utilitarianism-founder John Stuart Mill) he began writing newspaper articles on his views in 1809.\* He became friends with Rev. Thomas Robert Malthus and through correspondence, they debated each other's views on the possibility of a "general glut" - an excess supply of all goods - in an economy. \* In 1815, he published his groundbreaking essay "On Profits," where he formulated his theory of distribution in a one-commodity economy. \* In 1817, wrote "Principles of political economy and taxation," where he explored value theory.\* In "Essay on the funding system" in 1820, he introduced Ricardian Equivalence, but later rejected his own idea.

### equivalence—at: still stimulates

#### Ricardian equivalence still weakens the effects of stimulus

Sumo 08 the Senior Windows Administrator of The University of Chicago Booth School of Business. (Vanessa “Ricardian Equivalence” Region Focus Winter 2008 <http://search.proquest.com.proxy.lib.umich.edu/docview/201418252>)//BM

For this view to hold, a number of assumptions must be satisfied. First, most consumers must be of the type to think far ahead when deciding how much to consume and save, as well as understand some notion of the implications of Ricardian equivalence. Critics say that might be a stretch. After all, it is quite reasonable to assume that some people are shortsighted and fail to recognize that taxpayers ultimately pay for a government’s debt. Moreover, a person can hardly be blamed for not taking into account a tax liability that may come only decades from now. For instance, a government can issue a 30-year bond to finance the deficit spending. Consumers may not care about what happens that far in the future, especially if the liability will likely fall on forthcoming generations. But Barro argues that people leave bequests precisely because they care about their children’s welfare, and so would not want to consume more today at their children’s expense. Thus consumers think over a much longer, almost indefinite, horizon. If true, the Ricardian view should hold.

But a borrowing constraint can weaken Ricardian equivalence. If a person wishes to consume more today knowing that his future income can pay for his current purchases, then all he has to do is borrow money from a bank. As such, a tax cut would not alter his spending decisions because he can count on borrowed funds to smoothen his consumption. However, if for some reason he is unable to find a lender, then his consumption today is limited by the cash he has on hand. In this case, he may be more inclined to spend the extra cash from a tax cut. This could be especially true for poorer people. A study published in the American Economic Review by David Johnson, Jonathan Parker, and Nicholas Souleles on the impact of the 2001 tax rebates on household expenditures finds that families with low levels of liquid assets and income spent more of their rebates than the average household. In general, the authors find that a typical household spent 20 percent to 40 percent of their rebates on nondurable goods during the three-month period they received their checks. About two-thirds of the rebate was spent during this period and the next three months. Ricardian equivalence predicts that rebate spending should have been close to zero.

However, the overall evidence is inconclusive. Indeed, economists still call on the theory of Ricardian equivalence to debate the effectiveness of the 2008 tax rebate. Many seem to think that it is at least partially true. Government deficit spending may stimulate the economy, but **the impact would be somewhat subdued** in the Ricardian view

### at: key to spending

#### Differences in government and private sector spending guarantee stimulus doesn’t spill over

Cochrane, 9 – Prof @ University of Chicago Booth School of Business (John H. “Fiscal Stimulus, Fiscal Inflation, or Fiscal Fallacies?” Feb. 27, http://faculty.ses.wsu.edu/rayb/420/fiscal\_stimulus.pdf)//AH

Credit markets A much more plausible diagnosis of our current troubles is staring us in the. New issues of securitized debt have dropped to next to nothing, unless they are guaranteed by the Federal Government. Savings is going to low-interest Treasuries and guaranteed agency debt, yet consumers and businesses who need credit face a small supply at very high prices.3 Imagine by analogy that several major refineries had blown up. There would be tankers full of oil sitting in the harbor, and oil prices would be low, yet little gasoline would be available and gas prices would be high. Stimulating people to drive around would not revive gas sales. Borrowing gasoline and using it on infrastructure projects would be worse. The right policy action would obviously be to run whatever government or military refineries could be cobbled together on short notice at full speed, and focus on rebuilding the private ones. The former step is exactly what the Federal Reserve’s many charmingly acronymed facilities (TALF, etc.) are doing, to the tune of over a trillion and a half dollars. Together, the Treasury and Fed are issuing huge amounts of Government debt, and they are turning around and lending the proceeds to consumers and businesses. This basic idea makes sense, though there is plenty to worry about in the details. An unconventional potential defense of fiscal stimulus lurks in this story. If the Treasury borrows and the Government uses the proceeds for investment, then the government is in some sense acting as the missing intermediary. The focus on investment spending in the Obama plan reflects some of this thinking, though investment is anathema to the traditional Keynesian insistence that stimulus be channeled to consumption spending. However, this is a poor argument, since stimulus “investment” spending is on much different projects than the private sector would have funded. Fiscal stimulus investments make fuel oil, not gasoline. Moreover, the extra issues of Treasury debt will largely come from the few dollars that are flowing from savings to private investment, just what the “credit crunch” does not need. To “intermediate,” additional government borrowing would have to come out of consumption. People would have to be attracted to postponing a trillion dollars of consumption by slightly higher treasury yields.

### short-term only

#### Stimulus cant increase GDP-Trade offs and no long term solvency

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There are other reasons the stimulus bill has hurt rather than helped the economy. Four of every five jobs reported “created or saved” are government jobs. That’s far from the 90 percent private sector jobs the administration promised. Also, the Department of Education claims it has “created or saved” at least seven jobs for every job “created or saved” by any other agency.  In other words, federal stimulus funds have been used to keep teachers on state payrolls. By subsidizing public sector employment, the federal government is getting in the way of addressing the issue of overspending in the states.

These injections of cash may provide a short-term boost, but they don’t increase economic growth permanently. When the money goes away, the jobs go away too, and so will the artificial GDP growth.

In spite of such evidence, the administration keeps touting the success of stimulus. Speaking at the National Press Club in September, outgoing Council of Economic Advisors Chair Christina Romer crowed that “the Recovery Act has played a large role in the turnaround in GDP and employment,” citing as evidence an estimate she prepared before Obama’s inauguration that a stimulus package “would raise real GDP by about 3.5 percent and employment by about 3.5 million jobs, relative to what would otherwise have occurred.” The Congressional Budget Office, she claimed, agreed that the stimulus “has already raised employment by approximately two to three million jobs relative to what it otherwise would have been.”

But no such improvements have actually taken place. Romer was acting the part of weatherman repeating last week’s sunny forecast while ignoring the downpour outside. The only measurable evidence that these millions of jobs exist comes from models—including the CBO’s—that predict that these jobs will exist. Since some of those same models predicted the Recovery Act would cap unemployment at 8 percent, they do not belong in a discussion about the Act’s effectiveness.

Some stimulus advocates do admit that the spending package hasn’t worked. But that doesn’t mean they’ve turned their backs on the stimulus concept. In an August blog post, for example, New York Times columnist Paul Krugman argued that the “stimulus wasn’t nearly big enough to restore full employment—as I warned from the beginning. And it was set up to fade out in the second half of 2010.”

This argument is nonsense. As Megan McArdle of The Atlantic wrote in August, “If we assume that stimulus benefits increase linearly, that means we would have needed a stimulus of, on the low end, $2.5 trillion. On the high end, it would have been in the $4–5 trillion range. I’m going to go out on a limb and say that even if Republicans had simply magically disappeared, the government still would not have been able to borrow and spend $2.5 trillion in any reasonably short time frame, much less $4–5 trillion. The political support for that level of government expansion simply wasn’t there among Democrats, much less their constituents.”

Unless you believe that federal spending magically conjures up purchasing power (or that morphine heals bones), the total GDP will remain unchanged, because the federal government has to borrow the stimulus money from either domestic or foreign sources. This borrowing in turn reduces other areas of demand.

Stimulus spending does not increase total demand. It merely reshuffles it, leaving the economy just as weak as before—if not weaker, since it also increases the national debt. By trying to ease the pain, the administration may well have made the patient worse.

#### Stimulus Fails-09 ARRA prooves

[Chapman](http://reason.org/contrib/show/) 11-  columnist and editorial writer for the Chicago Tribune (Steve 6/30/11 "Stimulus to Nowhere", Reason.org, <http://reason.org/news/show/stimulus-to-nowhere>)//AP

Mired in excruciating negotiations over the budget and the debt ceiling, President Barack Obama might reflect that things didn't have to turn out this way. The impasse grows mainly out of one major decision he made early on: pushing through a giant stimulus.

When he took office in January 2009, this was his first priority. The following month, Obama signed the American Recovery and Reinvestment Act, with a price tag eventually put at $862 billion.

It was, he said at the time, the most sweeping economic recovery package in our history," and would "create or save three and a half million jobs over the next two years."

The president was right about the first claim. As a share of gross domestic output, it was the largest fiscal stimulus program ever tried in this country. But the second claim doesn't stand up so well. Today, total nonfarm employment is down by more than a million jobs.

What Obama didn't foresee is that his program would spark a populist backlash and give rise to the tea party. Where would Michele Bachmann be if the stimulus had never been enacted—or if it had been a brilliant success?

To say it has not been is to understate the obvious. The administration says the results look meager because the economy was weaker than anyone realized. Maybe so, but fiscal policy is a clumsy and uncertain tool for stimulating growth, which the past two years have not vindicated.

The package had three main components: tax cuts, aid to state governments, and spending on infrastructure projects. Tax cuts would induce consumers to buy stuff. State aid would prop up spending by keeping government workers employed. Infrastructure outlay would generate hiring to build roads, bridges, and other public works.

That was the alluring theory, which vaporized on contact with reality. The evidence amassed so far by economists indicates that the stimulus has come up empty in every possible way.

Consider the tax cuts. Wage-earners saw their take-home pay rise as the IRS reduced withholding. But as with past rebates and one-time tax cuts, consumers proved reluctant to perform their assigned role.

Claudia Sahm of the Federal Reserve Board and Joel Slemrod and Matthew Shapiro of the University of Michigan found that only 13 percent of households indicated they would spend most of the windfall. The rest said they preferred to put it in the bank or pay off debts—neither of which boosts the sale of goods and services.

This puny yield was even worse than that of the 2008 tax rebate devised by President George W. Bush. Neither attempt, the study reported, "was very effective in stimulating spending in the near term."

The idea behind channeling money to state governments is that it would reduce the paring of government payrolls, thus preserving the spending power of public employees. But the plan went awry, according to a paper by Dartmouth College economists James Feyrer and Bruce Sacerdote published by the National Bureau of Economic Research.

"Transfers to the states to support education and law enforcement appear to have little effect," they concluded. Most likely, they said, states used the money to avoid raising taxes or borrowing money.

That's right: The federal government took out loans that it will have to cover with future tax increases ... so states don't have to.It's like paying your Visa bill with your MasterCard.

The public works component could have been called public non-works. It sounds easy for Washington to pay contractors to embark on "shovel-ready projects" that needed only money to get started. The administration somehow forgot that even when the need is urgent, the government moves at the speed of a glacier.

John Cogan and John Taylor, affiliated with Stanford University and the Hoover Institution, reported earlier this year that out of that $862 billion, a microscopic $4 billion has been used to finance infrastructure. Even Obama has been chagrined.

"There's no such thing as shovel-ready projects," he complained last year.

Even if jobs were somehow created or saved by this ambitious effort, they came at a prohibitive price. Feyrer and Sacerdote say the costs may have been as high as $400,000 per job.

#### Next stimulus will be just as ineffective as the last-once money runs out new jobs dissapear and gov't is left with the debt

de [Rugy](http://reason.org/contrib/show/veronique-de-rugy) 11—Ph.D. and MA in Economics from the University of Paris, senior research fellow at the [Mercatus Center](http://mercatus.org/) at George Mason University (Veronique "The Facts About Stimulus Spending" Reason.org, 7/8/11, <http://reason.org/news/show/the-facts-about-stimulus-spending>)//AP

Economists on both sides of the aisles argue that one reason why the stimulus failed is that it wasn’t designed properly. Stanford University’s John Taylor, for instance, has argued that although much money was spent, very little stimulus money was spent in the form of actual government purchase. In a paper with he [co-authored with John Cogan](http://www.stanford.edu/~johntayl/Cogan%20Taylor%20multiplicand%2010-25.pdf), Taylor finds that, out of the total $682 billion package, federal infrastructure spending was just $0.9 billion in 2009 and $1.5 billion through the first half of 2010—or less than four-tenths of 1 percent.

Taylor and Cogan also noted that most of the money generated by tax cuts was saved, not spent, and that the money that went to state governments was spent to reduce the states’ reliance on borrowing and on other “non-purchase” items, such as transfer payments, subsidies, and interest payments. In other words, the additional money that went to states and taxpayers didn’t change a thing. Taylor claims that a better-designed stimulus would have probably been more effective.

But experience tells us that the next stimulus won’t be any better. As the chart above shows, only 3 percent of the last stimulus went to infrastructure spending. Why? Because such programs are not political winners. For one thing, they take too long to produce results. Therefore they always take a back seat to politically-popular tax credits and transfers to the states.

Furthermore, while it may be true that additional infrastructure spending would have proved more effective than the current stimulus, that doesn’t change the fact that once the stimulus money goes away, the jobs and increased demand also disappear, and the government is left holding the debt.

### at: multiplier

#### War expenditures disprove the Keynesian multiplier

Barro 9 Barro is the Paul M. Warburg Professor of Economics at Harvard University, a senior fellow of the Hoover Institution of Stanford University, and a research associate of the National Bureau of Economic Research. (Robert “voodoo multipliers” Berkley electronic press February 2009 <http://www.economics.harvard.edu/files/faculty/7_09_02_VoodooMultipliers_EconomistsVoice.pdf>)//BM

Back in the 1980s, many commentators ridiculed as “voodoo economics” the extreme supply-side view that across-the board cuts in income-tax rates might raise overall tax revenues. Now we have instead the extreme demand-side view that the multiplier effect of government spending on output is greater than one (Team Obama is reportedly using a number around 1.5).To think about this assumed multiplier, suppose first that it took on the lower value 1.0. In this case, an increase by one unit in government purchases and, thereby, in the aggregate demand for goods would lead to an increase by one unit in real gross domestic product (GDP). Thus, the added public goods are essentially free to society. If the government buys another airplane or bridge, the economy’s total output expands by enough to create the airplane or bridge without requiring a cut in anyone’s consumption or investment**.** The explanation for this magic is that idle resources—unemployed labor and capital—are put to work to produce the added goods andservices. If there is a social cost, it is only that people who used to be unemployed have less leisure because they are working. If the multiplier is greater than 1.0, as apparently assumed by Team Obama, the process is even more wonderful**.** In this case, real GDP rises by more than the increase in government purchases. Thus, in addition to the free airplane or bridge, we also have more goods and services left over to raise private consumption or investment. In this scenario, the government spending is a good idea even if the bridge goes to nowhere or if government employees are just uselessly filling holes. This free lunch would make Charles Ponzi proud. If the deal is genuine, why stop with only $1 trillion or so of added government purchases? So, where is the flaw in the argument? The theory (a simple Keynesian macroeconomic model) implicitly assumes that the government is better than the private market at marshaling idle resources to produce useful stuff. Unemployed labor and capital can be utilized at essentially zero social cost, but the private market is somehow unable to figure any of this out. Implicitly, there is something wrong with the price system. Keynes thought that the problem lay with wages and prices that were stuck at excessive levels. But this problem could be readily solved by expansionary monetary policy, enough of which will mean that wages and prices do not have to fall. So, something deeper must be involved—but economists have not convincingly identified market failures, such as incomplete information or moral-hazard problems that generate multipliers above one. A much more plausible starting point is a multiplier of zero. In this case, the real GDP is given, and a rise in government purchases requires an equal fall in the total of other parts of GDP—consumption, investment, and net exports. In other words, the social cost of one unit of additional government purchases is one. This approach is the one usually applied to cost-benefit analyses of public projects. In particular, the value of the project (counting, say, the whole flow of future benefits from a bridge or a road) has to justify the cost of the public outlay. I think this perspective, not the supposed macroeconomic benefits from fiscal stimulus, is the right one to apply to the many new and expanded government programs that we are likely to see this year and next. Aside from theory, what is true about multipliers in the data? Because it is not easy to separate movements in government purchases from overall business fluctuations, the best evidence comes from large changes in military purchases that are driven by shifts in war and peace. A particularly good experiment is the massive expansion of U.S. defense expenditures during World War II. This case works well because the United States from 1941 to 1945 did not suffer from the massive destruction of property and life that led to large declines in real GDP in many other countries during WWII. In any event, the usual Keynesian view is that the WWII fiscal expansion provided the stimulus that finally got the U.S. economy out of the Great Depression. Thus, I think that most macroeconomists would regard this case as a fair one for seeing whether a large multiplier ever exists. I have estimated (in my book Macroeconomics, A Modern Approach) that World War II raised U.S. real defense expenditures by $540 billion (1996 dollars) per year at the peak in 1943–44, amounting to 44% of trend real GDP. I also estimated that the war raised real GDP above trend by $430 billion per year in 1943–44. Thus, the multiplier was 0.8 (430/540). The other way to put this is that the war lowered components of GDP aside from military purchases. The main declines were in private investment, non-military parts of government purchases, and net exports—personal consumer expenditure changed little. We can consider similarly three other U.S. wartime experiences—World War I, the Korean War, and the Vietnam War—although the added defense expenditures were much smaller in comparison to GDP than that for WWII. When I combined the evidence for all four wars, I got an overall estimate of the multiplier of 0.8, the same value as before. (This similarity is not so surprising because WWII gets a lot of weight due to its particularly large change in government purchases when expressed as a ratio to GDP.) In an earlier study in the Journal of Political Economy, I got a similar regression-based estimate for the multiplier effect on real GDP from temporary defense purchases—for a sample from 1942 to 1978, the coefficient was 0.71, with a standard error of 0.06. There are reasons to believe that the war-based multiplier of around 0.8 substantially overstates the multiplier for peacetime government purchases. For one thing, the temporary nature of much of military spending during wars means that consumer demand would not fall a lot. In contrast, an increase in non-war spending—which historically has been mostly permanent—would tend to reduce consumer demand substantially through a negative income effect. Second, the use of the military draft in wartime has a direct, coercive effect on total employment. Third, the U.S. economy was already growing rapidly after 1933 (aside from the 1938 recession), and it is probably unfair to ascribe all of the rapid GDP growth from 1941 to 1945 to the added military outlays. Another point is that the added labor during the two world wars was very large, and much of this expansion cannot be viewed as merely putting idle labor to work. For example, the dramatic rise in female labor during WWII likely had a sizable social cost. When I attempted to estimate directly the multiplier associated with peacetime government purchases, I got a number that was statistically insignificantly different from zero. In the regression-based results from my 1981 Journal of Political Economy paper, for the sample from 1942 to 1978, the estimate was 0.14 with a standard error of 0.51. Thus, the regression did not pin down the non-war multiplier very well. As we all know, we are in the middle of what will likely be the worst U.S. economic contraction since the 1930s. In this context and from the history of the Great Depression, I can understand various attempts to prop up the financial system. These efforts, akin to avoiding bank runs in prior periods, recognize that the social consequences of credit-market decisions extend well beyond the individuals and businesses making the decisions. That is, externalities are likely to be important in the financial sector. But, in terms of fiscal-stimulus proposals, it would be sad if the best that Team Obama can offer is an unvarnished version of Keynes’s General Theory, 1936. The financial crisis and possible depression—which I take very seriously—do not invalidate everything we have learned about macroeconomics since 1936.In designing effective policy responses, much more focus should be on incentives for people and businesses to invest, produce, and work. On the tax side of fiscal stimulus, we should avoid programs that throw money at people and emphasize instead reductions in marginal income-tax rates—especially where these rates are already high and fall on capital income. We should keep in mind the structure of rate-cutting programs that worked: Kennedy-Johnson 1963–64, Reagan 1981–83 and 1986, and Bush 2003. At the present moment, the full elimination of the federal corporate income tax would be brilliant. (In the long run, the best way to raise more real tax revenue—for example, to pay for healthcare and public retirement programs—is likely to involve a value-added tax. However, I hesitate to recommend this efficient form of taxation because its presence makes it too easy for government to grow.) Going back to the spending side, my main point is that we should not use the cover of fiscal stimulus to undertake massive public works programs that do not pass muster from the perspective of cost-benefit analysis. (And, by the way, “shovel-ready project” is probably the silliest term I have ever heard in a discussion of macroeconomic policy.) Just as in the 1980s, when extreme supply-side views on tax cuts were unjustified, it is wrong now to think that added government spending is free.

### models

#### Keynesian stimulus conclusions are flawed – models and authors inaccurately describe their effects

Cochrane, 10 - professor of Finance at the University of Chicago Booth School of Business (John H. “Fiscal Stimulus, RIP” November 9, 2010, http://faculty.chicagobooth.edu/john.cochrane/research/papers/stimulus\_rip.html)//AH

Stimulus has all the telltale signs of bad, crackpot ideas. Already, I’ve mentioned repudiation of literally all macroeconomics taught in every Ph.D. program since 1980. Here are some more “Bad Science Detectors:” 1. Stimulus supporters never say how it will work, and just cite authority. Ok, there’s this Barro theorem that says stimulus can’t work. Which one of the assumptions did administration economists or popular advocates disagree with? Let’s check. Instead, they simply assert it will work not even mentioning the classic theorem to the contrary.2. They don’t take their own ideas seriously. Here are some examples. a) If you really believe Keynesian Stimulus, you think Bernie Medoff is a hero. Seriously. He took money from people who were saving it, and gave it to people who were going to consume it. In return he gave the savers worthless promises that look a lot like government debt. b) If you really believe in Keynesian Stimulus, then you don’t care if the money is spent properly or simply stolen. In fact, it would be better if it were stolen: thieves have a notoriously high propensity to consume, and their “spending” doesn’t wait for environmental impact statements unlike the unfortunate “shovel-ready” projects. Keynesian Stimulus believers should advocate leaving the money around with the doors open. c) Keynesian stimulus has nothing to do with “creating” or “saving jobs” directly, “green” industrial policy, or “infrastructure.” If they believe their model, they should say loudly that it doesn’t matter how the money is spent. (And even here, there seems to be a view that the electorate can’t divide. Even if you believe that $800 billion saved something like 2 million jobs, that’s $400,000 per job!) d) Berstein and Romer’s CEA report on the stimulus famously used a multiplier of 1.5 to evaluate the effects of the stimulus. They took this multiplier from models (p.12). But the multiplier is baked in to these models as an assumption. They might as well have just said “we assume a multiplier of 1.5.”More deeply, why use the multiplier from the model, and not the model itself? These “models” are after all, full-blown Keynesian models designed purposely for policy evaluation. They have been refined continuously for 40 years, and they epitomize the best that Keyesian thinking can do. So if you believe in Keynesian stimulus, why use the multiplier and not the model? The answer, of course, is that they would have been laughed at – nobody has believed the policy predictions of large Keynesian models since Bob Lucas (1975) destroyed them. But how is it that one multiplier from the model still is a valid answer to the “what if” question, when the whole model is ludicrously flawed? If you believe the Keynesian model, let’s see its full predictions. If you don’t believe it, why do you believe its multiplier? 3. More “Bad Science” detectors. One should always distrust advocates that have one fix (“more stimulus”) for everything, like the proverbial two-year-old with a hammer to whom everything looks like a nail. It sounds a lot like the old patent-medicine salesmen: “Recession got you down? Take some fiscal stimulus. Oh, a banking crisis is causing problems? Why it’s fiscal stimulus you need, son! Sclerotic labor markets? No problem, some fiscal stimulus will perk you right up. Nasty trade dispute? Why old Dr. Paul’s fiscal stimulus will perk you right up! Foreclosures giving a you headache? Why fiscal stimulus will solve that any day.”A modern economy is a lot more complex than a car, and the answer to car troubles is not always “more gas.” If you see a solution being advocated for every problem, you begin to wonder how serious is the analysis that it solves any problem. 4. Finally, the desperation of recent arguments Keynesian stimulus advocates is a good indication of empty ideas

#### Keynesian Stimulus fails– models inaccurately portray results

Shiff, 12 - CEO and chief global strategist of Euro Pacific Capital Inc., BA @ Berkley in finance and accounting( Peter, “Keynesians Jump The Gun On Inflation” Feb. 13, <http://articles.businessinsider.com/2012-02-13/markets/31054158_1_stimulus-paul-krugman-consumer-prices#ixzz1ySSlN9ZL)//AH>

Advocates of government stimulus are running victory laps before the race is even over. In particular, Paul Krugman compares the sluggish growth in Europe to the somewhat-less-sluggish growth in the US to prove that stimulus was more effective than austerity. Other economists are using government inflation measures to vindicate Fed Chairman Bernanke's easy-money policy. The only problem is, they're calling the race before the finish line is even in sight. As usual, Paul Krugman overlooks basic economics, which, despite his Nobel Prize, is a science about which Mr. Krugman really knows very little. The reason stimulus is so politically popular is that it appears to work in the short-term. However, appearances can often be deceiving, as they are right now in the US. Stimulus merely numbs the pain of economic contraction, as the underlying illness gets worse. The bitter taste of austerity is not nearly as pleasant to swallow – but it works. America has chosen the former and Europe the latter (albeit not quite as large a dose as needed). The fact that in the short-run Europe is suffering more than the US does not vindicate Washington's approach. On the contrary, this is exactly what is to be expected. Continue Below The true test is not the immediate effects of stimulus or austerity, but the long-term results. For that reason, Krugman’s conclusions are meaningless. The apparent success of stimulus simply results from spending more borrowed money on government programs and consumption. But don't we all agree now that this is exactly what caused the financial crisis in the first place? As far as inflation is concerned, a vindication of Federal Reserve Chairman Ben Bernanke is equally premature. First of all, it’s not that Quantitative Easing will lead to inflation; it’s that QE is inflation. Secondly, there is a lag between QE and rising consumer prices, so the jury is still out as to how high consumer prices will ultimately rise as a result of current and past Fed policy mistakes. But even more fundamentally, it is absurd to look solely at government price measures, which are built to understate inflation, and conclude that QE has not already produced an elevated cost-of-living . For example, the 2.4% rise in the Personal Consumption Expenditure (PCE) Index in 2011 is more of an indictment of the accuracy of the index than a vindication of Bernanke. In fact, of all the ways the government purports to measure inflation, the PCE is perhaps the most meaningless, as it relies on built-in mechanisms like goods substitution to hide a lower standard of living. For an example of how this works, imagine you are used to eating farm-fresh butter but have to switch to cheaper but also less-healthy margarine from a factory; the PCE would say you are no worse off. That's exactly why the Fed chose to use this uncommon metric. Mark Gertler, an economics professor at New York University, argues that even the Consumer Price Index, which rose at a more vigorous 3.2% in 2011, proves Bernanke’s critics wrong. According to Gertler, the CPI has risen at an average annual rate of 2.4% thus far under Bernanke’s tenure, significantly less than the 3.1% average under Alan Greenspan, and the 6.3% under Paul Volcker. However, Gertler overlooks two key points. First, the methodology used to calculate the CPI was much different during the Volker era. If we still calculated the CPI the way we did then, the numbers would be much higher for both Greenspan and Bernanke. Second, given the huge economic contraction that has taken place under Bernanke, consumer prices should have fallen – significantly. The fact that they rose anyway indicates tremendous inflation. Of course, the Fed’s ability to stimulate the economy with inflation only works as long as bondholders remain ignorant of their plan. For now, the seemingly hopeful news reports are giving the Fed cover to keep stimulating. As long as the market remains convinced there is no inflation, the Fed can continue to create it. However, once the effects are so pronounced that even the PCE can no longer hide them, the Fed will be in a real bind. Regardless of what the triumphant Keynesians would have you believe, the truth is that the current combination of monetary and fiscal stimulus will likely lead to disaster. Instead of a real recovery, the US will experience an inflationary depression. Europe, on the other hand, will suffer much less, precisely because it was not seduced by the short-term appeal of stimulus.

### delay

#### **Public investment particularly in infrastructure cause delays which result in negative economic effects**

Leeper, 10 - Department of Economics, Indiana University, research fellow @ NBER, (Eric M. “Government Investment and Fiscal Stimulus in the Short and Long Runs” March 31, [http://siteresources.worldbank.org/INTMACRO/Resources/SusanLWYGovtInvestRevisionMay20.pdf)//AH](http://siteresources.worldbank.org/INTMACRO/Resources/SusanLWYGovtInvestRevisionMay20.pdf%29/AH)

The analysis shows that implementation delays and expected ﬁscal adjustments can hinder the beneﬁcial eﬀects of government investment at both short and long horizons. Implementation delays determine the rate of spending outlays for government investment, and the 1ARRA was estimated to add about $720 billion stimulus between ﬁscal years 2009 and 2011, roughly 5 percent of GDP in 2009. In addition to ARRA, Congress also passed the Economic Stimulus Act of 2008 and the Worker, Homeownership, and Business Assistance Act of 2009, estimated to add about $190 billion stimulus between ﬁscal years 2008 and 2011. 2On March 17, 2010, Congress passed Hiring Incentives to Restore Employment Act, which authorizes funding for additional infrastructure projects. 1speed at which spending occurs is crucial for short-run stimulative eﬀects. Many projects, especially infrastructure, require coordination among federal, state, and local governments and have to go through a long process of planning, bidding, contracting, construction, and evaluation. To model these delays, we use a time-to-build setup to characterize the formation of public capital, as in Kydland and Prescott (1982). Compared to a scenario with little delay, implementation delays for government investment can lead private investment to fall more and labor and output to rise less (or even decline slightly) in the short run. So long as public capital is productive, the expectation of higher government investment spending generates a positive wealth eﬀect, which discourages current work eﬀort. Depending on the implementation speed, this positive wealth eﬀect could dominate the usual negative wealth eﬀects from increasing government purchases, resulting in small or even negative eﬀects on labor and output in the short run. In addition, because private investment projects typically do not entail the substantial delays associated with public projects, private investment falls initially and does not rebound until later, when the public capital is on line and raises the productivity of private inputs. Implementation delays can postpone the intended economic stimulus and may even worsen the downturn in the short run. Delays in government investment are analogous to the phased-in tax cuts enacted in 2001 and 2003, where expectations of future tax cuts may have induced workers and ﬁrms to postpone work and production, actions that House and Shapiro (2006) argue retarded the recovery from the 2001 recession. 3 Current weakness in employment growth, which falls short of the administration’s predictions of the eﬀects of the ARRA, may be partly attributable to implementation delays in government investment

### systematic problems

#### Government stimulus is pointless—fundamental systematic problems

Batra, 12 – Rishee’s dad and economics professor at Southern Methodist University (Ravi, “The Cost of Trickle-Down Government Job Creation: $1.5 Million Per Worker,” Truthout, 1/8/2012, <http://truth-out.org/index.php?option=com_k2&view=item&id=5932:the-cost-of-trickledown-government-job-creation-15-million-per-worker>)//HK

Suppose I were to tell you that for the past two years the federal government has been spending nearly $1.5 million to create one job, what would your reaction be? Would it be one of disbelief and bewilderment? But suppose I were to prove my statement by citing official data, then how would you react? Well, you make up your own mind, but my response is that the administration's advisers should rethink their approach. Does it make sense to spend so much money to generate one job when the average wage is less than $50,000 per year? In fact, this policy is so foolish that it might even be better just to hand over the average salary to the unemployed so they stay calm, make both ends meet and create consumer demand.

Let me prove my point. The administration's tack is that we should keep spending money at the current rate to preserve jobs, even though the annual federal budget deficit has been around $1.4 trillion over the past two years. In fact, the government even plans to increase its shortfall by raising the size of the payroll tax cut. It seems apparent that the main purpose of excessive federal spending is to preserve or generate jobs. This is a point emphasized by every American president since 1976, and especially since 1981 when the federal deficit began to soar. This is also how most experts defend the deficit nowadays.

In 2010, according to the Economic Report of the President, as many as 800,000 jobs were created, and the government's excess spending was $1.4 trillion, which when divided by 800,000 yields 1.7 million. In other words, our government spent $1.7 million to generate a single job. The economy has improved this year, providing work to 1.1 million people for the same expense. So, dividing 1.4 trillion by the new figure yields $1.3 million, which is now the cost of creating one job. Thus, the average federal deficit or cost per job over the past two years has been $1.5 million.

To be sure, a part of the red ink arose from financing the wars in Iraq and Afghanistan. Their expense each year was about $100 billion. This reduces the government cost of job creation somewhat, but then we should add the trillions that the Federal Reserve has spent since 2008, presumably to stabilize the financial system and preserve employment. In 2011, the Fed spent at least $600 billion in a program known as QE3 (Quantitative Easing 3) in order to stimulate the economy and revive the job market. If you do the math, the federal job creation cost is a minimum $1.5 million per worker. So, a trillion here, a trillion there, and pretty soon you're talking real money. Is it prudent to be wasting our precious resources like this? I don't think so.

The trillion dollar question is this: where is it all going, when the annual average wage is no higher than $50,000? Obviously, it must be going to the so-called 1 percent group or what the Republican Party calls the job creators, i.e., the mostly male CEOs and other executives of large corporations. See how generous these people are; they only want and get chump change from the government so as to offer work to the unemployed. Nearly the entire federal deficit goes to enrich the Big-Business-Big-Bonus CEO, yet he claims to do us all a favor by providing jobs, and demands all sorts of tax breaks.

Let us see how the main culprit for the mushrooming incomes of business magnates is our own government. This is how the process works and has been working since 1981. The CEO forces his employees to work very hard while paying them low wages; this hard work sharply raises production or supply of goods and services, but with stagnant wages, consumer demand falls short of growing supply. This then leads to overproduction and threatens layoffs, which in turn threatens the re-election chances of politicians. They then respond with a massive rise in government spending or huge tax cuts, so that total demand for goods and services rises to the level of increased supply. As a result, either those layoffs are averted or the unemployed are gradually called back to work. This way, the CEO is able to sell his entire output and reap giant profits in the process, because wages are dwindling or stagnant even as business revenue soars. In the absence of excess government spending, companies would be stuck with unsold goods and could even suffer losses. In other words, almost the entire federal deficit ends up in the pockets of business executives.

How does government spending generate demand for goods and services? Many administrative departments, such as defense, directly buy goods from the private sector. The government also pays employee salaries, Social Security pensions, unemployment benefits, among other things. Here, the generation of demand is indirect, as the recipients of such money also add to total spending. Both the direct and indirect government spending generate demand in the economy, absorb unsold goods and thus add to business revenues.

So, CEOs are very, very happy, and when they are happy, politicians of all persuasions are happy. After all, corporate America is ultra generous to the political class. No wonder, both Republicans and Democrats alike have been busy adding to the federal deficit in the name of creating jobs. We all need to understand the process through which our system works for the 1 percent clique, and how mega deficits are mainly responsible for enriching the rich.

We don't need higher government spending or tax cuts. We need fundamental economic reforms so that wages rise proportionately with ever-growing labor productivity. This is what used to happen in the United States until 1980, when consumer demand equaled supply without much government debt. But at that time. we did not have trade deficits, outsourcing and merger manias. Back then, the minimum wage was allowed to catch up with rising prices. However, ever since 1981, the official economic policy has been designed to keep wages stagnant even as people work hard and students take large loans to educate themselves to hone their skills. Consequently, almost the entire fruit of soaring productivity has gone to the 1 percent group, while millions of students are stuck with college loans.

From 1940 to 1980, there was little change in income and wealth disparity in the United States. However, ever since then, inequality has been soaring, leading to a shrinking middle class. The culprits: huge federal deficits and faulty official policies. And how are we financing these deficits? We are borrowing money from China and other countries, which in effect means that the wealthy prosper as never before, while the nation becomes a beggar to the world. Unfortunately, this system will continue unless the masses, the 99 percenters, revolt and demand fundamental economic reforms. The Occupy Wall Street movement opposes the interest of the Big-Business-Big-Bonus CEO, and in its success lies the revival of America and the middle class.

All the economic policies adopted by various administrations since 1981 have to be abandoned to fix our comatose economy. The system needs an overhaul, not bigger government. We need free markets, not monopoly capitalism. We need to break up business conglomerates and generate competition among companies, especially in the oil and health care industries, in order to bring down the cost of their products. We need to get rid of the trade deficit and outsourcing and link the minimum wage with the cost of living. Hats off to the Occupy Wall Street movement.

#### Stimulus fails to address root cause of economic problems-just makes them worse

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During the past three years, the U.S. economy has taken a dive and, in some important ways, remained more or less submerged since it hit bottom. According to the latest government estimates, **real GDP fell about 5 percent between its peak in the fourth quarter of 2007 and its trough in the second quarter of 2009**. Since then it has recovered slowly, but only back to approximately the same level it had attained at its pre-recession peak. Thus, nothing has been gained during the past three and a half years.

**Other aspects of the economy, however, look even worse**. Unemployment, as measured by the Labor Department’s most widely cited index, has been stuck at 9-10 percent of the civilian labor force for more than two years.

Making matters worse, long-term unemployment has increased greatly, as has part-time work by persons who say they would rather have full-time jobs. The Labor Department’s index of aggregate weekly hours worked by private employees fell by about 10 percent between June 2007 and October 2009. Although this index has increased a bit since then, in July 2011 it remained 6.6 percent below its previous peak.

Keynesians advise that in such circumstances, the federal government should increase its spending for final goods and services, and the government has taken this advice to heart with a vengeance. Real federal spending for consumption and gross investment goods increased by 18 percent between the fourth quarter of 2007 and the third quarter of 2010. Although this kind of spending has declined slightly in the past three quarters, it remained in the second quarter of 2011 almost 15 percent greater than it was in the fourth quarter of 2007So, we have had Keynesian stimulus aplenty, but the effects have fallen far short of putting the millions of unemployed workers back to work and propelling the economy to a high-employment rate of output. Recent economic conditions indicate that even the paltry recovery that has occurred may be petering out, and many economic prognosticators foresee another steep dive in the near-term future. Doctrinaire Keynesians insist that the economy needs a bigger dose of government deficit spending to recover fully, but less doctrinaire observers conclude that the various stimulus actions have simply failed. More important, perhaps, lenders who have financed the government’s recent spending binge are losing faith in the government’s ability to repay as promised, given the rapid recent run-up in total government indebtedness to the public.

No one is reassured, of course, by the idea that if private investors, sovereign lenders, and foreign central banks won’t continue to bankroll Uncle Sam’s profligacy, the Fed will do so. QE1 and QE2 have come and gone, with no greater success in bringing about recovery than the rest of the government’s ever-changing hodgepodge of loans, guarantees, stimulus packages, bailouts, and takeovers, and its massive borrowing to pay for the whole frantic undertaking. If the government turns to the Fed to monetize its rapidly mounting debt, we can only fear all the more that accelerating general price inflation awaits us.

In light of the foregoing facts, a radical change in policy making seems well warranted.

In politics, however, incumbency counts for a great deal. Officeholders have rigged the system by gerrymandering and other tricks to help to ensure their reelection. Established interest-groups have supported and attached themselves to the president, members of Congress, and bureaucrats from whom they secure government assistance―privileges and subsidies for their members and statutes, regulations, and administrative rulings that hobble their competitors. When a recession occurs, many of those who fall into trouble are, in effect, rotten apples. Their projects and enterprises need to be liquidated if the entire economy is to make rapid, sustainable headway. Their political clout, however, virtually guarantees that they will get bailouts and other government assistance to keep them afloat. They may float for a while, to be sure, yet they are nonetheless rotten. And they are a continuing drag on the overall economy’s recovery.

Thus, we now have, among other things, millions of houses sitting unoccupied, thousands of commercial properties similarly unused, and trillions of dollars in mortgage-related securities and derivatives whose values remain extremely iffy. Much of this debris would have been cleared away already, but for the government’s TARP, its series of stimulus-spending packages, its takeovers of huge auto and financial companies, and the Fed’s corresponding actions to flood the financial system with liquidity and prop up banks and other firms deemed “too big to fail.” Many of these incumbent firms continue to operate, even though they ought to have passed through bankruptcy proceedings long ago. Many banks are little more than zombies, living only by transfusions of reserves from the Fed and investing in little besides U.S. government securities.

All of this amounts to a rotten-apple operation. The contents of the economic barrel are still a mess. If the government and the Fed continue to pour trillions of dollars into efforts that do nothing more than polish the rotten apples, the entire contents of the barrel will become less and less valuable over time. Keynesianism was a bogus theory from the start. Thinking about why the economy succeeds or fails in terms of a handful of economic aggregates conceals everything we need to know if we are truly to understand it. Supposed experts who can’t tell a good apple from a rotten one should be kept out of the orchard. They are not helping. Indeed, they have made matters much worse at this point than would have been the case if the government **had done nothing at all** to reverse the recession.

### econ resilient

#### The economy is **resilient**

WSJ 6-19**-12** (Fannie Mae’s Economic and Strategic Research Group, “Global Political Economic Risks Rise at Mid-Year: U.S. Economy Slows”, Wall Street Journal, June 19, 2012, [http://www.marketwatch.com/story/global-political-economic-risks-rise-at-mid-year-us-economy-slows-2012-06-19)//sjl](http://www.marketwatch.com/story/global-political-economic-risks-rise-at-mid-year-us-economy-slows-2012-06-19%29/sjl)

"For the third year in a row we are experiencing a spring lull in economic activity," said Fannie Mae Chief Economist Doug Duncan. "Our view is that the underlying resilience of the economy and of consumers in particular that has been demonstrated during the past couple of years will persist. However, the magnitude of the uncertainties surrounding the European debt crisis and our fiscal condition here in the U.S. implies that the risks to the outlook are clearly tilted to the downside." The housing market has performed relatively well in the current environment supported by record affordability and very low interest rates, with home sales up 8 percent year over year, but from very depressed levels in numeric terms compared to 2011. In turn, cautious optimism remains in place for continued gradual healing of the housing market, albeit in the face of various headwinds, including weak employment growth, rising student loans, and a continuing stream of foreclosed households. Main measures of home prices have firmed in recent months, as the share of distressed sales has declined in a strong seasonal period. Despite this recent encouraging trend, the Group continues to expect that home prices on a national basis will show a slight additional decline before bottoming in the beginning of next year.

#### Stimulus is unnecessary – monetary policy is sufficient

Taylor, 9 - Professor of economics @ Stanford (John B. “THE LACK OF AN EMPIRICAL RATIONALE FOR A REVIVAL OF DISCRETIONARY FISCAL POLICY”, CESi fo Forum, Feb., http://www.ifo.de/portal/pls/portal/docs/1/1191494.PDF)//AH

Another reason for the widespread view a decade ago about fiscal policy was that monetary policy had improved after the late 1960s and 1970s and played an essential countercyclical role as it achieved both greater price and output stability during the great moderation. However, there were also concerns expressed about the limits of monetary policy if the zero bound on interest rates were to be reached as it CESi fo Forum 2/2009 12 Focus Table 3 had in Japan in the 1990s. The recent change in monetary policy in the United States and the resulting constraint of the zero bound is another reason why some are calling for discretionary fiscal policy actions. In my view, however, the experience during the past decade does not show that monetary policy is ineffective or that fiscal policy is more appropriate when the short term interest rate reaches the lower bound of zero. Indeed, the lesson from Japan is that it was the shift toward increasing money growth – quantitative easing – in 2001 that finally led to the end of the lost decade of the 1990s. It was certainly not discretionary fiscal policy actions. Increasing money growth – or simply preventing it from falling as in the Great Depression – remains a powerful countercyclical policy. While a full treatment of monetary policy in the current environment is well beyond the scope of this paper, there is no evidence in the past decade that suggests that monetary policy has run out of ammunition and must be supplemented by discretionary fiscal actions. Conclusion A decade ago there was widespread agreement that fiscal policy should avoid countercyclical discretionary actions and instead should focus on the automatic stabilizers and on longer term fiscal reforms that positively affect economic growth and provide appropriate government services, including infrastructure and national defense. In this paper I briefly summarized the empirical evidence during the past decade on (1) the temporary rebate programs of 2001 and 2008, (2) macro-econometric model simulations, (3) the changing cyclical response of the automatic stabilizers, and (4) the role of monetary policy in a zero interest situation. Based on this review I see no empirical rationale for a revival of countercyclical discretionary fiscal policy.

### econ uq—quantitative easing

#### Federal Reserve already planning to provide stimulus

**Reuters 6-20-12-(**Mark Felsenthal and Pedro da Costa, “Fed ramps up economic stimulus, says may do more”, Reuters, June 20, 2012, [http://www.reuters.com/article/2012/06/20/us-usa-fed-idUSBRE85I1Q020120620)//sjl](http://www.reuters.com/article/2012/06/20/us-usa-fed-idUSBRE85I1Q020120620%29/sjl)

The Federal Reserve on Wednesday delivered another round of monetary stimulus and said it was ready to do even more to help a U.S. economic recovery that looks increasingly fragile. "We are prepared to do what is necessary. We are prepared to provide support for the economy," Fed Chairman Ben Bernanke said at a news conference after a two-day policy meeting. The central bank expanded its "Operation Twist" by $267 billion, meaning it will sell short-term securities and buy long-term ones in an effort to keep borrowing costs down. The program, which was due to expire this month, will now run through the end of the year. It also slashed its estimates for U.S. economic growth this year to a range of 1.9 percent to 2.4 percent, down from an April projection of 2.4 percent to 2.9 percent. It cut forecasts for 2013 and 2014, as well. In addition, **Fed officials said they expect the job market to make slower progress than they did just a couple months ago,** with the unemployment rate now seen hovering above 8 percent for the remainder of this year. It stood at 8.2 percent in May. The announcement of the extension of Twist met with a mixed reaction in financial markets. Prices for U.S. stocks and government bonds see-sawed. The dollar fell against the euro and rose against the yen. "This is a small step. This is probably the least of their unconventional easing tools that they could have used," said Ethan Harris, North American economist for Bank of America/Merrill Lynch in New York. A number of economists said the Fed was likely to eventually launch a third round of outright bond purchases, or quantitative easing, which would expand the Fed's holdings of assets. "If we don't see continued improvement in the labor market, we will be prepared to take additional steps if appropriate," Bernanke said. "I think there should be some conviction that they are needed, but if we do come to that conviction, then we will take those additional steps."

#### Federal Reserve expected to boost US economy with quantitative easing

**Reuters 6-20-12-**(“Fed Extends 'Operation Twist,' Citing Concerns on Economy”, CNBC, June 20, 2012, [http://www.cnbc.com/id/47890974)//sjl](http://www.cnbc.com/id/47890974%29/sjl)

The Federal Reserve, worried about the US economic recovery and Europe's continued debt crisis, decided Wednesday to extend the stimulus program known as "Operation Twist" through the end of this year. Stocks initially fell on disappointment that the Fed offered no additional easing, but the market soon rebounded on hints the central bank is still weighing such a move. In a significant change in the post-meeting statement, the Fed said it is "prepared to take further action," a stronger sign that there may be a third round of quantitative easing, or QE3. Many economists had expected the Fed to extend "Operation Twist," the program aimed at pushing down longer-term interest rates to shield the still fragile economy, which faces rising financial strains in Europe, a year-end fiscal showdown in Washington and a sharp slowdown in hiring by U.S. employers.

### econ uq—growing now

#### Leading Indicators show US economy maintaining modest growth

**AP 6-21-12**-(“Measure of US economy rose 0.3 percent in May, the 7th increase in 8 months”, Washington Post, June 21, 2012, [http://www.washingtonpost.com/business/economy/measure-of-us-economy-rose-03-percent-in-may-the-7th-increase-in-8-months/2012/06/21/gJQAyptmsV\_story.html)//sjl](http://www.washingtonpost.com/business/economy/measure-of-us-economy-rose-03-percent-in-may-the-7th-increase-in-8-months/2012/06/21/gJQAyptmsV_story.html%29/sjl)

A measure of future U.S. economic activity rose in May to the highest level in four years, a sign the economy will keep growing but at a modest pace. The Conference Board said Thursday that its index of leading economic indicators rose 0.3 percent last month, after a 0.1 percent drop in April. April’s drop was the first in seven months. The index is now at 95.8. The last time it was higher was June 2008, six months into the Great Recession. Prior to the recession, the index routinely topped 100.

Other figures released Thursday, however, suggest the economy is softening. Weekly applications for unemployment benefits were little changed last week from a level that signals weak job growth. And factory activity in the Philadelphia region contracted for the second straight month, according to a survey by the Philadelphia Federal Reserve Bank. Seven of the ten components of the Conference Board’s index rose last month. The biggest drivers of the increase in the index were building permits, the spread between short-term and long-term interest rates, and an increase in new manufacturing orders, according to a survey by the Institute for Supply Management. The economy “is growing modestly, neither losing nor gaining momentum,” said Ken Goldstein, an economist at the Conference Board, a business research group. “The result is more of a muddle through.”

#### The economy will recover on its own by the end of 2012

**Dr. Gnuschke 12** Dr. John E. Gnuschke is Director of the Bureau of Business and Economic Research and the Center for Manpower Studies and Professor of Economics at the University of Memphis. The Bureau and the Center are the applied business, economic, and labor market research divisions of the Fogelman College of Business and Economics.Dr. Gnuschke received his PhD and MA degrees from the University of Missouri at Columbia and his BS from Utah State University.-( John E., “LOOK FOR A STRONGER ECONOMY IN 2012”, *Business Perspectives 21. 1*, 2012, [Proquest)//sjl](http://search.proquest.com.proxy.lib.umich.edu/docview/926976812%29/sjl)

Among the most important charts and graphs in this edition of Business Perspectives are those related to jobs and those related to major local industries - financial, real estate, and transportation based industries including distribution and logistics. Low interest rates set the table for the recovery, but they cannot make the recovery happen. Only the growth of job opportunities and the growth of market drivers like real estate will indicate that the great recession is a thing of the past.

The outlook for the economy in 2012 is for a stronger recovery, nearing 2.75 percent growth in GDP, with declining unemployment rates under 8.0 percent nationally by year end combined with renewed signs of strength in most major market sectors. A global economic recovery, combined with high single-digit growth returning to China and an acceptable debt recovery plan in place in Europe, will lead the way to an increasingly bullish 2012. Memphis will respond with modest growth in employment, less than 10,000 net new jobs, but stronger growth than experienced during the last few years. The government and private segments of the local economy will also show signs of new growth as the year progresses.

#### The US economy is growing and resilient – the trucking industry proves

**Bloomberg 6-13-12-**(Anna-Louise Jackson and Anthony Feld, “Truckers As Leading Indicator Show Stable U.S. Economic Growth”, Bloomberg, June 13, 2012, [http://www.bloomberg.com/news/2012-06-14/truckers-as-leading-indicator-show-stable-u-s-economic-growth.html)//sjl](http://www.bloomberg.com/news/2012-06-14/truckers-as-leading-indicator-show-stable-u-s-economic-growth.html%29/sjl)

Rising truck shipments show the U.S. economic expansion is intact, even amid concerns that a slowdown in retail sales and Europe’s sovereign-debt crisis could stall growth. Two measures of trucking activity signal the industry remains steady and has even “firmed up” since mid-May, according to Ben Hartford, an analyst in Milwaukee with Robert W. Baird & Co. The data complement anecdotal information from carriers that freight demand ended May on a strong note after more weakness than anticipated earlier in the month, he said. “Trucking trends are reflective of an economic environment that is stable, not deteriorating,” Hartford said. The for-hire truck-tonnage index rose 2.8 percent in April from a year earlier, up from 0.2 percent the prior month, marking 29 months of growth, based on data from the American Trucking Associations. The economy has never contracted without tonnage turning negative first, so the truck figures are a leading indicator, providing the “first signal” of a slump, said Thom Albrecht, an analyst in Richmond, Virginia, with BB&T Capital Markets. His “buy” recommendations include Celadon Group Inc. (CGI), Swift Transportation Co. (SWFT) and Old Dominion Freight Line Inc. (ODFL) Another index that tracks the movement of goods between manufacturers and consumers also is a “good barometer” of the economy, said Jonathan Starks, director of transportation analysis at FTR Associates. FTR’s index of U.S. truck loadings increased 3 percent to 115.9 in April from a year earlier, the highest since 2008, based on data from the Nashville, Indiana- based transportation-forecasting company. Not Stalling April’s improvement suggests the economy is expanding. “It’s not red-hot, but it’s not stalling, either,” Starks said, adding that annual gains above 5 percent would suggest robust activity. Index growth exceeded 5 percent between July 2010 and March 2011, the data show, while gross domestic product expanded an average 2.9 percent year-over-year in the same period. Contacts at trucking companies describe a “seasonally stable demand environment,” Hartford said. Albrecht agreed, saying two carriers characterized activity in early June as “robust”

### at: ARRA worked

#### American Recovery and Reinvestment Act and Studies prove stimulus is ineffective

De Rugy 11 Senior Research Fellow with the Mercatus Center at George Mason University (Veronique “Government Spending Shrinks the Private Sector” U.S. News Nov. 2011 http://www.usnews.com/debate-club/does-stimulus-spending-work/government-spending-shrinks-the-private-sector)//BM

Both George Bush and Barack Obama implemented stimulus to bolster economic activity. So let's look at the latest attempt to use government spending to jump start the economy: the American Recovery and Reinvestment Act. Three years after Congress passed that law, unemployment lingers over 9 percent, far above the promised 7.25 percent, and the economy remains weak. Clearly, the stimulus didn't work as advertised. There are two main reasons why not. First, contrary to claims of stimulus proponents, economists are far from having reached a consensus about the actual return of government spending. Some respected economists find every dollar in government spending means more than a dollar of economic growth (a large positive multiplier in economist speak), but others find every dollar in government spending results in less than a dollar of economic growth (a negative multiplier). After reviewing the academic literature, my colleague [Matt Mitchell](http://mercatus.org/matthew-mitchell) found that the median multiplier in relevant studies is 0.87, far lower than the administration's claim that every stimulus dollar would produce $1.57 worth of activity. [[See an opinion slide show of 10 wasteful stimulus projects.]](http://www.usnews.com/opinion/slideshows/10-wasteful-stimulus-projects) Second, even if one believes that government spending could trigger sustainable economic growth, the design of the stimulus bill was such that it could not have stimulated anything: During the law's tenure, [economists explained](http://online.wsj.com/article/SB10001424052748704679204575646603792267296.html) that instead of using the money to increase government purchases, states chose to use the money [to close their budget gaps](http://www.commentarymagazine.com/article/where-did-the-stimulus-go/). This choice meant that the money went to keeping school teachers in their jobs and paying [public sector workers](http://biggovernment.com/2009/11/02/stimulus-job-creation-bigger-government/), rather than to creating jobs in the private sector. Furthermore, the spending wasn't timely: Three years after the law was adopted, [some programs still have managed to spend only 60 percent](http://www.gao.gov/new.items/d11600.pdf.) of the appropriated funds. Not only was the spending poorly timed, it also wasn't targeted. The data show that stimulus [money](http://mercatus.org/sites/default/files/publication/Did_Stimulus_Dollars_Hire_The_Unemployed_Jones_Rothschild_WP34.pdf.) wasn't targeted to those areas with the highest rate of unemployment. In fact, a majority of the spending was used to poach workers from existing jobs in firms where they might not be replaced. Finally, [a review of historical stimulus efforts](http://ideas.repec.org/a/tpr/qjecon/v117y2002i4p1329-1368.html) shows that temporary stimulus spending tends to linger. Two years after the initial stimulus, 95 percent of the new spending becomes permanent. [[Check out a roundup of editorial cartoons on the economy.]](http://www.usnews.com/opinion/photos/economy-cartoons) The law may not have worked, but could other stimulus spending work? One could say that under the best case scenario, the existence of large multiplier, a perfect implementation, and an absence of massive debt accumulation, there is a chance that stimulus may deliver some results. That level of optimism requires a heavy dose of wishful thinking, however, and should be taken with a grain of salt. [Research](http://www.people.hbs.edu/cmalloy/pdffiles/envaloy.pdf) from Harvard Business School shows that federal spending in states causes local businesses to cut back rather than to grow. In other words, more government spending causes the private sector to shrink, the exact opposite of the intended result.

#### Only thing stimulus did was increase unemployment- empirically fails

**Reynolds 10**- Senior Fellow at the Cato Institute and was formerly Director of Economic Research at the Hudson Institute (Alan, " The 'Stimulus' Actually Raised Unemployment" Cato.org, 2/19/10, <http://www.cato.org/publications/commentary/stimulus-actually-raised-unemployment>)//AP

President Obama seized on the one-year anniversary of the American Recovery and Reinvestment Act (ARRA) as an opportunity to take credit for the belated and tenuous economic recovery.

But the economy always recovered from recessions, long before anyone imagined that government borrowing could "create jobs." And we didn't used to have to wait nearly two years for signs of recovery, as we did this time.

A famous 1999 study by Christina Romer, who now heads the Council of Economic Advisers, found the average length of recessions from 1887 to 1929 was only 10.3 months, with the longest lasting 16 months.

Recessions lasted longer during the supposedly enlightened postwar era, with three of them lasting 16 to 21 months.

Keynesian countercyclical schemes have never worked in this country, just as they never worked in Japan.

The issue of "fiscal stimulus" must not be confused with TARP or with the Federal Reserve slashing interest rates and pumping up bank reserves.

One might argue that those Treasury and Fed programs helped prevent a hypothetical depression, but it's impossible to make that argument about ARRA.

The "fiscal stimulus" refers only to a deliberate $862 billion increase in budget deficits. Importantly, only 23% ($200 billion) was spent in 2009, with 47% in 2010 and 30% in later years (according to the Congressional Budget Office this January).

How could the initial $200 billion have possibly had anything to do with the 5.7% rise in fourth-quarter GDP?

The Keynesian fable presumes that faster federal spending and consumers spending their federal benefit checks were the driving forces in the rebound.

Yet the GDP report clearly said the gain "reflected an increase in private inventory investment, a deceleration of imports and an upturn in nonresidential, fixed investment that was partly offset by decelerations in federal government (defense) spending and in personal consumption expenditures."

Since federal spending accounted for exactly zero of the only significant increase in GDP, how could such spending possibly have "created or saved" 2 million jobs?

The bill was launched last year amid grandiose promises of "shovel ready" make-work projects.

In reality, as the CBO explains, "five programs accounted for more than 80% of the outlays from ARRA in 2009: Medicaid, unemployment compensation, Social Security... grants to state and local governments... and student aid."

In other words, what was labeled a "stimulus" bill was actually a stimulus to government transfer payments — cash and benefits that are primarily rewards for not working, or at least not working too hard.

Vice President Joe Biden suggested that much of the real stimulus will occur this year. Yet the new budget has a chapter called "Reviving Job Creation" that does not even mention the 2009 giveaway legislation.

In 2010, as in 2009, the ARRA is mainly a stimulus to government. Shovel-ready or not, highway programs will get only $10 billion of the borrowed booty, about 2%. "Nearly half of the outlays resulting from ARRA in 2010," says the CBO, "will be for programs administered by Health and Human Services or the Department of Education."

From the CBO figures, it appears that 39% to 44% of the $862 billion will be for increased transfer payments, including refundable tax credits (checks to people who don't pay taxes).

The American Recovery and Reinvestment Act of 2009 had extended federally funded unemployment benefits by 53 weeks, and another bill in November added 20 more — bringing the total up to 99 weeks in states with high unemployment.

As the Federal Reserve's Open Market Committee minutes for January noted: "The several extensions of emergency unemployment insurance benefits appeared to have raised the measured unemployment rate, relative to levels recorded in past downturns, by encouraging some who have lost their jobs to remain in the labor force.... Some estimates suggested it could account for 1 percentage point or more of the increase in the unemployment rate during this recession."

My own estimate, in past articles available at cato.org, is that the stimulus act added about 2 percentage points to the unemployment rate.

The evidence that extended benefits have that effect is overwhelming, fully documented by the Organization for Economic Cooperation and Development and by at least two economists in the Obama administration.

It turns out that raising the unemployment rate by a percentage point or two is the only clearly identifiable effect the stimulus act had on the jobs market. It stimulated unemployment.

#### Stimulus bill has only made unemployment worse

**de** [**Rugy**](http://reason.org/contrib/show/veronique-de-rugy) **11**- Ph.D. and MA in Economics from the University of Paris, senior research fellow at the [Mercatus Center](http://mercatus.org/) at George Mason University. (Veronique de "The Facts About Stimulus Spending" Reason.org, 7/8/11, <http://reason.org/news/show/the-facts-about-stimulus-spending>)//AP

Myth 1: Stimulus spending can jump start the economy and fix unemployment.

Fact 1: Recent experience suggests stimulus spending won’t help.

There’s no question President Barack Obama inherited a lousy economy. Yet even many prominent Democrats, including Senate Majority Whip Dick Durbin and Democratic National Committee chair Debbie Wasserman Schultz, now acknowledge that after two and a half years in office, [the president owns the economy](http://abcnews.go.com/Politics/obama-tells-republicans-deficit-reduction-tax-hikes/story?id=13956637&page=2). Unfortunately for him, things still aren’t looking so so good. That’s why the president called on Congress last week to pass a series of spending measures that he said would boost the economy, including additional infrastructure spending and an extension of the payroll tax cut for another year.

With this in mind, I thought it would be interesting to update my chart on the level of stimulus spending and unemployment [rates](http://www.nationalreview.com/corner/271207/new-stimulus-veronique-de-rugy) since 2009.

The chart is based on the most recent data from the Bureau of Labor Statistics and the Center for Data Analysis. As you can see, the administration’s promise that the American Recovery and Reinvestment Act (ARRA) would keep unemployment rates from reaching 8.8 percent and would create some 3 million jobs—90 percent of them in the private sector—did not materialize.

The unemployment rate started at 7.6 percent when President Obama took office and peaked at 10.2 percent in October 2009. Since the enactment of the stimulus bill in February 2009, the unemployment rate has not approached pre-ARRA levels, even though $382 billion has been made available by government departments and agencies (on top of tax credits and other tax-related items). In fact, unemployment recently edged up, from 9 percent in April to 9.1 percent in May.

Based on this data, it is hard to make the case that doing more of the same will help. Yet that is precisely what New York Times columnist Paul Krugman think we should do. In his view, these dire results are due to a stimulus [that was too small](http://krugman.blogs.nytimes.com/2011/07/03/bad-tayloring/). It’s difficult to imagine what level of stimulus spending would be large enough for Krugman. What I do know is that we have spent $666 billion to date, yet unemployment remains above 9 percent. And under even the [rosiest of assumptions](http://www.whitehouse.gov/sites/default/files/cea_7th_arra_report.pdf), which claim 2.4 million jobs created, each of those jobs cost $278,000 (see [here](http://www.whitehouse.gov/sites/default/files/cea_7th_arra_report.pdf)).

#### Keynesianism bankrupts the nation

**Edwards 11** -director of tax policy studies at Cato and editor of [www.DownsizingGovernment.org](http://www.downsizinggovernment.org/). He is a top expert on federal and state tax and budget issues. Before joining Cato, Edwards was a senior economist on the congressional Joint Economic Committee, a manager with PricewaterhouseCoopers, and an economist with the Tax Foundation. Edwards has testified to Congress on fiscal issues many times, and his articles on tax and budget policies have appeared in the Washington Post, Wall Street Journal, and other major newspapers (Chris " Stimulus Spending Testimony", 2/18/11, <http://www.downsizinggovernment.org/stimulus-spending-testimony>)//AP

[I testified this week](http://www.cato.org/pub_display.php?pub_id=12788)to a a subcommittee of the House Oversight and Government Reform Committee looking at the effects of the 2009 stimulus bill (the "American Recovery and Reinvestment Act").

Some of the discussion regarded the continuing claims by stimulus supporters that the $800 billion bill created millions of jobs. To most people, such a claim now seems laughable--unemployment is still very high two years later and the recovery from the recession is very sluggish compared to prior recessions.

Also testifying was Stanford economist John Taylor, who [offered a view](http://oversight.house.gov/images/stories/Testimony/-_Taylor_Testimony_BIO_CV_TNT_-_2-16_The_2009_Stimulus_-_Two_Years_Later.pdf) on why economists using Keynesian models are still claiming success for the ARRA bill:

"Why do some argue that ARRA has been more effective than the facts presented here indicate? Many evaluations of the impact of ARRA use economic models in which the answers are built-in, and were built-in before the stimulus package was enacted. The same economic models that said, two years ago, that the impact would be large now show that the impact is in fact large."

Taylor's testimony looks at the actual effects of the stimulus in the national income accounts data, rather using an assumption-filled model. Taylor concludes:

"In sum, the data presented here indicate that the American Recovery and Reinvestment Act was not effective in stimulating the economy ... Currently, the increased debt caused by ARRA—both directly through its deficit financing and indirectly through its de-emphasis on controlling spending—**is likely a drag on economic growth."**

Thanks to Tyler Grimm and the committee team for organizing the hearing. It's important to explore the costly failures of such big spending programs as ARRA because the next time the economy goes into a downcycle the Keynesians, sadly, will be back to Capitol Hill pushing their expensive solutions and further bankrupting the nation.

### empirics

#### Empirics flow neg—Keynesian economics fails in practice

Cochrane 09 Myron S. Scholes Professor of Finance University of Chicago Booth School of Business (John H. “Fiscal Stimulus, Fiscal Inflation, or Fiscal Fallacies?” feb 27 2009 [http://faculty.ses.wsu.edu/rayb/420/fiscal\_stimulus.pdf)//BM](http://faculty.ses.wsu.edu/rayb/420/fiscal_stimulus.pdf%29//BM)

These ideas changed because Keynesian economics was a failure in practice, and not just in theory. Keynes left Britain 30 years of miserable growth. Richard Nixon said, “We are all Keynesians now,” just as Keynesian policy led to the inflation and economic dislocation of the 1970s--unexpected by Keynesians but dramatically foretold by Milton Friedman’s 1968 AEA address. Keynes disdained investment, where we now all realize that saving and investment are vital to long-run growth. Keynes did not think at all about the incentives effects of taxes. He favored planning, and wrote before Hayek reminded us how modern economies cannot function without price signals. Fiscal stimulus advocates are hanging on to a last little timber from a sunken boat of ideas, ideas that everyone including they abandoned, and from hard experience. If we forget all that, we could repeat the economics of postwar Britain, of spend-and-inflate Latin America, and of bureaucratic, planned India. There has been no grand empirical reevaluation of fiscal stimulus either. Empirical work is hard, since governments try fiscal stimulus in bad times. If you bleed with leaches when you have a cold, empirical work might say that the leaches cured you. Empirical work has to find fiscal stimulus events that were applied randomly, without regard to the state of the economy. Harder still, it has to find stimulus spending that people expected to be paid off rather than inflated away. Most current empirical work does not make this distinction, and therefore is in danger of measuring the slope of the Phillips curve rather than the fiscal multiplier. Finally, empirical work without a plausible mechanism is hard to believe. Even so, doing the best to surmount these problems, nothing in recent empirical work on US data has revised a gloomy opinion of fiscal stimulus.9 Looking across the world, large government deficits and spending programs are clearly not the keys to economic health, and evidence of stimulus effects over time in the US needs to be reconciled with this supreme lack of evidence across countries.The Administration's estimates for the effect of a stimulus plan cite no new evidence and no theory at all for their large multipliers. The multipliers come ".. from a leading private forecasting firm and the Federal Reserve’s FRB/US model." (Appendix 1) Multipliers are hard-wired in these models by assumption, rather than summarizing any evidence on the effectiveness of fiscal policy, and the models reflect the three theoretical fallacies above. The multipliers in this report are not conditioned on "slack output" or something else -- they state that every dollar of government spending generates 1.57 dollars of output always! If you've got magic, why not 2 trillion dollars? Why not 10 trillion dollars? Why not 100 trillion, and we can all have private jets? If you don't believe that, why do you think it works for a trillion dollars? Their estimates of industry effects come from a blog post (p. 8)! Ok, they did their best in the day and a half or so they had in the rush to put the report together. But really, before spending a trillion dollars of our money, wouldn't it make sense to spend, say one tenth of one percent on figuring out if it will work at all? (That would be 100 million dollars, more than has ever been spent on economic research in the entire history of the world. ) Some economists tell me, “Yes, all our models, data, and analysis and experience for the last 40 years say fiscal stimulus doesn’t work, but don’t you really believe it anyway?” This is an astonishing attitude. How can a scientist “believe” something different than what he or she spends a career writing and teaching? At a minimum policymakers shouldn’t put much weight on such “beliefs,” since they explicitly don’t represent expert scientific inquiry. Others say that we should have a fiscal stimulus to “give people confidence,” even if we have neither theory nor evidence that it will work. This impressively paternalistic argument was tried once with the TARP. Nobody could say how it would work in any way that made sense, but it was supposed to be important do to something grand to give people “confidence.” You see how that worked out. Public prayer would work better and cost a lot less. Seriously, as social scientists, economists don’t have any special expertise to prescribe what intrinsically meaningless gestures will and will not give “confidence,” so there is no reason for anyone to listen to our opinions on that score. "Well," I'm often asked, "we have to do something. Do you have a better idea?" This is an amazingly illogical question. If the patient has a heart attack, and the doctor wants to amputate his leg, it's perfectly fine to say "I know amputating his leg is not going to do any good," even if you don't have a five-step plan to cure heart attacks. As a matter of fact, as above, there are perfectly good answers to this question, but even if there were not, it simply makes no sense to "do something" that you know won't work. One of the most important things that scholars can do is to explain ignorance. I often say “I don’t know, but I do know with great precision why nobody else knows either.” Ninety percent of good economic policy is, “first, do no harm.”

### at: more stimulus will solve

#### Stimulus will never be enough

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[http://www.nationalreview.com/corner/253484/stimulus-spending-deficit-reduction-idea-just-needs-die-stephen-spruiell)//BM](http://www.nationalreview.com/corner/253484/stimulus-spending-deficit-reduction-idea-just-needs-die-stephen-spruiell%29//BM)

Both the Schakowsky deficit reduction plan, which I [wrote about](http://www.nationalreview.com/articles/253425/schakowsky-s-lack-principle-stephen-spruiell) today, and the Rivlin-Domenici plan, which Veronique [wrote about](http://www.nationalreview.com/corner/253455/rivlin-domenici-alternative-deficit-commission-report-veronique-de-rugy) below, call for increases in Keynesian stimulus spending to happen immediately, right now, as an essential step in the struggle to get deficits under control eventually. Their arguments rest on one correct assumption and two incorrect ones: While it is true that [restoring economic growth](http://www.nationalreview.com/articles/253392/thus-does-economy-grow-keith-hennessey) will make the task of reducing the deficit much easier, it is not true that short-term bursts of fiscal stimulus will get us there, and it is crazy to think that the 112th Congress will do more fiscal stimulus.

But let’s assume for arguments’ sake that some amount of short-term fiscal stimulus can produce lasting growth and that Congress could be persuaded to pass another stimulus bill. Even if we made those assumptions, it would appear that neither the Schakowsky nor the Rivlin-Domenici stimulus proposals would provide enough fiscal stimulus to get the job done — at least not according to Paul Krugman, a.k.a. the stimulus lover’s stimulus lover.

Krugman is an [ardent proponent](http://krugman.blogs.nytimes.com/2010/07/28/how-did-we-know-the-stimulus-was-too-small/) of the idea that the trillion-plus we have spent on stimulus since early 2008 was far too little to get us to that magical tipping point where short-term stimulus begets sustainable growth. And the figure he relies on when making that argument is the CBO’s output gap, which represents the difference between real GDP and the CBO’s estimate of what GDP would be if all the nation’s underutilized resources were fully employed. According to the CBO, we had an output gap of about $2 trillion over the two-year period covered by Obama’s stimulus bill, and according to Krugman, that means the stimulus bill should have spent $1.2 trillion, because, if you make some optimistic assumptions about Keynesian multipliers, then that would have filled the gap.

The CBO’s output gap remains wide, which is why Krugman thinks our next grand adventure in Keynesian fiscal stimulus [needs to be](http://www.onpointradio.org/2010/07/paul-krugman-1-trillion-more) on the order of $1 trillion, at least. But the Schakowsky plan only calls for about $200 billion in new stimulus, and the payroll-tax holiday called for in the Rivlin-Domenici plan would only provide a jolt of $650 billion. And again, all of this assumes that lots of people are going to make big decisions with long-term implications — such as how many workers to hire or fire — based on temporary policies. If the people who are praising the stimulus ideas in the Schakowsky and Rivlin-Domenici plans subscribe to the Krugman view that the last stimulus wasn’t big enough, then they’re not being consistent: Neither of the stimulus plans they’re embracing now would be big enough, either. And if they don’t subscribe to the Krugman view regarding output gaps and the need for a WWII-sized stimulus package, then what’s their explanation for why the first stimulus failed?

## stimulus bad/ offense

### competitiveness impact

#### More stimulus spending will kill competitiveness and crush the economy

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Mr. Chairman and members of the committee, thank you for inviting me to testify today. My comments will examine the likely damage to the economy if federal spending and debt keep spiraling upward.

Rising Spending and Debt

Federal spending and debt have soared over the past decade. As a share of gross domestic product, spending grew from 18 percent in 2001 to 24 percent in 2011, while debt held by the public jumped from 33 percent to 67 percent. The causes of this expansion include the costs of wars, growing entitlement programs, rising spending on discretionary programs, and the 2009 economic stimulus bill.

Projections from the Congressional Budget Office show that without reforms spending and debt will keep on rising for decades to come.1 Under the CBO's "alternative fiscal scenario," spending will grow to about 34 percent of GDP by 2035, as shown in Figure 1, and debt held by the public will increase to at least 187 percent of GDP.2

Hopefully, we will never reach anywhere near those levels of spending and debt. Going down that path would surely trigger major financial crises, as the ongoing debt problems in Europe illustrate. It is also very unlikely that Americans would support such a huge expansion of the government. **The results of the 2010 elections suggest that the public has already started to revolt against excessive federal spending and debt.**

Some policymakers are calling for a "balanced" package of spending cuts and tax increases to reduce federal deficits. But CBO projections show that the long-term debt problem is not a balanced one — it is caused by historic increases in spending, not shortages of revenues. Revenues have fallen in recent years due to the poor economy, but when growth returns, revenues are expected to rise to the normal level of about 18 percent of GDP — even with all current tax cuts in place. It is spending that is expected to far exceed normal levels in the future, and thus spending is behind the huge increases in debt that are projected.

America Has a High-Spending and High-Debt Government

Some analysts say that America can afford to increase taxes and spending because it is a uniquely small-government country. Alas, that is no longer the case. Data from the Organization for Economic Cooperation and Development (OECD) show that federal, state, and local government spending in the United States this year is a huge 41 percent of GDP.

Figure 2 shows that government in the United States used to be about 10 percentage points of GDP smaller than the average government in the OECD. But that size advantage has fallen to just 4 percentage points. A few high-income nations — such as Australia — now have smaller governments and much lower government debt than the United States.

Historically, America's strong growth and high living standards were built on our relatively smaller government. The ongoing surge in federal spending is undoing this competitive advantage we had enjoyed in the world economy. CBO projections show that without reforms federal spending will rise by about 10 percentage points of GDP by 2035. If that happens, spending by American governments will be more than half of GDP by that year**. That would doom young people to unbearable levels of taxation and a stagnant economy** with fewer opportunities.

American government debt has also soared to abnormally high levels. Figure 3 shows OECD data for gross government debt as a share of GDP.3 (The data include debt for federal, state, and local governments). In 2011, gross government debt is 101 percent of GDP in the United States, substantially above the OECD average of 78 percent.4

Harmful Effects of Deficit Spending

Federal deficit spending has exploded. Even with the recent passage of the Budget Control Act, the deficit is still expected to be about $1 trillion next year. The damage caused by this spending includes:

1. Transferring resources from higher-valued private activities to lower-valued government activities. With government spending already at 41 percent of GDP, new spending will likely have a negative return, which will reduce output.
2. Creating pressure to increase taxes in the future, which would reduce growth. Higher taxes impose "deadweight losses" on the economy of at least $1 for every $2 of added revenues, as discussed below.
3. Increasing federal debt, which creates economic uncertainty and a higher risk of financial crises, as Europe's woes illustrate. Research indicates that economic growth tends to fall as debt rises above about 90 percent of GDP, as discussed below.

Economists in the Keynesian tradition dispute the first point. They believe that the demand-side "stimulus" benefits of spending are so important that they outweigh the problems of microeconomic distortions and misallocations caused by federal programs. However, it is very difficult to see any economic boost from the huge deficit spending of recent years.

The total Keynesian stimulus in recent years includes not only the 2009 stimulus package of more than $800 billion, but the total amount of federal deficit spending. We've had deficit spending of $459 billion in fiscal 2008, $1.4 trillion in fiscal 2009, $1.3 trillion in fiscal 2010, and $1.3 trillion in fiscal 2011. Despite that huge supposed stimulus, U.S. unemployment remains at high levels and the current recovery has been the slowest since World War II.5

The Obama administration claimed that there are large "multiplier" benefits of federal spending, but the **recent spending spree seems to have mainly just suppressed private-sector activities.**6 Stanford University's John Taylor took a detailed look at GDP data over recent years, and he found little evidence of any benefits from the 2009 stimulus bill.7 Any "sugar high" to the economy from spending increases was apparently small and short-lived. Harvard University's Robert Barro estimates that any small multiplier benefits that the stimulus bill may have had is greatly outweighed by the future damage caused by higher taxes and debt.8

John Taylor recently testified that deficit-spending stimulus actions "have not only been ineffective, they have lowered investment and consumption demand by increasing concerns about the federal debt, another financial crisis, threats of inflation or deflation, higher taxes, or simply more interventions. Most businesses have plenty of cash to invest and create jobs. They're sitting on it because of these concerns."9

#### Stimulus spending guts competitiveness

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In the [Daily Caller](http://dailycaller.com/2011/07/01/federal-spending-doesnt-work/), Chris Edwards has an interesting article about why **government spending doesn’t “stimulate” the economy over the short-run or the long-run**. Rather than growing the economy, stimulus packages are typically wasteful wealth transfers akin to a “leaky bucket,” which harm the economy in the long run, whether or not there are any short-run stimulus effects.

As Edwards notes, “Despite ongoing federal deficits of more than $1 trillion a year, many liberals are calling for more government spending to ‘create jobs.’” But if government spending creates jobs, it’s hard to understand why unemployment has soared, even as government spending has exploded in recent years: “Federal spending has soared over the past decade. As a share of gross domestic product, spending grew from 18 percent in 2001 to 24 percent in 2011.” As he notes, “government spending and taxing creates ‘deadweight losses,’ which result from distortions to working, investment and other activities. The CBO says that deadweight loss estimates ‘range from 20 cents to 60 cents over and above the revenue raised.’ Harvard University’s Martin Feldstein thinks that deadweight losses ‘may exceed one dollar per dollar of revenue raised.’” Due partly to this “leaky-bucket” effect, Texas A&M economist Edgar Browning concluded that “It costs taxpayers $3 to provide a benefit worth $1 to recipients,” and that “today’s welfare state reduces GDP — or average U.S. incomes — by about 25 percent.”

Stimulus spending also will undermine America’s international competitiveness. We wrote earlier about how the stimulus package used taxpayer money [to outsource American jobs](http://www.examiner.com/scotus-in-washington-dc/stimulus-package-increases-trade-deficit-replaces-u-s-jobs-with-foreign-green-jobs) to foreign [countries like China](http://washingtonexaminer.com/blogs/opinion-zone/2011/04/obama-uses-green-subsidies-outsource-american-jobs-china) (in the name of promoting “green jobs”) and [wiped out jobs](http://www.examiner.com/scotus-in-washington-dc/stimulus-package-kills-jobs-by-igniting-trade-war-with-canada-and-mexico) in America’s export sector by reducing purchases of American goods in Mexico and Canada.

Edwards [points out](http://dailycaller.com/2011/07/01/federal-spending-doesnt-work/) that recent stimulus spending will undermine America’s international competitiveness in terms of tax rates. As he notes, the recent massive spending increases, if not curtailed, will have to be paid for with equally massive tax increases, wiping out America’s edge over other countries in taxes. “This year, government spending in the United States hit 41 percent of GDP, meaning that more than 4 out of every 10 dollars that we produce is consumed by our federal, state and local governments.  We used to have a substantial government size advantage compared to other countries. But . . . while government spending in the United States was about 10 percentage points of GDP smaller than the average  . . . in the past, that gap has now shrunk to just 4 points. A number of high-income nations — such as Australia — now have smaller governments than does the United States.  This is very troubling because America’s strong growth and high living standards were historically built on our relatively small government. The ongoing surge in federal spending is undoing this competitive advantage that we have enjoyed in the world economy.”

This surge in government spending is projected to  continue in the future. “CBO projections show that federal spending will rise by about 10 percentage points of GDP between now and 2035. If that happens, governments in the United States will be grabbing more than half of everything produced in the nation by that year.”

Despite all the “deficit-spending stimulus, U.S. unemployment remains stuck at more than 9 percent and the recovery is very sluggish compared to prior recoveries.” The Obama administration had claimed that “‘multipliers’ from government spending are large, meaning that spending would give a big boost to GDP. But other economists have found that . . . multipliers are actually quite small, meaning that added government spending mainly just displaces private-sector activities. Stanford University economist John Taylor took a detailed look at GDP data over recent years, and he found little evidence of any benefits from the 2009 stimulus bill” even in the short run, while Harvard’s Robert Barro concluded that it will have a harmful effect on the economy due to “future damage caused by higher taxes and debt.”

A recent study by economists Bill Dupor and Timothy Conley found that the 2009 stimulus package has [wiped out 550,000 jobs](http://www.openmarket.org/2011/05/21/stimulus-wiped-out-a-million-private-sector-jobs/). After reviewing its harmful provisions, Harvard University economist Jeffrey Miron concluded that the stimulus package was designed to[reward special-interest](http://www.openmarket.org/2010/10/31/harvards-jeffrey-miron-explains-why-the-stimulus-package-failed/) “constituencies,” not to boost the economy. The stimulus contained all sorts of [welfare](http://www.heritage.org/Research/Reports/2009/02/Stimulus-Bill-Abolishes-Welfare-Reform-and-Adds-New-Welfare-Spending).  The stimulus was so poorly run that stimulus money wound up going to [prisoners and dead people](http://www.examiner.com/scotus-in-washington-dc/stimulus-money-went-to-prisoners-and-dead-people), [bridges](http://www.examiner.com/scotus-in-washington-dc/obama-proposes-50-billion-more-wasteful-deficit-spending-after-original-stimulus-package-fails) to nowhere, and [useless](http://www.openmarket.org/2009/03/10/stimulus-subsidizes-corruption-waste-racism/) government buildings.

In pushing the $800 billion stimulus package, Obama cited Congressional Budget Office (CBO) claims that it would save jobs in the short run, while ignoring the [CBO’s own finding](http://www.npr.org/blogs/money/2009/02/cbo_stimulus_shrinks_economy.html) that the stimulus will actually [shrink the economy](http://www.openmarket.org/2009/02/10/stimulus-package-shrinks-economy-expands-welfare-rolls/) over the [long run](http://www.washingtontimes.com/news/2009/feb/04/cbo-obama-stimulus-harmful-over-long-haul/), by exploding the national debt and [crowding out](http://www.openmarket.org/2009/03/20/obama-budget-explodes-debt-taxes-cbo-admits/) private investment. Nothing in the CBO’s findings supported Obama’s outlandish claim that the stimulus package was necessary to avert “[irreversible decline](http://www.telegraph.co.uk/news/worldnews/northamerica/usa/barackobama/4571678/Barack-Obama-warns-economic-stimulus-delay-would-bring-disaster.html).”

### investment

#### Investment spending forces government borrowing- reduces consumption

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Credit markets

A much more plausible diagnosis of our current troubles is staring us in the face: credit markets. The institutions that channel your and my savings into consumer and business borrowing are not working. Banks are in trouble, and more importantly the much larger markets for securitized debt seem really broken. New issues of securitized debt have dropped to next to nothing, unless they are guaranteed by the Federal Government. Savings is going to low-interest Treasuries and guaranteed agency debt, yet consumers and businesses who need credit face a small supply at very high prices.3 Imagine by analogy that several major refineries had blown up. There would be tankers full of oil sitting in the harbor, and oil prices would be low, yet little gasoline would be available and gas prices would be high. Stimulating people to drive around would not revive gas sales. Borrowing gasoline and using it on infrastructure projects would be worse. The right policy action would obviously be to run whatever government or military refineries could be cobbled together on short notice at full speed, and focus on rebuilding the private ones. The former step is exactly what the Federal Reserve’s many charmingly acronymed facilities (TALF, etc.) are doing, to the tune of over a trillion and a half dollars. Together, the Treasury and Fed are issuing huge amounts of Government debt, and they are turning around and lending the proceeds to consumers and businesses. This basic idea makes sense, though there is plenty to worry about in the details. An unconventional potential defense of fiscal stimulus lurks in this story. If the Treasury borrows and the Government uses the proceeds for investment, then the government is in some sense acting as the missing intermediary. The focus on investment spending in the Obama plan reflects some of this thinking, though investment is anathema to the traditional Keynesian insistence that stimulus be channeled to consumption spending. However, this is a poor argument, since stimulus “investment” spending is on much different projects than the private sector would have funded. Fiscal stimulus investments make fuel oil, not gasoline. Moreover, the extra issues of Treasury debt will largely come from the few dollars that are flowing from savings to private investment, just what the “credit crunch” does not need. To “intermediate,” additional government borrowing would have to come out of consumption. People would have to be attracted to postponing a trillion dollars of consumption by slightly higher treasury yields.

#### Keynesian stimulus fails – debt disincentivizes investment

Edwards, 11 - director of tax policy studies at the Cato Institute (Chris, “Keynesian Policies Have Failed”, Cato, Dec. 2, <http://www.cato.org/publications/commentary/keynesian-policies-have-failed?print)//AH>

Lawmakers are considering extending temporary payroll tax cuts. But the policy is based on faulty Keynesian theories and misplaced confidence in the government's ability to micromanage short-run growth. In textbook Keynesian terms, federal deficits stimulate growth by goosing "aggregate demand," or consumer spending. Since the recession began, we've had a lot of goosing— deficits were $459 billion in 2008, $1.4 trillion in 2009, $1.3 trillion in 2010, and $1.3 trillion in 2011. Despite that huge supposed stimulus, unemployment remains remarkably high and the recovery has been the slowest since World War II. Yet supporters of extending payroll tax cuts think that adding another $265 billion to the deficit next year willsomehow spur growth. That "stimulus" would be on top of the $1 trillion in deficit spending that is already expected in 2012. Far from helping the economy, all this deficit spending is destabilizing financial markets, scaring businesses away from investing, and imposing crushing debt burdens on young people. For three years, policymakers have tried to manipulate short-run economic growth, and they have failed. They have put too much trust in macroeconomists, who are frankly lousy at modeling the complex workings of the short-run economy. In early 2008, the CongressionalBudget Office projected that economic growth would strengthen in subsequent years, and thus completely missed the deep recession that had already begun. And then there was the infamously bad projection by Obama's macroeconomists that unemployment would peak at 8 percent and then fallsteadily if the 2009 stimulus plan was passed. Some of the same Keynesian macroeconomists who got it wrong on the recession and stimulus are now claiming that a temporary payroll tax break would boost growth. But as Stanford University economist John Taylor has argued, the supposed benefits of government stimulus have been "built in" or predetermined by the underlying assumptions of the Keynesian models. Policymakers should ignore the Keynesians and their faulty models, and instead focus on reforms to aid long-run growth, which economists know a lot more about. Cutting the corporate tax rate, for example, is an overdue reform with bipartisan support that would enhance America's long-run productivity and competitiveness.

#### Spending failure and public debt disincentives economic growth during stimulus

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3) The effects on consumers and businesses of the stimulus package depend not only on the stimulus to short-term GDP, but also on how valuable the spending is. Whatever the merits of other government spending**, the spending in this package is likely to have less value. A very large amount of money will be spent quickly** over a two-year period: $500 billion amounts to about one-quarter of the total federal government annual spending of $2 trillion. **It is extremely difficult for any group, private as well as public, to spend such a large sum wisely in a short period of time.** In addition, although politics play an important part in determining all government spending, political considerations are especially important in a spending package adopted quickly while the economy is reeling, and just after a popular president took office. Many Democrats saw the stimulus bill as a golden opportunity to enact spending items they've long desired. For this reason, various components of the package are unlikely to pass any reasonably stringent cost-benefit test. 4) There are no free lunches in spending, public or private**. The increased federal debt caused by this stimulus package has to be paid for eventually by higher taxes on households and businesses. Higher income and business taxes generally discourage effort and investments, and result in a larger social burden than the actual level of the tax revenue needed to finance the greater debt.** The burden from higher taxes down the road has to be deducted both from any short-term stimulus provided by the spending program, and from its long-run effects on the economy.

### debt bad

#### Increasing federal debt is detrimental to the economy and reduces future growth

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As federal debt grows larger, the problems caused by fiscal uncertainty will get magnified. The CBO notes that "**growing federal debt also would increase the probability of a sudden fiscal crisis, during which investors would lose confidence in the government's ability to manage its budget and the government would thereby lose its ability to borrow at affordable rates. Such a crisis would . . . probably have a very significant negative impact on the country**."10

Research by economists Kenneth Rogoff and Carmen Reinhart found that government debt burdens above 90 percent of GDP are associated with lower economic growth.11 After examining data on dozens of countries, they concluded that "high debt is associated with slower growth; a relationship which is robust across advanced and emerging markets."12 High debt can also be associated with inflation crises, "financial repression," and other problems. Furthermore, high public and private debt acts as a "contagion amplifier" in the globalized economy.

A new paper by economists at the Bank for International Settlements (BIS) similarly found that when government debt in OECD countries rises above a threshold of about 85 percent of GDP, economic growth is slower.13 As debt rises, borrowers become increasingly sensitive to changes in interest rates and other shocks. "**Higher nominal debt raises real volatility, increases financial fragility, and reduces average growth**," the authors note.14

The BIS economists conclude that countries should build a "fiscal buffer" by keeping its debt well below the danger threshold. They note that without major reforms, debt-to-GDP levels will soar in coming decades in most advanced economies due to population aging. Thus, one more reason for the United States to cut its spending and debt is to help it weather future financial crises spilling over from countries that are in even worse shape than we are.

Baseline Projections Are Optimistic

In support of building a large "fiscal buffer," policymakers should recognize that both short-term and long-term CBO projections are optimistic in various ways. Perhaps the future will include some positive budget surprises, but the big risk factors seem to be on the negative side.

In CBO's baseline, federal deficits fall substantially over the coming decade, partly due to changes under the recent Budget Control Act. However, spending will be higher than projected if:

Policymakers lift caps in the Budget Control Act.

Policymakers launch new spending programs or respond to unforeseen crises or wars.

Higher interest rates push up interest costs, which is a risk that gets magnified as federal debt grows larger.

A major recession causes large cost increases in programs sensitive to economic cycles, such as unemployment insurance.

Policymakers respond to another recession with costly new "stimulus" plans. The persistence of Keynesian policy ideas in Washington is an important risk to the outlook for federal debt.

### deficit spending bad

#### Stimulus spending will put us into the economic dark ages

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Popular delusions are always debunked, but rarely before they do a lot of harm. The ancient physician Galen believed that bloodletting, the forced removal of blood from the body by the opening of a vein, could remove excess blood from the body and improve health. Countless sick people suffered for this delusion until the English doctor William Harvey realized that blood circulated through the body in the 1620s (although the practice continued for some time, with even Founding Father Benjamin Rush being an enthusiast). Today, the American economy suffers from a similar form of quackery.

There is now evidence that the process of Keynesian stimulus spending is just as harmful to the body politic. For nearly a century, politicians have been bleeding the economy when it has been at its sickest. To cure this delusion, just as physicians stopped talking about bodily humors, we need to stop talking about gross domestic product (GDP).

Our William Harvey is the economics professor Burton Abrams, who, in [a new article](http://www.bepress.com/ev/vol8/iss3/art2/) for theEconomists' Voice, reveals that **the** American Recovery and Reinvestment Act, the $800 billion "**stimulus act," actually made the nation worse off by at least $475 billion**. That figure alone should stop the current calls for stimulus stone dead.

The reason it cost so much is because, although some public debt can be beneficial, economists now recognize that **once public debt reaches a certain level it becomes a drag on the economy**. So debt-funded stimulus, of the sort that Keynesian physicians prescribe for a weak economy, can be exactly the worst thing to do if debt is already at high levels.

American debt is already above all the "tipping points" postulated by economists. Therefore, **the increase in debt to fund the stimulus has reduced our long-term growth rate by a present value of $1.875 trillion.**

If we believe the Keynesians, and accept that every dollar of public money spent in the stimulus did stimulate $1.75 of economic activity, we see that the stimulus provided $1.4 trillion of benefits. So Abrams's $475 billion is in fact a best case scenario. Of course, there is a strong possibility that the stimulus did not provide anywhere near the benefits claimed. If the stimulus didn't work and just wasted money, as most free market economists believe, then the cost was even higher.

The reason why we fall for the Keynesian argument for stimulus every time (President George W. Bush did, too) is that our main measure of economic well-being, gross domestic product, is designed to respond well to stimulus spending. The amount of stimulus spending is simply added to the GDP figure, with no accounting for the effects of debt. That stimulus increases GDP is a self-fulfilling prophecy.

To shake off this stimulus delusion, we need a new metric. Martin Hutchinson, co-author of the brilliant book, [Alchemists of Loss](http://www.amazon.com/Alchemists-Loss-government-intervention-financial/dp/0470689153): How modern finance and government intervention crashed the financial system, has suggested that we instead consider what he calls gross private product (GPP). GPP measures the value of transactions between a willing seller and a willing buyer, so activities that occur only because government wants them to, like ethanol mandates, do not count. GPP tells a much different story about Keynesian success stories, like the Second World War, and makes much more sense.

Without a shift away from GDP as our main measure of growth, we will continue to see politicians calling for stimulus and claiming success when GDP goes up, even as our economic welfare suffers. William Harvey's discovery led to the use of blood pressure as a vital sign -- a much more accurate assessment than the balance of "humors." **While people still insist on the efficacy of debt-funded stimulus and the relevance of GDP, we will remain stuck in the** economic dark ages.

#### Deficit spending destabilizes the financial markets and creates long term economic damage

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Lawmakers are considering extending temporary payroll tax cuts. But the policy is based on faulty Keynesian theories and misplaced confidence in the government's ability to micromanage short-run growth.

In textbook Keynesian terms, federal deficits stimulate growth by goosing "aggregate demand," or consumer spending. Since the recession began, we've had a lot of goosing — deficits were $459 billion in 2008, $1.4 trillion in 2009, $1.3 trillion in 2010, and $1.3 trillion in 2011. Despite that huge supposed stimulus, unemployment remains remarkably high and the recovery has been the slowest since World War II.

Yet supporters of extending payroll tax cuts think that adding another $265 billion to the deficit next year will somehow spur growth. That "stimulus" would be on top of the $1 trillion in deficit spending that is already expected in 2012. **Far from helping the economy, all this deficit spending is destabilizing financial markets, scaring businesses away from investing, and imposing crushing debt burdens on young people.**

For three years, policymakers have tried to manipulate short-run economic growth, and they have failed. They have put too much trust in macroeconomists, who are frankly lousy at modeling the complex workings of the short-run economy. In early 2008, the Congressional Budget Office projected that economic growth would strengthen in subsequent years, and thus completely missed the deep recession that had already begun. And then there was the infamously bad projection by Obama's macroeconomists that unemployment would peak at 8 percent and then fall steadily if the 2009 stimulus plan was passed.

Some of the same Keynesian macroeconomists who got it wrong on the recession and stimulus are now claiming that a temporary payroll tax break would boost growth. But as Stanford University economist John Taylor has argued, the supposed benefits of government stimulus have been "built in" or predetermined by the underlying assumptions of the Keynesian models.

Policymakers should ignore the Keynesians and their faulty models, and instead focus on reforms to aid long-run growth, which economists know a lot more about. Cutting the corporate tax rate, for example, is an overdue reform with bipartisan support that would enhance America's long-run productivity and competitiveness.

If Congress is intent on cutting payroll taxes, it should do so within the context of long-run fiscal reforms. One idea is to allow workers to steer a portion of their payroll taxes into personal retirement accounts, as Chile and other nations have done. That reform would feel like a tax cut to workers because they would retain ownership of the funds, and it would begin solving the long-term budget crisis that looms over the economy.

#### Stimulus causes long and short term economic damage-only a risk of our offence

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Stunning.

That’s really the only word we can use to describe the release of a [“sensitive and confidential” 57 page memo](http://s3.documentcloud.org/documents/285065/summers-12-15-08-memo.pdf), written by then soon-to-be U.S. Treasury Secretary Larry Summers in December 2008, about what became President Obama’s signature economic program in the first year of his presidency: the “stimulus package”.

James Pethokoukis has [summarized](http://blog.american.com/2012/01/11-stunning-revelations-from-larry-summers-secret-economics-memo-to-barack-obama/) some of the most significant aspects of the memo, which we’ve excerpted below, and which reveals the Obama administration’s thinking behind what became an over [821 billion dollar boondoggle](http://content.usatoday.com/communities/theoval/post/2011/02/obama-stimulus-bill-has-new-price-tag----another-one/1). The bold text represents Pethokoukis’ summary of that thinking, which is directly followed by a supporting quotation from Larry Summers’ memo:

1. The stimulus was about implementing the Obama agenda.

The short-run economic imperative was to identify as many campaign promises or high priority items that would spend out quickly and be inherently temporary.... The stimulus package is a key tool for advancing clean energy goals and fulfilling a number of campaign commitments.

2. Team Obama knows these deficits are dangerous (although it has offered no long-term plan to deal with them).

Closing the gap between what the campaign proposed and the estimates of the campaign offsets would require scaling back proposals by about $100 billion annually or adding new offsets totaling the same. Even this, however, would leave an average deficit over the next decade that would be worse than any post-World War II decade. This would be entirely unsustainable and could cause serious economic problems in the both the short run and the long run.

3. Obamanomics was pricier than advertised.

Your campaign proposals add about $100 billion per year to the deficit largely because rescoring indicates that some of your revenue raisers do not raise as much as the campaign assumed and some of your proposals cost more than the campaign assumed.... Treasury estimates that repealing the tax cuts above $250,000 would raise about $40 billion less than the campaign assumed.... The health plan is about $10 billion more costly than the campaign estimated and the health savings are about $25 billion lower than the campaign estimated.

4. Even Washington can only spend so much money so fast.

Constructing a package of this size, or even in the $500 billion range, is a major challenge. While the most effective stimulus is government investment, it is difficult to identify feasible spending projects on the scale that is needed to stabilize the macroeconomy. Moreover, there is a tension between the need to spend the money quickly and the desire to spend the money wisely. To get the package to the requisite size, and also to address other problems, we recommend combining it with substantial state fiscal relief and tax cuts for individuals and businesses.

5. Liberals can complain about the stimulus having too many tax cuts, but even Team Obama thought more spending was unrealistic.

As noted above, it is not possible to spend out much more than $225 billion in the next two years with high-priority investments and protections for the most vulnerable. This total, however, falls well short of what economists believe is needed for the economy, both in total and especially in 2009. As a result, to achieve our macroeconomic objectives—minimally the 2.5 million job goal—will require other sources of stimulus including state fiscal relief, tax cuts for individuals, or tax cuts for businesses.

[...]

7. Team Obama thought a stimulus plan of more than $1 trillion would spook financial markets and send interest rates climbing.

To accomplish a more significant reduction in the output gap would require stimulus of well over $1 trillion based on purely mechanical assumptions—which would likely not accomplish the goal because of the impact it would have on markets.

[...]

11. The financial crisis wasn’t just Wall Street’s fault.

A significant cause of the current crisis lies in the failure of regulators to exercise vigorously the authority they already have.

On December 31, 2008, the total public debt outstanding for the United States was $10,699,804,964,612.13. President Obama’s economic stimulus package of approximately $821,000,000,000 represents 7.7% of that figure, all of which was added to the national debt and went to no good end.

Over three years later, there is little-to-no indication that the Obama administration has learned what it already knew would be true from the very beginning: **their idea of an economic stimulus package was an extraordinarily bad idea that would be a monumental waste of taxpayer dollars.** We’ll have to see what new ideas the President has for spending taxpayer dollars in tonight’s [State of the Union](http://www.whitehouse.gov/state-of-the-union-2012)address.

#### Continued Stimulus will create another recession

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THE United States is in the third year of a grand experiment by the Obama administration to revive the economy through enormous borrowing and spending by the government, with the Federal Reserve playing a supporting role by keeping interest rates at record lows.

How is the experiment going? By the looks of it, not well.

The economy is growing much more slowly than in a typical recovery, housing prices remain depressed and the stock market has been in a slump — all troubling indicators that another recession may be on the way. Most worrisome is the anemic state of the labor market, underscored by the zero growth in the latest jobs report.

The poor results should not surprise us given the macroeconomic policies the government has pursued. I agree that the recession warranted fiscal deficits in 2008-10, but the vast increase of public debt since 2007 and the uncertainty about the country’s long-run fiscal path mean that we no longer have the luxury of combating the weak economy with more deficits.

Today’s priority has to be austerity, not stimulus, and it will not work to announce a new $450 billion jobs plan while promising vaguely to pay for it with fiscal restraint over the next 10 years, as Mr. Obama did in his address to Congress on Thursday. Given the low level of government credibility, fiscal discipline has to start now to be taken seriously. But we have to do even more: I propose a consumption tax, an idea that offends many conservatives, and elimination of the corporate income tax, a proposal that outrages many liberals.

These difficult steps would be far more effective than the president’s failed experiment. The administration’s $800 billion stimulus program raised government demand for goods and services and was also intended to stimulate consumer demand. These interventions are usually described as Keynesian, but as John Maynard Keynes understood in his 1936 masterwork, “The General Theory of Employment, Interest and Money” (the first economics book I read), the main driver of business cycles is investment. As is typical, the main decline in G.D.P. during the recession showed up in the form of reduced investment by businesses and households.

What drives investment? Stable expectations of a sound economic environment, including the long-run path of tax rates, regulations and so on. And employment is akin to investment in that hiring decisions take into account the long-run economic climate.

The lesson is that effective incentives for investment and employment require permanence and transparency. Measures that are transient or uncertain will be ineffective.

### at: can reduce deficits later

#### Keynesian economics makes any credible long term deficit reduction plan impossible

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There’s an internal contradiction in the way that Keynesian-oriented economists and policymakers address the federal budget situation. I’ve noticed it over and over. A passage [in a Washington Post op-ed today](http://www.washingtonpost.com/opinions/congress-shouldnt-delay-in-addressing-the-fiscal-cliff/2012/05/03/gIQAx3F0zT_story.html) by Mohamed El-Erian of Pimco captures it perfectly:

[T]he U.S. fiscal situation requires a carefully designed and well-timed overhaul to make government finances more efficient and fairer—among other things, combining immediate stimulus with a credible set of medium-term tax and entitlement reforms and a sustainable effort to reduce the deficit over time.

El-Erian seems to want more deficit-fueled “stimulus” now, combined with a “credible” plan that would reduce the deficit later on. We hear similar things from administration economists and centrist and liberal budget experts all the time.

Yet how can a Keynesian administration or Keynesians in Congress ever make a “credible” medium- or long-term commitment to deficit reduction? As soon as the next recession hits, they will demand ripping up any previous deficit-reduction deal so that they can stimulate aggregate demand some more.

**To Keynesians, the short run is**[**always more important**](http://thinkexist.com/quotation/in_the_long_run-we-re_all_dead/210498.html)**than the long run, so** it’s impossible for them to have a “credible” long-run commitment to deficit reduction. Even today, prominent Keynesian economists are demanding more “stimulus,” but the economy is not in recession and the budget deficit (which is “stimulus” to Keynesians) is already over $1 trillion. What happens if the economy slips into recession in 2013 or 2014? The Keynesians would surely break any budget deal and push for a $2 trillion deficit.

Everybody knows that federal policymakers usually break prior deals on discretionary budget caps and agreed-to entitlement cuts. The dominance of Keynesian-minded policymakers and advisers in Washington these days further reduces the believability of any long-term budget deal that policymakers may come up with.

Thus, the best way for policymakers to be truly “credible” on deficit reduction is to start cutting spending right now. Then cut spending more next year, and chop it further the year after that, and then keep on going.

### private sector crowd-out

#### Stimulus spending creates net loss in GDP—crowd-out is empirically proven

**Barro 10**- professor of economics at Harvard University and a senior fellow at Stanford University's Hoover Institution (Robert J. "The Stimulus Evidence One Year On" The Wall Street Journal 2/23/10 <http://online.wsj.com/article/SB10001424052748704751304575079260144504040.html>)//AP

The first anniversary of the Obama stimulus package generated a lot of discussion about whether and how much the package (originally estimated at $787 billion but now priced at $862 billion) moderated the recession. These are complex questions, and their answers require more than merely counting the quantity of goods and services that the government purchased or the number of people that the government hired.

We need to ask whether the government's spending reduced or enhanced private spending and whether public-sector hiring lowered or raised private hiring. This requires an empirical model based on the history of past fiscal actions in the U.S. or other countries. The administration must have such a model, but my own analysis makes me skeptical about the numbers they've reported about GDP increases and saved jobs.

To realistically evaluate the stimulus, I've been using long-term U.S. macroeconomic data to estimate some key economic relationships: the effects on GDP from increased government purchases (the spending multiplier) and from increased taxes (the tax multiplier).

For spending, the main results come from fluctuations in defense outlays associated with major wars such as World War I, World War II and the Korean War. The data feature large positive values in the early stages of wars (extra spending of 26% of GDP in 1942) and large negative values in war aftermaths (27% of GDP in 1946).

Although stimulus packages usually concentrate on nondefense outlays, the information from defense spending is useful for two reasons. First, the defense-spending multiplier can be precisely estimated from the available data and, second, this multiplier provides a reasonable gauge (and likely an upper bound because of the strong wartime boost to labor supply due to patriotism) for the effects of nondefense government purchases.

I estimate a spending multiplier of around 0.4 within the same year and about 0.6 over two years. Thus, if the government spends an extra $300 billion in each of 2009 and 2010, GDP would be higher than otherwise by $120 billion in 2009 and $180 billion in 2010. These results apply for given taxes and, therefore, when spending is deficit-financed, as in 2009 and 2010. Since the multipliers are less than one, the heightened government outlays reduce other parts of GDP such as personal consumer expenditure, private domestic investment and net exports.

For taxes, I focus on a newly constructed measure of average marginal income-tax rates; these rates apply to federal and state income taxes and the Social Security payroll tax. I estimate that an increase in marginal tax rates reduces GDP, particularly in the next year. When one factors in the typical relationship between tax rates and tax revenue, the multiplier is around minus 1.1. Hence, an increase in taxes by $300 billion lowers GDP the next year by about $330 billion.

Christina Romer, the chair of President Obama's Council of Economic Advisers, and her husband, David, have been major contributors to research on tax multipliers. Their results, which rely on the history of U.S. tax legislation since 1945, show tax multipliers of larger magnitude than the one I found. (So my conclusions here—based on the coming increases in taxes—would be strengthened if I switched to their estimates.) By contrast, I have not seen serious scientific research by Ms. Romer on spending multipliers, so I cannot understand her rationale for assuming values well above one, as she has apparently done when evaluating the fiscal stimulus plan. If the spending multiplier were really larger than one, it would mean that GDP would rise by even more than the rise in government spending.

My estimates allow me to assess the 2009-10 fiscal-stimulus package, which I characterize as roughly $300 billion of added government purchases in each of 2009 and 2010. I assume that, as of 2011, government spending goes back down to its 2008 level, although I could assume—perhaps more realistically—that the added spending is permanent.

I suppose that taxes do not change in 2009-10, so that the incremental spending is deficit-financed. The spending multipliers that come from my research imply that GDP rises by $120 billion (or 0.8% of GDP) in 2009 and $180 billion (or 1.2% of GDP in 2010)—all compared to the baseline of no stimulus package. These results imply that other parts of GDP fall by $180 billion in 2009 and $120 billion in 2010.

In other words, the deal looks pretty good in the short run because we "buy" the added government outlays by paying 60 cents on the dollar in 2009 (losing 180 in private spending to get 300 in government spending) and 40 cents on the dollar in 2010.

How attractive this short-run deal looks depends on how much one values the added governmental activity. If it's considered useful public investment—such as building a needed highway or, more modestly, fixing potholes—it might look good. If it's wasteful spending in a hastily constructed and highly political stimulus package, it looks bad.

But these calculations are not nearly the end of the story, because the added $600 billion of government spending leads to a correspondingly larger public debt. These added obligations must be paid for sometime by raising taxes (unless future government spending declines below its 2008 level, an unlikely scenario).

I suppose that the government collects an additional $300 billion of taxes in each of 2011 and 2012. The timing of the future taxes does not matter for the main calculations—the key point is that the government has no free lunch and must collect the extra taxes eventually. Since I assume a tax multiplier of minus 1.1, applying with a one-year lag, the higher taxes reduce GDP by $330 billion in each of 2012 and 2013.

We can now put the elements together to form a "five-year plan" from 2009 to 2013. The path of incremental government outlays over the five years in billions of dollars is +300, +300, 0, 0, 0, which adds up to +600. The path for GDP is +120, +180, +60, minus 330, minus 330, adding up to minus 300. GDP falls overall because the famous "balanced-budget multiplier"—the response of GDP when government spending and taxes rise together—is negative. This result accords with the familiar pattern whereby countries with larger public sectors tend to grow slower over the long term.

The projected effect on other parts of GDP (consumer expenditure, private investment, net exports) is minus 180, minus 120, +60, minus 330, minus 330, which adds up to minus 900. Thus, viewed over five years, the fiscal stimulus package is a way to get an extra $600 billion of public spending at the cost of $900 billion in private expenditure. This is a bad deal.

The fiscal stimulus package of 2009 was a mistake. It follows that an additional stimulus package in 2010 would be another mistake.

#### Stimulus cannot lead to increased consumption – it only offsets private activity

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Simple observation has its place, but how does the Keynesian stimulus approach break down in theory? Keynesian stimulus theory ignores the second half of the story – deficit spending must still be financed and financing carries budgetary and economic costs. Proponents generally acknowledge the long-term budgetary costs, but ignore the offsetting near-term economic costs. In a closed economy, government borrowing reduces the pool of saving available for private spending, either investment or consumption. Government lacks a wand to create real purchasing power out of thin air (with the fleeting exception of monetary expansions, discussed below). Government spending or deficit-increasing tax cuts increase demand as advertised, and government borrowing reduces demand by the same amount. The dynamics in an open economy are slightly more complicated but the final outcome for output is unchanged. An open economy permits a government to finance its deficits by importing saving from abroad as the United States has done for years, rather than by tapping domestic sources. However, an increase in deficit spending met by an increase in net imports of foreign saving must in turn be matched by an increase in net imports of goods and services to preserve the balance of payments. Thus, the increase in domestic demand due to deficit spending is fully offset by a reduction in demand arising from net exports. Once again, Keynesian stimulus is of no effect. What if the extra government borrowing soaks up idle savings in an underperforming economy, proponents may ask? In troubled economic times, those who can save more often do so, directing their saving toward very safe investments like Treasury Bonds and bank deposits. (The US personal saving rate is already up significantly.) However, these cautious savers almost never withdraw their savings from the financial system entirely by stuffing cash into mattresses and the like. Aside from the occasional mattress stuffer, even savings held in the safest of instruments remains part of the financial system, working to find its most productive uses through the available channels. Borrowing to finance Keynesian stimulus then remains a subtraction from the funds available to the private sector. Suppose widespread fear spurred savers to engage in rampant mattress stuffing, withdrawing purchasing power from the economy and creating large amounts of truly idle savings. This has happened before, and could be happening now. Surely Keynesianism works then? Not likely. Nothing about a flood of government bonds engulfing capital markets to finance a surge in wasteful government spending is likely to convince the mattress stuffers that their concerns are misplaced. Such deficit spending is then a competitor for an even smaller pool of available private saving. Worse, mattress stuffers are likely to increase their mattress-based saving in the face of a surge of profligate, irresponsible government spending. Keynesian “stimulus” would then be an economic depressant. Printing money to make fiscal stimulus work Government cannot create real purchasing power by whim, dictate, or debt, but the monetary authority can create the illusion of purchasing power through a policy of monetizing debt and increasing cash liquidity in the economy. Combining an obliging monetary policy with increased deficit spending may create the illusion that fiscal policy is effective, but as Mr. Callaghan attests, it is temporary and only an illusion.

#### Perception means stimulus fails – detracts investors

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Investors understand that increased government spending diverts valuable resources away from the private sector and ends up imposing even more demoralizing taxes on labor and capital. In reality, the so-called stimulus package was actually just a deferred tax increase of $787 billion plus interest. A major study of 18 large economies by Alberto Alesina of Harvard and three colleagues appeared in the 2002 American Economic Review. This paper, "Fiscal Policy, Profits and Investment" found that the surest way to make economies boom can be through deep cuts in government spending--the exact opposite of the "fiscal stimulus" snake oil. Ireland, for example, slashed government spending by more than 7% of GDP from 1986 to 1989--nearly as much as the 8.4% of GDP the U.S. spends on Social Security and Medicare combined. The Irish economy suddenly switched from a 0.2% pace of economic growth in the early 1980s to annual real GDP growth of 7.2% from 1989 to 2001. With GDP doubling every decade, government debt dropped from 125% of GDP to less than 40%. By contrast, Japan spent trillions on Keynesian "stimulus" schemes after 1991, doubling the ratio of national debt to GDP. Amazingly, they are doing it still. Japan's "lost decade" of economic stagnation is now approaching two decades with no end in sight. Spending cuts ensured much lower tax rates in Ireland, including substantial cuts in personal income and payroll tax rates and the VAT, as well as the famed 12.5% corporate tax. Similar fiscal restraint in India, while it lasted, facilitated cutting the top income tax rate to 30% from 60% at the start of yet another "economic miracle." By contrast, because of the huge debts piled up by "fiscal stimulus" schemes, Japan felt compelled to add new taxes on consumer spending, land, securities trading and capital gains. The Alesina study acknowledges that spending cuts were conducive to pro-growth tax policies, but that same study also found that big government spending is inherently bad for economic growth. The authors noted that government hiring lures skilled workers away from private businesses, and so private employers are forced to raise wages even if that means reduced hiring. Artificially boosting labor costs per employee, in turn, depresses profits and investment. They also found that a reduction of 1 percentage point in the ratio of government spending to GDP leads to an immediate increase in the ratio of private investment to GDP, which adds up to 0.8 percentage points after five years. In other words, government spending (regardless of whether it is financed by borrowing, taxing or printing money) will eventually "crowd out" private investment on nearly a dollar-for-dollar basis.

#### Stimulus fails – it leads to tax hikes that create unemployment and hurt growth because of crowd out

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President Obama and congressional leaders meeting yesterday confronted calls for four key fiscal decisions: short-run fiscal stimulus, medium-term fiscal consolidation, and long-run tax and entitlement reform. Mr. Obama wants more spending, especially on infrastructure, and higher tax rates on income, capital gains and dividends (by allowing the lower Bush rates to expire). The intellectual and political left argues that the failed $814 billion stimulus in 2009 wasn't big enough, and that spending control any time soon will derail the economy. But economic theory, history and statistical studies reveal that more taxes and spending are more likely to harm than help the economy. Those who demand spending control and oppose tax hikes hold the intellectual high ground. Writing during the Great Depression, John Maynard Keynes argued that "sticky" wages and prices would not fall to clear the market when demand declines, so high unemployment would persist. Government spending produced a "multiplier" to output and income; as each dollar is spent, the recipient spends most of it, and so on. Ditto tax cuts and transfers, but the multiplier is assumed smaller. Macroeconomics since Keynes has incorporated the effects of longer time horizons, expectations about future incomes and policies, and incentives (including marginal tax rates) on economic decisions. Temporary small tax rebates, as in 2008 and 2009, result in only a few cents per dollar in spending. The bulk (according to economists such as Franco Modigliani and Milton Friedman) or all (according to Robert Barro of Harvard) is saved, as people spread any increased consumption over many years or anticipate future taxes necessary to finance the debt. Empirical studies (such as those by my colleague Robert Hall and Rick Mishkin of Columbia) conclude that most consumption is based on longer-term considerations. In a dynamic economy, many parts are moving simultaneously and it is difficult to disentangle cause and effect. Taxes may be cut and spending increased at the same time and those may coincide with natural business cycle dynamics and monetary policy shifts. Using powerful statistical methods to separate these effects in U.S. data, Andrew Mountford of the University of London and Harald Uhlig of the University of Chicago conclude that the small initial spending multiplier turns negative by the start of the second year. In a new cross-national time series study, Ethan Ilzetzki of the London School of Economics and Enrique Mendoza and Carlos Vegh of the University of Maryland conclude that in open economies with flexible exchange rates, "a fiscal expansion leads to no significant output gains." My colleagues John Cogan and John Taylor, with Volker Wieland and Tobias Cwik, demonstrate that government purchases have a GDP impact far smaller in New Keynesian than Old Keynesian models and quickly crowd out the private sector. They estimate the effect of the February 2009 stimulus at a puny 0.2% of GDP by now. By contrast, the last two major tax cuts—President Reagan's in 1981-83 and President George W. Bush's in 2003—boosted growth. They lowered marginal tax rates and were longer lasting, both keys to success. In a survey of fiscal policy changes in the OECD over the past four decades, Harvard's Albert Alesina and Silvia Ardagna conclude that tax cuts have been far more likely to increase growth than has more spending. Former Obama adviser Christina Romer and David Romer of the University of California, Berkeley, estimate a tax-cut multiplier of 3.0, meaning $1 of lower taxes raises short-run output by $3. Messrs. Mountford and Uhlig show that substantial tax cuts had a far larger impact on output and employment than spending increases, with a multiplier up to 5.0. Conversely, a tax increase is very damaging. Mr. Barro and Bain Capital's Charles Redlick estimate large negative effects of increased marginal tax rates on GDP. The best stimulus now is to stop the impending tax hikes. Mr. Alesina and Ms. Ardagna also conclude that spending cuts are more likely to reduce deficits and debt-to-GDP ratios, and less likely to cause recessions, than are tax increases. These empirical studies leave many leading economists dubious about the ability of government spending to boost the economy in the short run. Worse, the large long-term costs of debt-financed spending are ignored in most studies of short-run fiscal stimulus and even more so in the political debate. Mr. Uhlig estimates that a dollar of deficit-financed spending costs the economy a present value of $3.40. The spending would have to be remarkably productive, both in its own right and in generating jobs and income, for it to be worth even half that future cost. The University of Maryland's Carmen Reinhart, Harvard's Ken Rogoff and the International Monetary Fund all conclude that the high government debt-to-GDP ratios we are approaching damage growth severely. The complexity of a dynamic market economy is not easily captured even by sophisticated modeling (an idea stressed by Friedrich Hayek and Robert Solow). But based on the best economic evidence, we should reject increased spending and increased taxes.

#### Stimulus requires an increase in debt – displaces private investment

McCormick, 9 - Distinguished Service Professor of Finance Booth School of Business University of Chicago (Robert R., “Bailouts and Stimulus Plans”, 2010, [http://faculty.chicagobooth.edu/brian.barry/igm/bailoutsandstimulusplansJanuary\_16\_2009.pdf)//AH](http://faculty.chicagobooth.edu/brian.barry/igm/bailoutsandstimulusplansJanuary_16_2009.pdf%29/AH)

Government bailouts and stimulus plans seem attractive when there are idle resources – unemployment. Unfortunately, bailouts and stimulus plans are not a cure. The problem is simple: bailouts and stimulus plans are funded by issuing more government debt. (The money must come from somewhere!) The added debt absorbs savings that would otherwise go to private investment. In the end, despite the existence of idle resources, bailouts and stimulus plans do not add to current resources in use. They just move resources from one use to another. And bailouts and stimulus plans only enhance future incomes when the activities they favor are more productive than the activities they displace. I come back to these fundamental points several times below. A Bailout of the Auto Industry The bailout of the auto industry is a good place to cut one’s teeth on the effects of government action. Most politicians favor the auto bailout. They fear that if the big three automakers fail, millions of jobs will be lost. Many people have pointed out that U.S. bankruptcy law makes this outcome unlikely. When a big company goes into (Chapter 11) bankruptcy, it is not liquidated. Instead, the company continues to operate, while reorganizing under court supervision.There is, however, an important point, never mentioned by those in favor or those against a bailout. I phrase it in terms of the equation above. Bailouts of auto firms will be financed with government debt. The government deficit gets larger; that is, government savings, GS, become more negative. If private and other corporate savers do not save more in response to additional government debt, the auto bailout displaces productive investments elsewhere. If private and other corporate savers do save more in response to additional government debt, private consumption must go down by the same amount. This lost consumption and investment, and the incomes they would create, are the big costs of a bailout. The real question posed by the auto bailout is then clear. Will the benefits, in terms of higher current and future incomes in the auto industry, fully offset the incomes lost as a result of the lost consumption and investment that the bailouts displace? We are all moved by the visible prospect of lost jobs in the auto industry. We tend to forget the unnamed people who lose jobs or don’t get jobs, the businesses that close or the new businesses that don’t start, because the bailout displaces productive activities elsewhere. The Sad Logic of a Fiscal Stimulus In a “fiscal stimulus,” the government borrows and spends the money on investment projects or gives it away as transfer payments to people or states. The hope is that government spending will put people to work, either directly on government investment projects or indirectly through the consumption and savings decisions of the recipients of government spending. The current stimulus plan adds up to about $750 billion. Will it work? Unfortunately, there is a fly in the ointment. Like the auto bailout, government infrastructure investments must be financed -- more government debt. The new government debt absorbs private and corporate savings, which means private investment goes down by the same amount. Government infrastructure investments benefit the economy if they are more productive than the private projects they displace. Some government investments are in principle productive. The government is the natural candidate to undertake investments that have widespread positive spillovers (what economists call externalities). For example, a good national road system increases the efficiency of almost all business and consumption activities. Because all the benefits of a good road system are difficult for a private entity to capture without creating inefficiencies (toll or EZ Pay booths on every corner), the government is the natural entity to make decisions about road building and other investments that have widespread spillovers. Like all government actions, however, government investments are prone to inefficiency. To survive, private entities must invest in projects that generate more wealth than they cost. Public investments face no such survival threat. Even good government investment projects can become wealth burners because their implementation is captured by interest groups (for example, minority or gender set asides, or insisting on unionized labor). Moreover, a $750 billion stimulus package will draw a feeding frenzy by public (state and local) and private interest groups, to pressure for their favored projects, which might not otherwise meet the market test. If the interest groups win, the country will be poorer, and future incomes will be lower. But we’re talking about future benefits. “Stimulus” spending must be financed, which means it displaces other current uses of the same funds, and so does not help the economy today. If you want to build roads or do other investment projects, defend them by standard cost/benefit calculations. And don’t use the misleading “s” word. Suppose the stimulus plan takes the form of lower taxes, another proposal of the incoming administration. Alas, we can’t get something for nothing this way either. If the government doesn’t also spend less, lower tax receipts must be financed dollar for dollar by more government borrowing. The government gives with one hand but takes them back with the other, with no net effect on current incomes. The details of the effects of lower taxes depend on how the public uses the proceeds. If taxpayers understand that lower taxes now are exactly offset by the current market value of the future tax liabilities implied by the current increase in government debt, they may simply save the proceeds from the tax windfall. Private savings then substitute for the fall in public savings due to the government debt issue, and there is no effect on private investment or economic activity more generally. (This is what Robert Barro dubbed Ricardian Equivalence.) Suppose the recipients of the tax reduction from the stimulus don’t know about Ricardian Equivalence, and they use the windfall to buy consumption goods. Does this increase economic activity? The answer is again no. The composition of economic activity changes, but the total is unchanged. Private consumption goes up by the amount of the new government debt issues, but private investment goes down by the same amount. I must shade my arguments a bit (but just a bit). Remember that the (investment equals savings) equation above holds for the global economy but not necessarily for an individual country. If we can get foreigners to buy the additional debt to finance bailouts and a stimulus, we can have additional government spending without reducing private spending. This is how we have financed government deficits for at least the last eight years, so perhaps we can do it for another year or so, and on a grand scale. At the moment, however, most countries are deep into their own bailout-stimulus games. More important, this “cure,” if available, is temporary. When foreigners transfer savings to us now in exchange for our government bonds, they take back the resources plus interest later. If the government expenditures generate less wealth than they cost, the wealth loss is borne by future taxpayers, when the government debt is repaid. A common counter to my arguments about why stimulus plans don’t work is to claim that the current situation is different. Specifically, the investment equal savings equation doesn’t work because savers currently prefer to invest in low risk assets like government bonds rather than in potentially productive but more risky private investment projects. In other words, there is a “flight to quality.” Sorry, but this is a fallacy. A flight to quality does raise the prices of less risky assets and lower the prices of more risky assets. But when new savings are used to buy government bonds, the people who sold the bonds must do something with the proceeds. In the end, the new savings have to work their way through to new private investment, and equation (1) always holds. The Bottom Line The general message bears repeating. Even when there are lots of idle workers, government bailouts and stimulus plans are not likely to add to employment. The reason is that bailouts and stimulus plans must be financed. The additional government debt means that existing current resources just move from one use to another, from private investment to government investment or from investment to consumption, with no effect on total current resources in the system or on total employment. And stimulus plans only enhance future incomes when they move current resources from less productive private uses to more productive government uses – a daunting challenge, to say the least.

#### Stimulus hurts the economy – economic misallocation and private-sector unemployment

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Professor Allan Meltzer of Carnegie Mellon University has a must-read column in today’s Wall Street Journal, beginning with what should be an obvious statement. Those who heaped high praise on Keynesian policies have grown silent as government spending has failed to bring an economic recovery. Except for a few diehards who want still more government spending, and those who make the unverifiable claim that the economy would have collapsed without it, most now recognize that more than a trillion dollars of spending by the Bush and Obama administrations has left the economy in a slump and unemployment hovering above 9%. He then asks a rather important question. Why is the economic response to increased government spending so different from the response predicted by Keynesian models? Prof. Meltzer gives four reasons, beginning with the threat of higher taxes. First, big increases in spending and government deficits raise the prospect of future tax increases. Many people understand that increased spending must be paid for sooner or later. Meanwhile, President Obama makes certain that many more will reach that conclusion by continuing to demand permanent tax increases. His demands are a deterrent for those who do most of the saving and investing. I especially like how he highlights Obama’s actions, which clearly show the link between more spending and more taxes. I also would have added the European fiscal crisis, which has made more people aware of the negative long-run consequences of excessive government. He then lists the negative impact of having the government distort the allocation of resources, a point that is music to my ears. Second, most of the government spending programs redistribute income from workers to the unemployed. This, Keynesians argue, increases the welfare of many hurt by the recession. What their models ignore, however, is the reduced productivity that follows a shift of resources toward redistribution and away from productive investment. He then discusses the impact of red tape, a point which I’ve never addressed, but obviously is very important if politicians use Keynesian spending as an excuse for expanding the scope of government as well as the size of government. Third, Keynesian models totally ignore the negative effects of the stream of costly new regulations that pour out of the Obama bureaucracy. Who can guess the size of the cost increases required by these programs? ObamaCare is not the only source of this uncertainty, though it makes a large contribution. Prof. Meltzer then dings the short-term mentality of Keynesians. Fourth, U.S. fiscal and monetary policies are mainly directed at getting a near-term result. The estimated cost of new jobs in President Obama’s latest jobs bill is at least $200,000 per job, based on administration estimates of the number of jobs and their cost. How can that appeal to the taxpayers who will pay those costs? Once the subsidies end, the jobs disappear—but the bonds that financed them remain and must be serviced. These medium and long-term effects are ignored in Keynesian models. The only thing I would change about this argument is that he also could have explained that so-called stimulus spending actually destroys jobs, on net, when you consider the loss of private-sector jobs that takes place when government diverts resources from the productive sector of the economy.

#### Government spending hurts the private sector-there are no benefits

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Let's take a look at how federal spending damages the economy over the long-run. Federal spending is financed by extracting resources from current and future taxpayers. The resources consumed by the government cannot be used to produce goods in the private marketplace. For example, the engineers needed to build a $10 billion government high-speed rail project are taken away from building other products in the economy. The $10 billion rail project creates government-connected jobs, but it also kills $10 billion worth of private activities.

Indeed, **the** **private sector would actually lose more than $10 billion** in this example. That is because government spending and taxing creates "deadweight losses," which result from distortions to working, investment, and other activities. The CBO says that deadweight loss estimates "range from 20 cents to 60 cents over and above the revenue raised."19 Harvard University's Martin Feldstein thinks that deadweight losses "may exceed one dollar per dollar of revenue raised, making the cost of incremental governmental spending more than two dollars for each dollar of government spending."20 Thus, a $10 billion high-speed rail line would cost the private economy $20 billion or more.

The government uses a "leaky bucket" when it tries to help the economy. Stanford University's Michael Boskin, explains: "The cost to the economy of each additional tax dollar is about $1.40 to $1.50. Now that tax dollar ... is put into a bucket. Some of it leaks out in overhead, waste, and so on. In a well-managed program, the government may spend 80 or 90 cents of that dollar on achieving its goals. Inefficient programs would be much lower, $.30 or $.40 on the dollar."21Texas A&M University's Edgar Browning comes to similar conclusions about the magnitude of the government's leaky bucket: "It costs taxpayers $3 to provide a benefit worth $1 to recipients."22

The larger the government grows, the leakier the bucket becomes. On the revenue side, tax distortions rise rapidly as marginal tax rates rise.23 On the spending side, funding is allocated to activities with ever lower returns as the government expands. Figure 4 illustrates the consequences of the leaky bucket. On the left-hand side, tax rates are low and the government delivers useful public goods such as crime reduction. Those activities create high returns, so per-capita income initially rises as the government grows.

As the government expands further, it engages in less productive activities. The marginal return from government spending falls and then turns negative. On the right-hand side of the figure, average income falls as the government expands. Government in the United States — at 41 percent of GDP — is almost certainly on the right-hand side of this figure. In a 2008 book on federal fiscal policy, Professor Browning concludes that today's welfare state reduces GDP — or average U.S. incomes — by about 25 percent.24 That would place us substantially to the right in Figure 4, and it suggests that major federal spending cuts would boost incomes over time.

Conclusions

Federal spending is soaring, and government debt is piling up at more than a trillion dollars a year. Official projections show rivers of red ink for years to come unless policymakers enact major budget reforms. Unless spending and deficits are cut, the United States is headed for economic ruin as growth falls and rising debt threatens further financial crises.

Policymakers should turn their full attention to long-run spending reforms. They should begin terminating the many unneeded and damaging federal programs that draw resources out of the private sector and sap the economy's strength. The essays on Cato's website www.DownsizingGovernment.org describe many federal programs that produce low or negative returns. Programs often create economic distortions, damage the environment, restrict individual freedom, or have high levels of fraud and abuse.

#### Government spending hurt the private sector

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[Far more people](http://blog.heritage.org/2012/06/11/morning-bell-the-private-sector-is-not-doing-fine/) have lost their jobs in the private sector than in the public sector, and the percentage of the economy consumed by the federal government has [gone up](http://www.openmarket.org/2012/05/25/no-obama-is-not-the-smallest-government-spender-since-eisenhower/) from 20 percent in 2008 to [24](http://reason.com/blog/2012/05/23/the-obama-spending-binge) percent today. But President Obama [claims that](http://blogs.telegraph.co.uk/news/timstanley/100164660/while-obama-campaigns-the-private-sector-is-not-doing-fine-and-the-middle-class-is-shrinking/) “The private sector is doing fine. Where we’re seeing weaknesses in our economy have to do with state and local government.” Similarly, six months ago, Senate Majority Leader Harry Reid (D-Nev.) [claimed](http://www.washingtonpost.com/opinions/its-the-public-sector-thats-doing-fine/2012/06/11/gJQAKNpvUV_story.html) that unemployment was [not a problem](http://www.examiner.com/article/senator-harry-reid-d-claims-unemployment-is-not-a-problem-private-sector) in the private sector, and that “It’s very clear that private-sector jobs have been doing just fine; it’s the public-sector jobs where we’ve lost huge numbers.” These claims are utterly false: as a [historian notes](http://blogs.telegraph.co.uk/news/timstanley/100164660/while-obama-campaigns-the-private-sector-is-not-doing-fine-and-the-middle-class-is-shrinking/) in the London Telegraph, job losses in America have been “much smaller within the public sector than the private (407,000 vs 4.6 million).” And as a Washington Post columnist [notes](http://www.washingtonpost.com/opinions/its-the-public-sector-thats-doing-fine/2012/06/11/gJQAKNpvUV_story.html),

Obama and Reid have it precisely backward: It’s the public sector that’s doing fine. According to the [Bureau of Labor Statistics](http://www.bls.gov/news.release/empsit.t14.htm), the unemployment rate for government workers last month was just 4.2 percent (up slightly from 3.9 percent a year ago). Compare that to private-sector industries such as construction (14.2 percent unemployment), leisure and hospitality services (9.7 percent), agriculture (9.5 percent), professional and business services (8.5 percent) and wholesale and retail trade (8.1 percent). As Andrew Biggs of the American Enterprise Institute points out, the public-sector unemployment rate “is the lowest of any industry or class of worker, even including the growing energy industry.”

Meanwhile, **the private sector continues to struggle** under the weight of Obamacare, the spiraling national debt, the [$46 billion in annual costs](http://washingtonexaminer.com/politics/washington-secrets/2012/03/regulation-nation-new-study-finds-obama%E2%80%99s-regs-cost-46-billion) of the new regulations imposed by Obama, and the looming threat of “taxmageddon” — **when, come January 2013, the private economy will get hit with hundreds of billions in higher taxes**. . . 23 million Americans who are unemployed, underemployed or have quit looking for work don’t share their complacency.

Similarly, Amy Paine [notes that](http://blog.heritage.org/2012/06/11/morning-bell-the-private-sector-is-not-doing-fine/) “If anyone is ‘doing fine,’ it’s government employees. This goes beyond the far more generous pension and health benefits they enjoy. While the private sector lost 4.6 million jobs (a 3.9 percent drop) since the recession began, government payrolls have only fallen by 240,000 jobs (a 1.1 percent drop). Federal employment has actually grown nearly 12 percent since the end of 2007, and while the country suffers from 8.2 percent unemployment, the unemployment rate for government employees is just [4.2 percent](http://www.bls.gov/news.release/empsit.t14.htm).”

Obama administration policies have [impeded the economic recovery that otherwise would](http://www.openmarket.org/2012/04/02/economic-recovery-is-slow-and-weak-due-to-obama-administration-policies/) have taken place. The administration has discouraged hiring through costly [new employment-law mandates](http://www.examiner.com/article/obama-eeoc-wipes-out-jobs-by-making-hiring-more-difficult) and [burdensome](http://www.examiner.com/article/dodd-frank-law-wipes-out-4-300-more-jobs-takes-away-mortgage-choices) taxes and regulations [contained in Obamacare](http://www.examiner.com/article/obamacare-causes-layoffs-job-losses-medical-device-industry) and the [Dodd-Frank Act](http://www.openmarket.org/2012/01/20/dodd-frank-claims-4300-more-jobs-reduces-consumer-choice-in-mortgage-market/). Obamacare is causing [layoffs in the medical device industry](http://www.openmarket.org/2012/01/03/obamacare-causes-layoffs-in-medical-device-industry-harms-medical-innovation/), and is preventing some[employers from hiring](http://www.openmarket.org/2011/12/23/businessmen-obamacare-stops-them-from-hiring/) and [from making the investments needed](http://www.openmarket.org/2011/12/28/obamacare-stifles-job-creation-causes-layoffs/) for new jobs and expanded operations. The Dodd-Frank law backed by President  Obama has also [wiped out jobs](http://www.openmarket.org/2012/01/20/dodd-frank-claims-4300-more-jobs-reduces-consumer-choice-in-mortgage-market/) and[driven thousands of jobs overseas](http://www.openmarket.org/2011/09/23/dodd-frank-financial-law-uses-regulations-to-outsource-american-jobs/). Indeed, the $46 billion estimate for the cost of new regulations cited by Marc Thiessen is a gross underestimate.

Senator Reid made his ridiculous claim about unemployment not being a problem in the private sector in order [to try to justify](http://www.examiner.com/article/senator-harry-reid-d-claims-unemployment-is-not-a-problem-private-sector) Obama’s costly [American Jobs Act](http://www.openmarket.org/2011/09/08/obamas-costly-unaffordable-new-stimulus-the-american-jobs-act/) proposals, which would explode the already colossal budget deficit in order to spend billions more on state government employees, who are already much [better paid](http://www.usatoday.com/news/nation/2008-02-01-civil-servants_N.htm) than the average American worker, and who have[generous pension](http://www.openmarket.org/2008/02/03/public-employees-are-compensated-better-than-private-sector-workers/) benefits that have [resulted in trillions](http://www.openmarket.org/2011/05/06/new-cbo-pension-report-underfunding-could-be-higher/) in [unfunded pension](http://www.pewcenteronthestates.org/uploadedFiles/Pew_pensions_retiree_benefits.pdf) benefits at taxpayer expense.

#### Deficit expansion will crowd out the private sector

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5. Fiscal expansion will crowd out private investment (and also consumption) through raising interest rates. This is very clear in the IS/LM model. The LM curve is given, representing a given real money supply, and fiscal expansion shifts the IS curve to the right, so that the interest rate rises and interest-sensitive investment and consumption decline. Here an important feature of the fiscal stimulus policies that I have been discussing earlier should be noted. Constant monetary policy is defined not as a constant quantity of base money, determined by the central bank, but as a constant interest rate policy, also determined by the central bank. When the government increases the fiscal deficit and hence sells more bonds (thus potentially raising the market interest rate) the central bank is assumed to go into the market and buy sufficient bonds to keep the interest rate at its target level. (I have discussed this in more detail in Corden (2010). If one thinks of monetary policy as consisting of management of base money, then one can regard monetary policy as being accommodating to fiscal policy. (This assumption is explicitly made in International Monetary Fund, 2008.). The important point is that monetary policy on its own is assumed to be (more or less) ineffective in reducing an output gap either because the interest rate is at a minimum (near-zero), this being Keynes’ liquidity trap, or private demand is not responsive to declines in official interest rates or to increases in the quantity of money (quantitative easing) because of balance sheet problems in the financial or the non-financial sector, or both.

#### Government borrowing money ruins the private sector

**Ritenour 09**—professor of economics at Grove City College (Shawn, “The Stimulus Does Not Work,” Free Market Magazine produced by the Mises Institution, July 2009, <http://mises.org/journals/fm/july09.pdf> //EH)

Because taxes are so politically unpopular, governments usually resort to additional ways to raise funds, one of which is borrowing. A good case can be made that government borrowing is more harmful for long-run economic progress than taxation. Although taxation reduces both consumption and investment spending, government borrowing comes entirely from the nation’s pool of savings. The money that is lent to the government in treasury bond purchases is entirely money that was saved and ready for investment. Instead of being invested in productive capital accumulation, however, it is being lent to the government to fund state consumption. When the government borrows, it becomes a major demander of loanable funds, so market interest rates increase, making it harder for private entrepreneurs to gain access to capital for their production. As private capital available for productive enterprise shrinks, our economy becomes less productive and less prosperous.

### taxes bad

#### Funding from taxes mean stimulus spending cant help the economy long term and hurts it in the short term as well

de [Rugy](http://reason.org/contrib/show/veronique-de-rugy) 10—Ph.D. and MA in Economics from the University of Paris, senior research fellow at the [Mercatus Center](http://mercatus.org/) at George Mason University (Veronique "Stimulus: Still Not Working!" Reason.org, 11/16/10, <http://reason.org/news/show/stimulus-still-not-working>)//AP

Imagine that I break my arm, but instead of getting a cast I take a big shot of morphine. The drug will make me feel better, but it won’t fix my arm. When the effect wears off, the pain will come back. And instead of being restored to their proper position, my bones will remain out of place, perhaps solidifying there, which will surely mean chronic pain in the long run.

Stimulus spending is like morphine. It might feel good in the short term for the beneficiaries of the money, but it doesn’t help repair the economy. And it causes more damage if it gets in the way of a proper recovery.

When the American Recovery and Reinvestment Act was signed on February 13, 2009, it became the biggest spending bill in the history of the country. Its original cost of $787 billion was divided into three main pieces: $288 billion in tax benefits such as a refundable tax credit; $272 billion in contracts, grants, and loans (the shovel-ready projects); and $302 billion in entitlements such as food stamps and unemployment insurance.The checks felt good for the Americans who received them. And the contractors who got those grants and contracts were happy to have the work. But the idea behind the stimulus was that this money would not just be a subsidy to those in need; it would revive the economy through a multiplier effect. The unemployed worker, for instance, would cash his unemployment check and spend it at the grocery store. The store owner would in turn spend the money on supplies, and so on, triggering a growth in the economy that goes beyond the original investment and jumpstarts the hiring process.

White House economists used forecasting models that assumed each dollar of spending would trigger between $1.50 and $2.50 of growth. As a result, President Barack Obama announced that his plan would grow the economy by more than 3 percent and “create or save” 3.5 million jobs over the next two years, mostly in the private sector. These models also forecasted that without the spending, the unemployment rate would increase from 7 percent to 8.8 percent.

Since then the U.S. economy has shed another 2.5 million jobs and the unemployment rate has climbed to 9.6 percent. Figure 1 shows the monthly unemployment rate, as measured by the Bureau of Labor Statistics, since the adoption of the act, alongside the cumulative grant, contract, and loan spending as reported by the recipients on recovery.gov.

The stimulus isn’t working because it is based on faulty economics. Using historical spending data, the Harvard economist Robert Barro and recent Harvard graduate Charles Redlick have shown that in the best case scenario, a dollar of government spending produces much less than a dollar in economic growth—between 40 and 70 cents. They also found that if the government spends $1 and raises taxes to pay for it, the economy will shrink by $1.10. In other words, greater spending financed by tax increases hurts the economy. Even if the tax is applied in the future, taxpayers today adjust their consumption and business owners refrain from hiring based on the expectation of future tax increases, which worsen the economy today.

#### Taxes as a source of revenue fails- weakens the economy

**Ritenour 09-** professor of economics at Grove City College (Shawn, “The Stimulus Does Not Work,” Free Market Magazine produced by the Mises Institution, July 2009, <http://mises.org/journals/fm/july09.pdf> //EH)

The most obvious thing the government could do to raise the funds to spend on ﬁscal stimulus is to raise taxes. However, this method is the economic equivalent of robbing Peter to pay Paul. Taxation directly impinges on taxpayers’ well-being because they are left with less income from their labors with which to provide for themselves and their families. Additionally, taxation reduces prosperity in the long run, because it fosters capital consumption over time. Taxation reduces the ability to save and invest in capital. Because savings come out of income and as people have less income at their disposal, they have less to save and invest. Taxation reduces the incentive to invest as well, because future rates of return on any investment will be reduced by taxes on positive income. A project that might have netted 10 percent without new taxes might only net 7 percent after taxes. If a 7 percent rate of return is not an acceptable rate for a speciﬁc capitalist, he will choose not to save and invest. If saving and investment decreases over time, capital will be consumed. Labor will become less productive, resulting in lower incomes and less prosperity. Not what you want to happen when trying to get out of a depression.

### at: global empirics

#### Stimulus creates increased debt without benefiting the economy—empirics disprove Keynesian theory

**Barro 12**- professor of economics at Harvard University and a senior fellow at Stanford University's Hoover Institution (Robert J. " Robert Barro: Stimulus Spending Keeps Failing" The Wall Street Journal 5/9/12[http://online.wsj.com/article/SB10001424052702304451104577390482019129156.html KEYWORDS=ROBERT+J+BARRO](http://online.wsj.com/article/SB10001424052702304451104577390482019129156.html?KEYWORDS=ROBERT+J+BARRO))//AP

The weak economic recovery in the U.S. and the even weaker performance in much of Europe have renewed calls for ending budget austerity and returning to larger fiscal deficits. Curiously, this plea for more fiscal expansion fails to offer any proof that Organization for Economic Cooperation and Development (OECD) countries that chose more budget stimulus have performed better than those that opted for more austerity. Similarly, in the American context, no evidence is offered that past U.S. budget deficits (averaging 9% of GDP between 2009 and 2011) helped to promote the economic recovery.

Two interesting European cases are Germany and Sweden, each of which moved toward rough budget balance between 2009 and 2011 while sustaining comparatively strong growth—the average growth rate per year of real GDP for 2010 and 2011 was 3.6% for Germany and 4.9% for Sweden. If austerity is so terrible, how come these two countries have done so well?

The OECD countries most clearly in or near renewed recession—Greece, Portugal, Italy, Spain and perhaps Ireland and the Netherlands—are among those with relatively large fiscal deficits. The median of fiscal deficits for these six countries for 2010 and 2011 was 7.9% of GDP. Of course, part of this pattern reflects a positive effect of weak economic growth on deficits, rather than the reverse. But there is nothing in the overall OECD data since 2009 that supports the Keynesian view that fiscal expansion has promoted economic growth.

For the U.S., my view is that the large fiscal deficits had a moderately positive effect on GDP growth in 2009, but this effect faded quickly and most likely became negative for 2011 and 2012. Yet many Keynesian economists look at the weak U.S. recovery and conclude that the problem was that the government lacked sufficient commitment to fiscal expansion; it should have been even larger and pursued over an extended period.

This viewpoint is dangerously unstable. Every time heightened fiscal deficits fail to produce desirable outcomes, the policy advice is to choose still larger deficits. If, as I believe to be true, fiscal deficits have only a short-run expansionary impact on growth and then become negative, the results from following this policy advice are persistently low economic growth and an exploding ratio of public debt to GDP.

The last conclusion is not just academic, because it fits with the behavior of Japan over the past two decades. Once a comparatively low public-debt nation, Japan apparently bought the Keynesian message many years ago. The consequence for today is a ratio of government debt to GDP around 210%—the largest in the world.

This vast fiscal expansion didn't avoid two decades of sluggish GDP growth, which averaged less than 1% per year from 1991 to 2011. No doubt, a committed Keynesian would say that Japanese growth would have been even lower without the extraordinary fiscal stimulus—but a little evidence would be nice.

Despite the lack of evidence, it is remarkable how much allegiance the Keynesian approach receives from policy makers and economists. I think it's because the Keynesian model addresses important macroeconomic policy issues and is pedagogically beautiful, no doubt reflecting the genius of Keynes. The basic model—government steps in to spend when others won't—can be presented readily to one's mother, who is then likely to buy the conclusions.

Keynes worshipers' faith in this model has actually been strengthened by the Great Recession and the associated financial crisis. Yet the empirical support for all this is astonishingly thin. The Keynesian model asks one to turn economic common sense on its head in many ways. For instance, more saving is bad because of the resultant drop in consumer demand, and higher productivity is bad because the increased supply of goods tends to lower the price level, thereby raising the real value of debt. Meanwhile, transfer payments that subsidize unemployment are supposed to lower unemployment, and more government spending is good even if it goes to wasteful projects.

#### Keynesian policies fail around the globe-Portugal, Japan, and the US

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President Obama imposed a big-spending faux stimulus program on the economy back in 2009, claiming that the government [needed to squander about $800 billion to keep the unemployment rate from rising above 8 percent](http://www.cato-at-liberty.org/even-obamas-make-believe-jobs-are-not-real/).

How did that work out? One possible description is that the so-called stimulus became a festering pile of manure. About three years have passed, and [the joblessness rate hasn’t dropped below 8 percent](http://danieljmitchell.wordpress.com/2012/04/06/using-labor-department-data-to-indict-obamas-dismal-performance-on-jobs/). But the White House has been [sprinkling perfume on that pile of you-know-what and claiming that the Keynesian spending binge was good policy](http://danieljmitchell.wordpress.com/2010/02/19/the-so-called-stimulus-was-a-flop/).

But not every politician is blindly ideological like Obama. Vitor Gaspar, Portugal’s Finance Minister, is willing to admit error. Here are some relevant [excerpts from a New York Times report](http://dealbook.nytimes.com/2012/04/23/portugals-finance-minister-we-tried-stimulus-and-it-didnt-work/).

Mr. Gaspar, speaking to The New York Times last week, has a message for observers who say Europe needs to substantially relax its austerity approach: We tried stimulus and it backfired. Like some other European countries, Portugal tried what Mr. Gaspar called “a Keynesian style expansion” in 2008, referring to a theory by economist John Maynard Keynes. But it didn’t turn things around, and may have made things worse.

Why does the Portuguese Finance Minister have this view? Well, for the simple reason that the economy got worse and more spending put his country in a deeper fiscal ditch.

The yield on Portuguese government bonds – more than 11 percent on longer-term bonds — is substantially higher than the yields on debt issued by Ireland, Spain or Italy. …The main fear among investors is that Portugal is going to have to ask for a second bailout from the International Monetary Fund and the European Union, which committed $103 billion of financial aid in 2011.

Maybe the big spenders in Portugal should import some of the statist bureaucrats at Congressional Budget Office. The CBO folks could then [regurgitate the moving-goalposts argument that they’ve used in the United States](http://www.cato-at-liberty.org/cbo-the-wizard-of-oz-and-the-keynesian-fairy-tale/) and [claim that the economy would be even weaker if the government hadn’t wasted more money](http://www.cato-at-liberty.org/a-confession-from-the-cbo-director/).

But perhaps the Portuguese left doesn’t think that will pass the laugh test.

In any event, some of us can say we were right from the beginning about this issue.

Not that being right required any keen insight. [Keynesian policies failed for Hoover and Roosevelt in the 1930s](http://danieljmitchell.wordpress.com/2011/07/10/heres-more-evidence-for-andrew-sullivan-about-herbert-hoovers-big-government-statism/). So-called stimulus policies also failed for Japan in 1990s. And Keynesian proposals failed for Bush in 2001 and 2008.

Just in case any politicians are reading this post, I’ll make a point that normally goes without saying: [Borrowing money from one group of people and giving it to another group of people does not increase prosperity](http://danieljmitchell.wordpress.com/2009/04/10/keynesian-economics-is-wrong/).

But since politicians probably aren’t capable of dealing with a substantive argument, let’s keep it simple and offer three very insightful cartoons: [here](http://danieljmitchell.wordpress.com/2011/09/01/keynesian-economics-in-a-cartoon/), [here](http://danieljmitchell.wordpress.com/2012/02/06/classic-cartoon-on-so-called-stimulus-is-amusing-and-economically-accurate/), and [here](http://danieljmitchell.wordpress.com/2011/11/20/this-cartoon-does-show-how-politicians-think/).

#### Canada proves Keynesianism is false

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Canada was starting to move in the right direction, but rising government spending and debt were undermining growth and creating financial instability. By the early 1990s combined federal, provincial, and local spending peaked at more than half of gross domestic product (GDP). In the 1993 elections, Prime Minister Jean Chretien’s Liberals gained power promising fiscal restraint, but this was the party of Trudeau, and so major reforms seemed unlikely. In the first Liberal budget in 1994, Finance Minister Paul Martin provided some modest spending restraint. But in his second budget in 1995, he began serious cutting. In just two years, total noninterest spending fell by 10 percent, which would be like the U.S. Congress chopping $340 billion from this year’s noninterest federal spending of $3.4 trillion. When U.S. policymakers talk about “cutting” spending, they usually mean reducing spending growth rates, but the Canadians actually spent less when they reformed their budget in the 1990s. The Canadian government cut defense, unemployment insurance, transportation, business subsidies, aid to provincial governments, and many other items. After the first two years of cuts, the government held spending growth to about 2 percent for the next three years. With this restraint, federal spending as a share of GDP plunged from 22 percent in 1995 to 17 percent by 2000. The spending share kept falling during the 2000s to reach 15 percent by 2006, which was the lowest level since the 1940s. The nearby chart contrasts the fall of federal spending in Canada since the 1990s with the rise of federal spending in the United States. In recent years, spending spiked upward in both countries because of the recession, but while U.S. spending remains at elevated levels, Canadian spending is now back down to 15.9 percent of GDP and is expected to fall further in the government’s current forecast. The spending reforms of the 1990s allowed the Canadian federal government to balance its budget every year between 1998 and 2008. The government’s debt plunged from 68 percent of GDP in 1995 to just 34 percent today. In the United States federal debt held by the public fell during the 1990s, reaching a low of 33 percent of GDP in 2001, but debt has soared since then to reach more than 70 percent today. Data from the Organization for Economic Cooperation and Development show that total federal, provincial, and local government spending in Canada plunged from a peak of 53 percent of GDP in 1992 to just 39 percent by the mid-1990s. In 2012, spending will be 42 percent of GDP, which compares to total government spending in the United States of 41 percent. Government spending in both countries is too high, but Canada has at least been moving in the right direction on fiscal reforms. Aside from budget cuts, Canada improved its fiscal outlook by fixing the Canada Pension Plan, which is like our Social Security system. In 1998 Canada began moving the CPP from a pay-as-you-go structure to a partially funded system. Today the CPP is solvent over the foreseeable future, which contrasts with Social Security’s huge unfunded obligations. Note, however, that Canada supplements the CPP with additional retirement subsidies out of general tax receipts. Canada’s fiscal reforms undermine the Keynesian notion that cutting government spending harms economic growth. Canada’s cuts were coincident with the beginning of a 15-year boom that only ended when the United States dragged Canada into recession in 2009. The Canadian unemployment rate plunged from more than 11 percent in the early 1990s to less than 7 percent by the end of that decade as the government shrank in size. After the 2009 recession, Canada has resumed solid growth and its unemployment rate today is about a percentage point lower than the U.S. rate. Another lesson from Canada is that the rise of groups outside of the major political parties can pressure governments to make reforms. Canada’s version of the Tea Party was the Reform Party, which arose in the early 1990s and pushed the major parties to support spending cuts, tax cuts, decentralization, and parliamentary reforms. The Reform Party elected numerous members to parliament in 1993, and it became the main opposition party in parliament in 1997. In the 2000s, the party went through structural changes and ultimately merged with the Progressive Conservatives to become the Conservative Party of current Canadian prime minister Stephen Harper.

#### US needs to cut spending in order to recover economic strength-Canada proves

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Two decades ago Canada suffered a deep recession and teetered on the brink of a debt crisis caused by rising government spending. The Wall Street Journal said that growing debt was making Canada an “honorary member of the third world” with the “northern peso” as its currency. But Canada reversed course and cut spending, balanced its budget, and enacted various pro-market reforms. The economy boomed, unemployment plunged, and the formerly weak Canadian dollar soared to reach parity with the U.S. dollar. In some ways the United States is in even worse fiscal shape today than Canada was two decades ago. For one thing baby boomers are now retiring in droves, which is pushing the federal government deeper into debt every year. America risks becoming a “first world” country like those in Europe, where huge deficit spending is wrecking economies and ruining opportunities for young people. America needs to get its fiscal house in order, and Canada has shown how to do it. Our northern neighbor still has a large welfare state, but there is a lot we can learn from its efforts to restrain the government and adopt market-oriented reforms to spur strong economic growth.

## inflation

### stimulus causes inflation

#### Government stimulus leads to massive inflation – upsets all underpinnings of the economy

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For several years, a heated debate has raged among economists and policymakers about whether we face a serious risk of inflation. That debate has focused largely on the Federal Reserve—especially on whether the Fed has been too aggressive in increasing the money supply, whether it has kept interest rates too low, and whether it can be relied on to reverse course if signs of inflation emerge. But these questions miss a grave danger. As a result of the federal government’s enormous debt and deficits, substantial inflation could break out in America in the next few years. If people become convinced that our government will end up printing money to cover intractable deficits, they will see inflation in the future and so will try to get rid of dollars today—driving up the prices of goods, services, and eventually wages across the entire economy. This would amount to a “run” on the dollar. As with a bank run, we would not be able to tell ahead of time when such an event would occur. But our economy will be primed for it as long as our fiscal trajectory is unsustainable. Needless to say, such a run would unleash financial chaos and renewed recession. It would yield stagflation, not the inflation-fueled boomlet that some economists hope for. And there would be essentially nothing the Federal Reserve could do to stop it. This concern, detailed below, is hardly conventional wisdom. Many economists and commentators do not think it makes sense to worry about inflation right now. After all, inflation declined during the financial crisis and subsequent recession, and remains low by post-war standards. The yields on long-term Treasury bonds, which should rise when investors see inflation ahead, are at half-century low points. And the Federal Reserve tells us not to worry: For example, in a statement last August, the Federal Open Market Committee noted that “measures of underlying inflation have trended lower in recent quarters and, with substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time.” But the Fed’s view that inflation happens only during booms is too narrow, based on just one interpretation of America’s exceptional postwar experience. It overlooks, for instance, the stagflation of the 1970s, when inflation broke out despite “resource slack” and the apparent “stability” of expectations. In 1977, the economy was also recovering from a recession, and inflation had fallen from 12% to 5% in just two years. The Fed expected further moderation, and surveys and long-term interest rates did not point to expectations of higher inflation. The unemployment rate had slowly declined from 9% to 7%, and then as now the conventional wisdom said it could be further lowered through more “stimulus.” By 1980, however, inflation had climbed back up to 14.5% while unemployment also rose, peaking at 11%. Over the broad sweep of history, serious inflation is most often the fourth horseman of an economic apocalypse, accompanying stagnation, unemployment, and financial chaos. Think of Zimbabwe in 2008, Argentina in 1990, or Germany after the world wars.

#### Stimulus leads to inflation – results in stagflation

Melloan, 9 – economist and financial writer, Gerald Loeb award for distinguished business and financial analysis (George, “Why 'Stimulus' Will Mean Inflation” Feb. 6, <http://online.wsj.com/article/SB123388703203755361.html#printMode)//AH>

So what is the outlook? The stimulus package is rolling through Congress like an express train packed with goodies, so an enormous deficit seems to be a given. Entitlements will go up instead of being brought under better control, auguring big future deficits. Where will the Treasury find all those trillions in a depressed world economy? There is only one answer. The Obama administration and Congress will call on Ben Bernanke at the Fed to demand that he create more dollars -- lots and lots of them. The Fed already is talking of buying longer-term Treasurys to support the market, so it will be more of the same -- much more. And what will be the result? Well, the product of this sort of thing is called inflation. The Fed's outpouring of dollar liquidity after the September crash replaced the liquidity lost by the financial sector and has so far caused no significant uptick in consumer prices. But the worry lies in what will happen next. Even when the economy and the securities markets are sluggish, the Fed's financing of big federal deficits can be inflationary. We learned that in the late 1970s, when the Fed's deficit financing sent the CPI up to an annual rate of almost 15%. That confounded the Keynesian theorists who believed then, as now, that federal spending "stimulus" would restore economic health. Inflation is the product of the demand for money as well as of the supply. And if the Fed finances federal deficits in a moribund economy, it can create more money than the economy can use. The result is "stagflation," a term coined to describe the 1970s experience. As the global economy slows and Congress relies more on the Fed to finance a huge deficit, there is a very real danger of a return of stagflation. I wonder why no one in Congress or the Obama administration has thought of that as a potential consequence of their stimulus package.

#### Government creation of currency guarentees inflation – Keynesian stimulus is wrong and their models fail

Grice, 11 (Dylan, “Inflation Causes Infighting and Oppression … And We’ve Got a Lot Of Hidden Inflation”. Dec. 15, [http://www.washingtonsblog.com/2011/09/inflation-causes-problems-hidden-inflation.html)//AH](http://www.washingtonsblog.com/2011/09/inflation-causes-problems-hidden-inflation.html%29/AH)

Money printing creates inflation. But quantitative easing doesn’t help anyone but the biggest Wall Street companies (and see this, this and this). We can’t inflate our way out of our debt crisis, and without prosecution of Wall Street, all of the stimulus in the world won’t work. Indeed, Bernanke knew in 1988 that quantitative easing doesn’t work. (War also causes inflation, and we’ve been on an endless series of wars over the past 10 years.) Stimulus Versus Austerity: A False Debate And as I’ve repeatedly noted, the never-ending fight between Keynesian stimulus and debt-cutting is a false debate. It is really a debate between helping the American people or continuing policies which simply redistribute wealth upwards to the richest .1%. Stimulus could work … if it went to the American people and Main Street, instead of the Wall Street fatcats. And the Fed could easily deploy trillions into the economy if it simply stopped paying banks to park their excess reserves at the Fed. By issuing bonds to itself the government seems to have miraculously raised revenue without burdening anyone else. This is probably why the mechanism is universally adopted throughout the world’s financial system. Yet free money does not, and cannot, exist. Since there can be no such thing as a government, or anyone else for that matter, raising revenue “at no cost” simple logic tells us that someone, somewhere has to pay. But who? This is where the subtle dishonesty resides, because the answer is that no-one knows. If the money printing creates inflation in the product market, the consumers in that product market will pay. If the money printing creates inflation in asset markets, the purchaser of the more elevated asset price pays. Of course, if the printed money ends up in asset markets even less is known about who ultimately pays for the government’s ‘free lunch’, because in this case the money printing sets off its own dynamic via the perpetual Ponzi machine that is the global financial system. The ‘free lunch’ providers will be the late entrants into whatever asset-bubble or investment fad the money printing inflates. The point is we can’t know who will pay, only that someone will pay. Thus the government has raised revenues without even knowing upon whom the burden falls, let alone telling them. Compare this to raising explicit ‘honest’ taxes, which are at least transparent. We know who levied the sales tax or the income tax, when it was levied, when it is payable, and how much has to be paid. The burden of this money printing, in contrast, seeps silently into the economy, falling indiscriminately but indubitably on unseen, unknowing victims. The economic hardships this clandestine tax operation imposes are real and keenly felt. But because no one knows from where it comes the enemy is unseen. Thus, during great inflations, societies turn on themselves with each faction blaming another for its malaise: the third century inflation crisis in ancient Rome coincided with Diocletian’s infamous persecution of the Christians; the medieval European debasements coincided with surging witchcraft trials; the extreme Central European hyperinflations following WW1 saw whole societies blaming their Jewish communities. More recently, the aftermath of the historically modest asset inflations in the tech market and the US real estate market have seen society turn on “fat-cat CEOs” and “greedy bankers” respectively. By now, some of you might feel this all to be irrelevant. Surely, you might be thinking, the plain fact is that there is no inflation. I disagree. To see why, think about what inflation is in the light of the above thinking. I know economists define it as changes in the price of a basket of consumer goods, the CPI. But why should that be the definitive measure, given that it’s only one of the many possible destinations in money’s Brownian journey from the printing presses? Why ignore other destinations, such as asset markets? Isn’t asset price inflation (or bubbles as they are more commonly known) more distortionary and economically inefficient than product price inflation? I believe economists focus so firmly on product prices in their analysis of inflation not because of any judgment over the relative importance of one type of inflation over the other, but simply because CPI-type measures of inflation are easier to see. In doing so, they resemble the fabled driver who lost his keys one evening and was found looking for them under a streetlamp. When asked by his wife why he was looking there when he’d probably lost them further back, he replied “Because here it’s easier to see.” We know that revenue cannot be raised for one person without costing someone else. We know that money printing generates revenue for the public sector. So we also know that money printing must be a tax. We know that the magnitude of that tax – the inflation rate – can be reliably measured by the increase in the rate of base money growth. Since we don’t know which markets new money will end up in or even when, we know we can’t reliably count on measures of inflation in those markets to tell us what the ‚inflation rate? is. Thus, the only reliable measure of inflation is the expansion of the monetary base. So to those who say there is no inflation, I give you the following chart. By now, the more polite economists among those still reading may be thinking something like: “What utter drivel you are full of Grice! When there is a recession/depression on and the pressure faced by an economy is deflation, which can become self-fulfilling, the only correct thing to do is to create inflation to protect jobs.” To this I would reply that every right thinking person wants to see job creation. Those advocating the creation of inflation, or fiscal stimulus are doing so because that’s what the system of logic known as ‘theoretical macroeconomics’ teaches. Yet this system of logic with its deeply flawed epistemological foundations is what brought us here in the first place! The macroeconomic body of knowledge represents no such thing – a cacophony of faiths would be more accurate. The instruments and gauges it recommends policy makers rely on – CPI, trend growth, output gaps, NAIRUs, budget deficits, debt/GDP – are subject to such wide conceptual ambiguity, not to mention estimation error, as to render them utterly meaningless. The fact is the captains of our ship have no reliable gauges. They have no understanding of what a yank of this lever, or a push on that button will ultimately achieve. They just think they do. Intoxicated by trumped up notions of what they know and understand, the drunk driving of macroeconomists is what led us to where we are today.

#### **Stimulus causes inflation**

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4. Some critics of fiscal stimuli deny that an output gap exists initially or—more realistically—they argue that the stimulus, including its potential multiplier effects, exceeds the output gap. The measured multiplier in real terms will then be low. Inflation, rather than increases in output, may result. This is an empirical issue. Furthermore, if the policy is designed to forestall the emergence of an output gap one may never see such a gap. This is the same point as discussed in point 1 above: a mistake may be made in choosing the counter-factual.

#### Just the perception of the plan causes inflation

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If people come to believe that bonds held today will be paid off in the future by printing money rather than by running surpluses, then a large debt and looming future deficits would risk future inflation. And this is what most observers assume. In fact, however, fears of future deficits can also cause inflation today.

**Stimulus-induced growth is unsustainable—it’s only a short-term disruption that kills long-term productivity and causes inflation**

**Mueller, econ prof, 3/12**—doctorate in economics, professor at UFS in Brazil (Antony P., 3/12/12, “The Stimulus Scam,” <http://mises.org/daily/4158>, RBatra)

It is quite common for policy makers, economic analysts, and commentators of all kinds to fail to distinguish between economic growth, which enlarges the productive capacity of an economy, and mere expansion of demand. Yet there is a huge difference between the kind of economic growth that comes as a consequence of victories in the battle against scarcity and the kind that is **merely an output expansion resulting from increased spending.**

The Austrian business-cycle theory emphasizes the problem of intertemporal misallocation due to monetary and fiscal stimuli. According to Austrian economic theory, stimulus packages induce **the launch of projects that are bound to fail because their completion will be cut short by the lack of sustainable funding**. In the short run, stimulus policies will bring an increase of the nation's gross domestic product, yet **what matters for long-term economic growth is not credit-induced demand but the nation's capacity for production.**

There is general agreement in the economics profession that the much-vaunted expenditure multiplier of Keynesian theory has quite different real and monetary effects depending on the state of the economy. However, the negative impact of stimulus policies on productivity is much less understood. **When the economy expands due to fiscal or monetary stimulus, the productive capacity of the economy will actually decrease because the artificial expansion will mainly encourage malinvestment, i.e., the pursuit of business projects that are not viable in the long run.**

It is easy indeed to fall into the trap of phony economic growth; as long as capacity utilization is below the normal level, demand expansions fueled by monetary and fiscal impulses increase economic activity. But the more the economy approaches full capacity, the more the effect on the production of real goods gets weaker and the effect on prices gets stronger. Eventually, this reaches the point when the monetary expansion **only has inflationary price effects**, and its impact on real production becomes nil.

When distortions in the economy are still small, and only a minor recession would be necessary to correct the misallocation, a modest amount of monetary or fiscal stimulus often will be sufficient to make the boom continue; this represents another source of deception. Central bankers and finance ministers enjoy praise for this cheap feat of having prevented what would otherwise have been only a mild and short slump. Yet by not letting mild recessions happen, these policy makers heap one pile of economic distortions upon another **until the big downturn becomes unavoidable.**

When finally confronted with the threat of a severe depression, these same authorities fall into panic. Acting in fear, they tend to deny experience and to flout prudence and rationality. In the face of a major economic downturn, monetary authorities resort to flooding the economy with even more easy money. Furthermore, their deficit spending heaps new debt upon old debt.

**Research and empirics prove—stimulus effects are temporary but still create huge amounts of inflation**

**Issing 10**—President of the Center for Financial Studies at Frankfurt University (Otmar, The International Economy. 24.2, Spring 2010: p35, “Is monetarism dead? Has the resurgence of Keynesianism already peaked?,” Academic OneFile, RBatra)

This dominance of Keynesianism was finally undermined by two developments. The first was new **theoretical and empirical research**, chiefly associated with the American economist Milton Friedman. The work of those economists, who soon came to be termed "monetarists," called into question fundamental elements of both Keynesian theory and the economic policy it underpinned. Growing skepticism toward Keynesian thinking concerning the effectiveness of fiscal policy and its multiplier effects, the disregard for money and monetary policy, and the hubristic attempt at fine-tuning the economy--was replaced by growing support for monetarism.

The second development, just as important, was that **Keynesian policy had failed to deliver in practice**. No one could have conceded this more plainly than then-British premier James Callaghan in his speech to the Labour Party Conference in Blackpool in September 1976: "We used to think that you could just spend your way out of a recession and increase employment by cutting taxes and boosting Government spending. I tell you, in all candor, that that option no longer exists, and that insofar as it ever did exist, it only worked by **injecting bigger doses of inflation into the economy followed by higher levels of unemployment as the next step**. That is the history of the past twenty years."

### at: money supply causes inflation

#### No correlation between money supply and inflation

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While I also worry about inflation, I do not think that the money supply is the source of **the** danger. In fact, the correlation between inflation and the money stock is weak, at best. The chart on the next page plots the two most common money-supply measures since 1990, along with changes in nominal gross domestic product. (M1 consists of cash, bank reserves, and checking accounts. M2 includes savings accounts and money-market accounts. Nominal GDP is output at current prices, which therefore includes inflation.) As the chart shows, money-stock measures are not well correlated with nominal GDP; they do not forecast changes in inflation, either. The correlation is no better than the one between unemployment and inflation. Why is the correlation between money and inflation so weak? The view that money drives inflation is fundamentally based on the assumption that the demand for money is more or less constant. But in fact, money demand varies greatly. During the recent financial crisis and recession, people and companies suddenly wanted to hold much more cash and much less of any other asset. Thus the sharp rise in M1 and M2 seen in the chart is not best understood as showing that the Fed forced money on an unwilling public. Rather, it shows people clamoring to the Fed to exchange their risky securities for money and the Fed accommodating that demand.

### inflation bad

**Inflation is the biggest chance of messing up status quo recovery**

**Reuters 3/14**—quoting Paul Volcker, former Chairman of the Federal Reserve, M.A. in Political Economy from Harvard University (3/14/12, [h0ttp://www.reuters.com/article/2012/03/14/us-economy-us-volcker-idUSBRE82D1AE20120314](http://www.reuters.com/article/2012/03/14/us-economy-us-volcker-idUSBRE82D1AE20120314), RBatra)

The U.S. economy is recovering "pretty well" and trying to juice it up by allowing a little extra inflation would be disastrous, Paul Volcker, the former Federal Reserve chairman known for successfully reining in double-digit inflation, said on Wednesday.

"I think **that is kind of a doomsday scenario**," Volcker told an economic summit when asked if the Fed should foster higher inflation to stimulate faster growth.

Higher inflation would backfire by causing interest rates to rise. "You are not going to get any stimulus and you are going to make it much harder to restore price stability," Volcker told the Atlantic magazine conference.

#### Inflation kills the economy

Zakaria 9—Editor of Newsweek, BA from Yale, PhD in pol sci, Harvard. He serves on the board of Yale University, The Council on Foreign Relations, The Trilateral Commission, and Shakespeare and Company. Named "one of the 21 most important people of the 21st Century" (Fareed, The Secrets of Stability, 12 December 2009, http://www.fareedzakaria.com/articles/articles.html)

The second force for stability is the victory—after a decades-long struggle—over the cancer of inflation. Thirty-five years ago, much of the world was plagued by high inflation, with deep social and political consequences. Severe inflation can be far more disruptive than a recession, because while recessions rob you of better jobs and wages that you might have had in the future, inflation robs you of what you have now by destroying your savings. In many countries in the 1970s, hyperinflation led to the destruction of the middle class, which was the background condition for many of the political dramas of the era—coups in Latin America, the suspension of democracy in India, the overthrow of the shah in Iran. But then in 1979, the tide began to turn when Paul Volcker took over the U.S. Federal Reserve and waged war against inflation. Over two decades, central banks managed to decisively beat down the beast. At this point, only one country in the world suffers from -hyperinflation: Zimbabwe. Low inflation allows people, businesses, and governments to plan for the future, a key precondition for stability.

#### Increases in inflation have an immediate negative effect on growth—inflation is necessarily contractionary

Dr. Fair 02**-** received his B.A. from Fresno State College in 1964 and his Ph.D. from MIT in 1968. He spent several years at Princeton University before moving to Yale. He is now a professor within the Cowles Foundation and the International Center for Finance.(Ray C., “On Modeling the Effects of Inflation Shocks”, Yale, March 2002, [http://www.cepii.fr/anglaisgraph/communications/pdf/2002/01020702/fair2000.pdf)//sjl](http://www.cepii.fr/anglaisgraph/communications/pdf/2002/01020702/fair2000.pdf%29/sjl)

The results in this paper suggest, however, that an inflation shock with the nominal interest rate held constant has a negative effect on real output. There are three reasons. First, the data support the use of nominal rather than real interest rates in aggregate expenditure equations. Second, the evidence suggests that the percentage increase in nominal household wealth from a positive inflation shock is less than the percentage increase in the price level, which is contractionary because of the fall in real wealth. Third, there is evidence that wages lag prices, and so a positive inflation shock results in an initial fall in real wage rates and thus real labor income, which is contractionary. If these three features are true, they imply that a positive inflation shock has a negative effect on aggregate demand even if the nominal interest rate is held constant. Not only does the Fed not have to increase the nominal interest rate more than the increase in inflation for there to be a contraction, it does not have to increase the nominal rate at all!

#### Inflation causes an economic apocalypse—empirics prove

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But the **Fed’s** view that inflation happens only during booms is too narrow, based on just one interpretation of America’s exceptional post-war experience. It overlooks, for instance, the stagflation of the 1970s, when inflation broke out despite “resource slack” and the apparent “stability” of expectations. In 1977, the economy was also recovering from a recession, and inflation had fallen from 12% to 5% in just two years. The Fed expected further moderation, and surveys and long-term interest rates did not point to expectations of higher inflation. The unemployment rate had slowly declined from 9% to 7%, and then as now the conventional wisdom said it could be further lowered through more “stimulus.” By 1980, however, inflation had climbed back up to 14.5% while unemployment also rose, peaking at 11%. Over the broad sweep of history, serious inflation is most often the fourth horseman of an economic apocalypse, accompanying stagnation, unemployment, and financial chaos. Think of Zimbabwe in 2008, Argentina in 1990, or Germany after the world wars. The key reason serious inflation often accompanies serious economic difficulties is straightforward: Inflation is a form of sovereign default. Paying off bonds with currency that is worth half as much as it used to be is like defaulting on half of the debt. And sovereign default happens not in boom times but when economies and governments are in trouble..

#### No advantage to increased inflation rates and costs more

**Todter and Ziebarth 99-** German Economists/ smart people(Karl-Heinz and Gerhard, “PRICE STABILITY VS. LOW INFLATION IN GERMANY: AN ANALYSIS OF COSTS AND BENEFITS”, University of Chicago Press, September 1999, http://www.nber.org/papers/w6170.pdf?new\_window=1)//sjl

In that respect, this study has confirmed for Germany what Feldstein discovered for the United States: inflation is anything but an attractive option. The interaction of even moderate rates of inflation with the existing system of taxation results in a significant loss of welfare. The change from an equilibrium 'true' inflation rate of 2 % (which may correspond to a measured rate of 3 %) to a rate of zero brings permanent welfare gains, equivalent to 1.4 % of GDP year for year. The deadweight loss of two percent inflation is so great because Germany has a high savings rate, capital income is taxed heavily, and the tax system is not indexed. Inflation intensifies the distortions of taxation on capital income. For that reason the welfare gains of price stability should not be measured by a “Harberger triangle", but by a “Feldstein trapezoid". Even if we regard the output losses (in the form of a temporary Okun gap) during disinflation as far away from being negligible, there are, in our opinion, no convincing arguments for a moderate inflation being superior to price stability.

#### Even a moderate increase an inflation will end growth

**Dr. Sarel 95**- Israel’s Head of Economics and State Revenues at the Ministry of Finance, has a Ph.D. in Economics from Harvard University and a BA in Economics and Computer Science from Hebrew University. (Michael, “NonLinear effects of Inflation on Economic Growth”, International Monetary Fund, May 1995, Social Science Research Network)//sjl

This paper explored the possibility of nonlinear effects of inflation on economic growth. It found evidence of the existence of a structural break in the function that relates growth rates to inflation. It found that when inflation is low, it has no significant negative effect on economic growth. The effect may even be slightly positive. But when inflation is high, it has a negative effect on growth. This negative effect is robust, statistically significant and very powerful. The point of a structural break was estimated to occur where the average annual rate of inflation is 8 percent. If a structural break exists, failing to take it into account introduces a significant bias in the estimated effect of inflation. This study demonstrated that when the structural break is taken into account, the estimated effect of inflation on economic growth increases by a factor of three. The existence of such a structural break also suggests a specific numerical target for policy: keep inflation always below the structural break. One possible interpretation of the empirical results of this paper is that **when inflation rates doubles** (For example a relatively moderate increase in inflation from 20 to 40 percent), the growth rate decreases by 1.7 percentage points. This difference of 1.7 percentage points is much higher than previous studies estimated, and is exactly equal to the average growth rate of income per person in the last two decades. In other words, it is the difference between sustained growth and stagnation. This interpretation implies that a macroeconomic policy to avoid high inflation is one of the best recommendations an economist can make.

#### Even the most minor increases in inflation reduces capital investment by private companies

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M.A., Economics, l981; The University of Chicago. B.A., Economics (High Honors) and Mathematics, 1979, The University of Michigan., Pearlman: BA and PHD in economics (Parantap, Max Gillman, Joseph Pearlman, “Inflation, Human Capital and Tobin's q”, CENTRE FOR DYNAMICMACROECONOMIC ANALYSIS CONFERENCE PAPERS 2009, May 2009, [http://www.st-andrews.ac.uk/economics/CDMA/papers/cp0904.pdf)//sjl](http://www.st-andrews.ac.uk/economics/CDMA/papers/cp0904.pdf%29/sjl)

A pervasive empirical finding for the US economy is that inflation is negatively correlated with the normalized market price of capital (Tobin's q) and growth. A dynamic stochastic general equilibrium model of endogenous growth is developed to explain these stylized facts. In this model, human capital is the principal driver of selfsustained growth. Long run comparative statics analysis suggests that inflation diverts scarce time resource to leisure which lowers human capital utilization. This impacts growth adversely and modulates capital adjustment cost downward resulting in a decline in Tobin's q. For the short run, a Tobin effect of inflation on growth weakens the negative association between inflation and q.

### inflation bad—turns consumer spending

#### High inflation turns consumer spending

Time 11 – (Stephen Gandel, “Is Inflation Causing Americans to Stop Spending?”, Time, March 28,2011, [http://business.time.com/2011/03/28/is-inflation-causing-americans-to-stop-spending/)//sjl](http://business.time.com/2011/03/28/is-inflation-causing-americans-to-stop-spending/%29/sjl)

The American consumer, after seemingly brushing off the Great Recession far faster than expected, seems to be headed back into retreat. And it appears this time not to be the job market that is doing it or the state of the economy, but inflation. So will inflation cause Americans to finally embrace the “new normal,” stop spending and derail the recovery? On Monday morning, the Bureau of Economic Analysis announced it’s monthly totals for February for personal income and expenditures. Both numbers were up and looked good. That was until you factored in inflation. The BEA releases its own measure of inflation called the Personal Consumption Expenditures Index. It is less well known than the popular Consumer Price Index, but some members of the Federal Reserve think it is a more accurate measure of inflation than the CPI. Well the PCE index rose 0.4% in February, that was the largest monthly increase for that figure in two and a half years. The result is that when you adjust for inflation, personal income appears to be falling, down 1%. And that strong spending rebound we were seeing a few months ago? Well, again adjust for inflation, and that seems to be disappearing as well. Here’s what the popular economics blog Calculated Risk had to say (note when economists say “real” that means they are adjusting for inflation): Even though PCE growth was at expectations, real PCE was low – and this suggests analysts will downgrade their forecasts for Q1 GDP. Using the two month estimate for PCE growth (averaging the growth of January and February over the first two months of the previous quarter) suggests PCE growth of around 1.4% in Q1 (down sharply from 4.0% in Q4). So is inflation the thing that will get consumers to finally close their wallets? The thing is inflation is actually a two-edged sword when it comes to consumption. When inflation rises quickly, that can hurt confidence in the economy and as long as prices are rising faster than incomes (which usually happens when inflation really takes off) that can cause people to conserve their dollars. But if inflation is too low, that can hurt spending as well. Here’s the thing: Inflation is part of recoveries. As the economy starts to grow faster, that boosts demand and with it prices tend to rise as well. This happens in every recovery. And it is a hump that every recovery has to get over. If prices start to rise faster than the economy, then recoveries fail. But that doesn’t usually happen. This time around the usually weak job growth has people concerned that rising prices will overtake the recovery. For now that doesn’t look likely. Even with February’s 0.4% jump in inflation as measured by the PCE, prices are still only up 1.6% in the past 12 months. (And that is actually less than the CPI’s jump in the past month of 2.1%.) Real GDP, by comparison, rose nearly 3% in 2010. So, for now, inflation seems unlikely to derail the recovery. But if prices continue to rise like they did in February we might have a problem. Stay tuned.

### at: inflation causes growth

#### Inflation will not cause growth, but recession

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But these questions miss a grave danger. As a result of the federal government’s enormous debt and deficits, substantial inflation could break out in America in the next few years. If people become convinced that our government will end up printing money to cover intractable deficits, they will see inflation in the future and so will try to get rid of dollars today — driving up the prices of goods, services, and eventually wages across the entire economy. This would amount to a “run” on the dollar. As with a bank run, we would not be able to tell ahead of time when such an event would occur. But our economy will be primed for it as long as our fiscal trajectory is unsustainable. Needless to say, such a run would unleash financial chaos and renewed recession. It would yield stagflation, not the inflation-fueled boomlet that some economists hope for. And there would be essentially nothing the Federal Reserve could do to stop it.

### unsustainable

#### Government inflations as a source of revenue fails

**Ritenour 09-** professor of economics at Grove City College (Shawn, “The Stimulus Does Not Work,” Free Market Magazine produced by the Mises Institution, July 2009, <http://mises.org/journals/fm/july09.pdf> //EH)

Monetary inﬂation produces another set of negative economic consequences. In the ﬁrst place, when the government increases the money supply, in general people hold more money than they want to at prevailing overall prices. They relieve this excess supply by spending the excess money on consumer and producer goods. Increasing the money supply does not spontaneously increase the stock of these goods; it merely increases the amount of money being spent on the same quantity of goods. Because more money is spent, the demand for producer and consumer goods increases, so overall prices increase and the purchasing power of the dollar falls. There is, therefore, no general social beneﬁt from inﬂation. In fact, monetary inﬂation via credit expansion is the source of our present trouble. Artiﬁcial credit expansion— credit not funded by savings—creates the business cycle by spawning capital malinvestment. Artiﬁcial credit expansion makes many unwise investments (say in residential and commercial real estate and ﬁnancial derivatives) look proﬁtable because of the accessibility of cheap credit, so business activity expands, manifesting itself in an inﬂationary boom. Bad investments, however, are not made economically sound merely because there is more money in existence. These bad investments eventually must be liquidated. The boom resolves itself in a bust whose twin children are capital consumption and unemployment. The moral of the story is that monetary inﬂation is not a way to sustainably generate economic prosperity.

## topic-specific

### generic

#### Infrastructure stimulus will be counterproductive – multiple reasons

de Rugy\* and Mitchell\*\* 11 \*a senior research fellow at the Mercatus Center at George Mason University. Her primary research interests include the U.S. economy \*\*a senior research fellow at the Mercatus Center at George Mason University. His primary research interests include economic freedom and economic growth, government spending, state and local fiscal policy, public choice, and institutional economics. (Veronique and Mathew " WOULD MORE INFRASTRUCTURE SPENDING STIMULATE THE ECONOMY?" Mercatus Center George Mason University September 2011 [http://mercatus.org/sites/default/files/publication/infrastructure\_deRugy\_WP\_9-12-11.pdf)//BM](http://mercatus.org/sites/default/files/publication/infrastructure_deRugy_WP_9-12-11.pdf%29/BM)

The problems with infrastructure stimulus: There are unique problems with infrastructure stimulus that tend to diminish its chances of success. Chief among these are long implementation delays. The Congressional Budget Office reports that:

[F]or major infrastructure projects supported by the federal government, such as highway construction and activities of the Army Corps of Engineers, initial outlays usually total less than 25 percent of the funding provided in a given year. For large projects, the initial rate of spending can be significantly lower than 25 percent.17

Economists from the IMF studied the impact of implementation delays on the multiplier and found that, ―Implementation delays can postpone the intended economic stimulus and may even worsen the downturn in the short run.‖

Implementation

Perhaps the most important reasons to be skeptical about further stimulus—particularly infrastructure stimulus—have to do with the way it is implemented. As a general rule, the studies that obtain large multipliers do so by assuming that stimulus funds will be distributed just as Keynesian theory says they ought to be. Keynesian economist and former presidential economic advisor Lawrence Summers has offered a widely accepted summary of how—ideally—fiscal stimulus ought to be applied.18 He argues that fiscal stimulus ―can be counterproductive if it is not timely, targeted, and temporary.‖ In reality, however, **infrastructure spending cannot fulfill these criteria.**

There is no such thing as a “shovel ready” project: By nature, infrastructure spending fails to be timely. Even when the money is available, it can be months, if not years, before it is spent. This is because infrastructure projects involve planning, bidding, contracting, construction, and evaluation.19

Un-targeted: Effective targeting means that stimulus money should be spent in those areas that have been hardest hit by the recession. The goal is to make the most use of ―idle resources‖ (as Keynesian theory terms them). For instance, depressed areas like Detroit have a considerable number of unemployed resources (people, firms, equipment, etc.). So theoretically, government stimulus should be able to put these idle resources to work. A number of studies, however, have shown that stimulus funding tends not to go to those areas that have been hardest hit by a recession.21

 Even targeted stimulus may fail: Many of the areas that were hardest hit by the recession are in decline because they have been producing goods and services that are not, and will never be, in great demand. Therefore, the overall value added by improving the roads and other infrastructure in these areas is likely to be lower than if the new infrastructure were located in growing areas that might have relatively low unemployment but do have great demand for more roads, schools, and other types of long-term infrastructure.22

 Job poaching, not creating: Unemployment rates among specialists, such as those with the skills to build roads or schools, are often relatively low. Moreover, it is unlikely that an employee specialized in residential-area construction can easily update his or her skills to include building highways. As a result, we can expect that firms receiving stimulus funds will hire their workers away from other construction sites where they were employed rather than from the unemployment lines. This is what economists call ―crowding out.‖ Except that in this case, labor, not capital, is being crowded out. In fact, new data confirm that a plurality of workers hired with ARRA money were poached from other organizations rather than from the unemployment lines.23

Not temporary: Even in Keynesian models, stimulus is only effective as a short-run measure. In fact, Keynesians also call for surpluses during an upswing.24 In reality, however, the political process prefers to implement the first Keynesian prescription (deficit-financed spending) but not the second (surpluses to pay off the debt).25 The inevitable result is a persistent deficit that, year-in, year-out, adds to the national debt.26 A review of historical stimulus efforts has shown that temporary stimulus spending tends to linger and that two years after an initial stimulus, 95 percent of the spending surge remains.27

#### Stimulus fails – empirics and models prove

Taylor, 9 - Professor of economics @ Stanford (John B. “THE LACK OF AN EMPIRICAL RATIONALE FOR A REVIVAL OF DISCRETIONARY FISCAL POLICY”, CESi fo Forum, Feb., http://www.ifo.de/portal/pls/portal/docs/1/1191494.PDF)//AH

There is little evidence that short government impulses will jump start an economy adversely affected by other forces. In the current recession, the economy has been pulled down by the housing slump, the financial crisis, and the lagged effects of high energy prices. Expectations of future income and employment growth are low because the effects of the financial crisis are expected to last for years into the future. Unless these effects are addressed, a short-term fiscal stimulus has little chance of causing a sustained recovery. The theory that a short-run stimulus will jump start the economy is based on older “Keynesian” theories which do not adequately include**, in my view,** the complex dynamic or general equilibrium effects of a modern international economy. Nor do they usually include endogenous (or rational) expectations of the future**.** The problems with such models can be illustrated by again using the evidence from the rebates, and I believe similar problems arise when analyzing other stimulus proposals as well. For example, according to model simulations of Zandi (2008), GDP would have risen by about a dollar and a quarter for every dollar of a refundable one-time rebate. But Figure 1 and Table 2 show that in reality the impact was only a few pennies for each dollar and insignificantly different from zero in 2008. One needs to understand why the models were in error before using the same models to analyze the impacts of new types of proposals for 2009. In contrast, simulations of my (1992) empirically estimated multicountry dynamic model with rational expectations indicates that multiyear changes in government spending phased in at realistic rates have a maximum government spending multiplier less than one because of offsetting reductions in the other components of GDP. To be sure, it may be appropriate to increase government purchases in some areas including for infrastructure as in the 1950s when the interstate highway system was built. But such multiyear programs did not help end, mitigate, or prevent the recessions of the 1950s. In sum, there is little reliable empirical evidence that government spending is a way to end a recession or accelerate a recovery that rationalizes a revival of discretionary countercyclical fiscal policy. The earlier widespread view of fiscal policy was that instead of focusing on discretionary countercyclical actions it should focus on the automatic stabilizers as well as on more lasting long run reforms that benefit the economy, from tax reform, to entitlement reform, to infrastructure spending, to keeping the debt to GDP ratio in line. Is there any change in the behavior of the automatic stabilizers which would change this view? Table 3 provides evidence of how the automatic stabilizers have changed over time. It is an update of a similar table and analysis in my 2000 paper. It divides the total federal budget deficit on a quarterly basis into two components: a structural part and a cyclical part. The structural part is a quarterly interpolation of the annual number reported by the Congressional Budget Office (CBO). According to CBO methodology the structural deficit is affected by changes in tax rates or spending programs such as the 1982 tax rate cuts, the 1993 tax rate increases and the 2001 tax rate cuts. The structural deficit is also affected by changes in the economy such as changes in the income distribution or the share of income in different tax categories. The cyclical part is computed in Table 3 as the difference between total deficit and the structural part. To measure how the automatic stabilizers have changed over time I regressed each of these measures (structural, cyclical and total) as a percentage of GDP separately on the percentage GDP gap. I used the CBO measure of potential GDP to compute the GDP gap which results in a reasonable description of the ups and downs of the economy at a business cycle frequency. I report the slope coefficients from each of these regressions in Table 3 for several different sample periods. All the coefficients are highly statistically significant. As computed, the sum of the coefficients in the first two columns should equal the coefficient in last column except for rounding errors. Table 3 shows that there indeed have been large changes in the relation between these measures of the deficit and the GDP gap.While the coefficient on the cyclical component has remained fairly constant around 1 /3, the coefficient on the structural component has increased dramatically over time. In fact, the cyclical movements in the structural deficit have overtaken the cyclical movements in the cyclical deficit. More research is needed to determine exactly why this change has occurred. It is important to determine whether this high responsiveness will continue into the current recession. If so, the automatic stabilizers will be very powerful and the deficit will increase significantly on this account. In any case, Table 3 provides no evidence to change the “widespread agreement” of a decade ago to focus fiscal policy on the automatic stabilizers rather than on discretionary countercyclical actions. It may suggest the opposite. Changes in monetary policy effectiveness Another reason for the widespread view a decade ago about fiscal policy was that monetary policy had improved after the late 1960s and 1970s and played an essential countercyclical role as it achieved both greater price and output stability during the great moderation. However, there were also concerns expressed about the limits of monetary policy if the zero bound on interest rates were to be reached as it In my view, however, the experience during the past decade does not show that monetary policy is ineffective or that fiscal policy is more appropriate when the short term interest rate reaches the lower bound of zero. Indeed, the lesson from Japan is that it was the shift toward increasing money growth – quantitative easing – in 2001 that finally led to the end of the lost decade of the 1990s. It was certainly not discretionary fiscal policy actions. Increasing money growth – or simply preventing it from falling as in the Great Depression – remains a powerful countercyclical policy. While a full treatment of monetary policy in the current environment is well beyond the scope of this paper, there is no evidence in the past decade that suggests that monetary policy has run out of ammunition and must be supplemented by discretionary fiscal actions. Conclusion A decade ago there was widespread agreement that fiscal policy should avoid countercyclical discretionary actions and instead should focus on the automatic stabilizers and on longer term fiscal reforms that positively affect economic growth and provide appropriate government services, including infrastructure and national defense. In this paper I briefly summarized the empirical evidence during the past decade on (1) the temporary rebate programs of 2001 and 2008, (2) macro-econometric model simulations, (3) the changing cyclical response of the automatic stabilizers, and (4) the role of monetary policy in a zero interest situation. Based on this review I see no empirical rationale for a revival of countercyclical discretionary fiscal policy.

### delay

#### Transportation Stimulus is spent too slowly to help the economy

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In the midst of a sluggish economy, nearly every state is facing a significant budget crisis. California's 2010 deficit is expected to be $25 billion to $41 billion. New York, New Jersey, Illinois, Ohio, Florida, and many other states expect at least $1 billion each in red ink next year. As state legislatures grapple with these deficits, it is no secret many are counting on money from federal stimulus package to fill their gaps.

Transportation is widely viewed as a key component for any stimulus, and the current House proposal doesn't skimp when it comes to roads and transit. However, even with stimulus assistance, a paradigm shift towards private sector participation in transportation funding is needed if states want to solve the underlying problems that caused this mess and avoid additional trouble in the long-term.

The House democrats proposed an $825 billion stimulus package two weeks ago that included $550 in spending, of which $40 billion was for infrastructure:

$30 billion for highway construction;

$10 billion for transit and rail to reduce traffic congestion and gas consumption.

The proposed package plans to use existing models for sending the stimulus money to the states. For the states, several of which have construction project backlogs, this has come as welcome news.

But this is not good news for taxpayers. At the end of 2008, the Conference of Mayors presented Congress with a list of "ready-to-go" projects. State governors have requested money for highways, bridges, and other transportation infrastructure projects. However, most of projects were less than impressive, and few, if any projects on the list, will solve the transportation issues pressing in congested urban areas.

Yet, even if all the projects were good ones (which they are not), "ready-to-go" is a gross over statement for many of the state requests. A Congressional Budget Office (CBO) analysis released on January 26 predicts that just $3 billion of the $30 billion for highways is likely to be spent by the end of fiscal 2009; a total of $10.5 billion will be spent by the end of 2010; and just over half, $16.5 billion, will have been spent by the end of 2011.

The report states, "Historically, money appropriated for highways and transit is spent at a slow rate in the first year and has an extremely long 'tail,' in that funds provided in a particular year are frequently spent over a six-to-eight-year period. As a result, when those programs have seen previous significant increases in budgetary resources, outlays have increased more slowly….CBO consulted with transportation officials in nearly half of the states, accounting for roughly two-thirds of annual highway spending. CBO found that many states are anxious to receive additional funding and can probably begin some projects quickly, but that many states are also concerned about how quickly local governments can undertake new projects. In addition, concerns exist about how quickly state and local governments can adjust their contracting procedures to accommodate the significant increase in the amount of funding."

State officials will get some relief from a stimulus plan, but it will be far from enough to put their transportation budgets back on track.

The simple fact is, **even with federal stimulus aid, business as usual will not deliver the infrastructure needs of the 21st century**. The proposed road projects were conceived years ago and reflect yesterday's thinking about transportation. Instead of spending on short-term solutions, policy makers should **embrace the private sector** as a key player in financing transportation construction, operations and maintenance that significantly reduce traffic congestion, improve mobility and modernize our air traffic control system.

#### Public investment particularly in infrastructure cause delays which result in negative economic effects

Leeper, 10 - Department of Economics, Indiana University, research fellow @ NBER, (Eric M. “Government Investment and Fiscal Stimulus in the Short and Long Runs” March 31, [http://siteresources.worldbank.org/INTMACRO/Resources/SusanLWYGovtInvestRevisionMay20.pdf)//AH](http://siteresources.worldbank.org/INTMACRO/Resources/SusanLWYGovtInvestRevisionMay20.pdf%29/AH)

The analysis shows that implementation delays and expected ﬁscal adjustments can hinder the beneﬁcial eﬀects of government investment at both short and long horizons. Implementation delays determine the rate of spending outlays for government investment, and the 1ARRA was estimated to add about $720 billion stimulus between ﬁscal years 2009 and 2011, roughly 5 percent of GDP in 2009. In addition to ARRA, Congress also passed the Economic Stimulus Act of 2008 and the Worker, Homeownership, and Business Assistance Act of 2009, estimated to add about $190 billion stimulus between ﬁscal years 2008 and 2011. 2On March 17, 2010, Congress passed Hiring Incentives to Restore Employment Act, which authorizes funding for additional infrastructure projects. 1speed at which spending occurs is crucial for short-run stimulative eﬀects. Many projects, especially infrastructure, require coordination among federal, state, and local governments and have to go through a long process of planning, bidding, contracting, construction, and evaluation. To model these delays, we use a time-to-build setup to characterize the formation of public capital, as in Kydland and Prescott (1982). Compared to a scenario with little delay, implementation delays for government investment can lead private investment to fall more and labor and output to rise less (or even decline slightly) in the short run. So long as public capital is productive, the expectation of higher government investment spending generates a positive wealth eﬀect, which discourages current work eﬀort. Depending on the implementation speed, this positive wealth eﬀect could dominate the usual negative wealth eﬀects from increasing government purchases, resulting in small or even negative eﬀects on labor and output in the short run. In addition, because private investment projects typically do not entail the substantial delays associated with public projects, private investment falls initially and does not rebound until later, when the public capital is on line and raises the productivity of private inputs. Implementation delays can postpone the intended economic stimulus and may even worsen the downturn in the short run. Delays in government investment are analogous to the phased-in tax cuts enacted in 2001 and 2003, where expectations of future tax cuts may have induced workers and ﬁrms to postpone work and production, actions that House and Shapiro (2006) argue retarded the recovery from the 2001 recession. 3 Current weakness in employment growth, which falls short of the administration’s predictions of the eﬀects of the ARRA, may be partly attributable to implementation delays in government investment

### expensive

#### Transportation needs to be cut to save the economy

[**Fraser**](http://www.heritage.org/about/staff/f/alison-fraser) **12**-Director of the Roe Institute for Economic Policy Studies,member of the Fiscal Wake-Up Tour, Deputy Director of the Oklahoma Office of State Finance where she directed economic research and developed tax and fiscal policy recommendations for then-Gov. Frank Keating. Prior to that, she was a budget manager for Orange County, Calif., where she developed recommendations for bankruptcy recovery.(Alison Acosta, " Will Transportation Reauthorization Be Another Big Spending Boondoggle?" Heritage.org, 2/2/12, <http://www.heritage.org/research/reports/2012/02/transportation-program-reauthorization-another-big-spending-problem>)//AP

As Congress gears up for another year, reining in spending and debt should top the agenda, but one issue heading squarely against that priority is reauthorization of the transportation program. The last transportation bill, SAFETEA-LU, was marked by gluttonous excesses, which ranged from its porcine spending increases and wasteful spending on programs that did not improve roads, to its earmarks, which spawned the infamous “Bridge to Nowhere.” Spending in SAFETEA-LU was so excessive that Congress was repeatedly called on to bail out the Highway Trust Fund.

This story is similar to the federal government’s total finances—a massive run-up in spending and declining revenues. The latest projections from the Congressional Budget Office (CBO) for 2012 show a deficit of just over $1 trillion, publicly held debt at 73 percent of GDP, and a rapidly deteriorating scenario over the next 10 years, during which publicly held debt will soar to nearly 100 percent of GDP.[[1]](http://www.heritage.org/research/reports/2012/02/transportation-program-reauthorization-another-big-spending-problem%22%20%5Cl%20%22_ftn1)

It is past time for Washington to stop spending money on wasteful projects and to live within its means. **This should start with the** first major opportunity of the year: reauthorization of **the transportation program**. Rather than increasing spending and then looking for new sources of revenue to pay for it, Congress should eliminate wasteful transportation programs and reduce spending so that the program lives within its means.

Bloated Spending Outpaces Taxes

The federal highway program was created in 1956 to build the interstate highway system, which would connect all major cities spanning both coasts and reaching both borders. The program was funded by a federal fuel tax, originally 3 cents per gallon of gasoline. The original plan was to turn over the maintenance to the states after the interstate highway system was completed. But, as Ronald Reagan famously quipped, “a government bureau is the nearest thing to eternal life we’ll ever see on this earth!” Thus, rather than turning a modest program over to the states, the highway program was vastly expanded and the gas tax increased to where it stands today at 18.3 cents per gallon.[[2]](http://www.heritage.org/research/reports/2012/02/transportation-program-reauthorization-another-big-spending-problem%22%20%5Cl%20%22_ftn2)

Not content to live within the means of the Highway Trust Fund and its dedicated funding, Congress added scores of new programs accompanied by new spending on all manner of projects that hardly fall within the purview of a transportation system. In fact, these programs in the past have diverted around 38 percent of the trust fund spending to things other than general-purpose roads, leaving America’s drivers with a mere 62 percent of every gas tax dollar they pay funding the roads they actually use.[[3]](http://www.heritage.org/research/reports/2012/02/transportation-program-reauthorization-another-big-spending-problem%22%20%5Cl%20%22_ftn3)

Many of these programs can only be thought of as luxuries, such as scenic byways, ferryboats, bicycles, historic covered bridges, and horse trails. Others include transit (which largely goes to fund trolleys, buses, commuter rail, etc., and serves only 1.8 percent of surface travel passengers); the enhancement program (under which states are currently forced to spend money on projects like facilities for pedestrians and bicycles, scenic easements including historic battlefields, landscaping and other scenic beautification, historic preservation, and transportation museums); and recreational trails.[[4]](http://www.heritage.org/research/reports/2012/02/transportation-program-reauthorization-another-big-spending-problem%22%20%5Cl%20%22_ftn4)

These programs reached new complexity and magnitude in SAFETEA-LU and help explain the new heights that spending reached under this bill. They also help explain the bailouts from general revenue of $35 billion, which began in 2008.[[5]](http://www.heritage.org/research/reports/2012/02/transportation-program-reauthorization-another-big-spending-problem%22%20%5Cl%20%22_ftn5)

The picture for the future continues to look bleak. Gas tax revenues have not grown to keep pace with transportation needs, let alone the burgeoning wants of Congress and the vast collection of special-interest groups and their lobbyists. The most recent forecast by CBO[[6]](http://www.heritage.org/research/reports/2012/02/transportation-program-reauthorization-another-big-spending-problem%22%20%5Cl%20%22_ftn6) projects that the trust fund will run out of money sometime in 2013 with a deficit of $12 billion and cumulative deficits of $136 billion through 2022. Even this may be a conservative estimate given the way CBO projected both taxes and spending.[[7]](http://www.heritage.org/research/reports/2012/02/transportation-program-reauthorization-another-big-spending-problem%22%20%5Cl%20%22_ftn7)

Transportation Goals vs. Wasteful Spending

The federal government is projected to run deficits in the trillion-dollar range through the end of the decade, reaching $1.5 trillion in 2022. **Transportation spending is one contributor to this gloomy outlook**. As a first step toward the larger goal of solving the nation’s spending and debt crisis, Congress should make the transportation program live within its means. It should reserve the program exclusively for improving mobility and safety and decreasing congestion.

This means Congress should strip out or trim wasteful programs like the enhancement program, transit, and Amtrak. Gone should be plans for quaint cobblestones, hiking trails, tourist attractions and archaeology, streetscapes and flower planting projects, and the excess spending they represent.

Eliminate Waste and Reduce Spending

The current reauthorization bills (S. 1813 and H.R. 7) contain some important reforms. For example, both versions put an end to the corruptive and wasteful practice of earmarks. The Senate version would allow states the flexibility to spend enhancement program money on roads as opposed to projects like a road museum. The House version would start to remove Amtrak’s wasteful subsidy and require operational improvements.

Sadly, however, both bills would continue funding the program at bloated levels similar to today’s, leading to the need for more revenues or bailouts by the general fund. The solution that each bill offers is more revenues. The House bill, for example, purports to generate oil and gas royalty revenues by opening up areas now restricted to exploration. This is a sound policy. Unfortunately, it doesn’t solve the true problem: spending. Instead, it locks in higher levels of spending rather than preserving royalty revenues for deficit reduction.

Rather than perpetuating ever-growing government, albeit with a somewhat improved and streamlined transportation program, Congress should live within its means. Instead of bailouts, this means eliminating wasteful programs and cutting the spending that goes with them.

#### Transportation spending is mismanaged and overbuilt, federal spending fails

**Staley 12**- Ph.D, senior research fellow at Reason Foundation, and Managing Director at the DeVoe L. Moore Center at Florida State University where he teaches urban economics, land use, and urban planning. (Samuel R., "Highway Construction As Stimulus? Not So Fast" Reason.org, 5/15/12, <http://reason.org/news/show/highway-construction-as-stimulus-no>)//AP

President Obama is sending strong signals that he wants more stimulus spending to keep the American economy out of recession, even if the White House is not saying it explicitly. The president's "the private sector is fine" moment clearly emphasized a perceived need for state, local, and federal governments to increase spending to pick up the slack in an anemic economy.That means more stimulus money for public works projects like building new firehouses, hiring more cops, and reviving the idea for an infrastructure bank. But let's look at some hard sobering facts before we jump on the public spending bandwagon.

Transportation infrastructure is a case on point. The Interstate Highway System is justly lauded as one of the greatest engineering and political achievements of the 20th century. President Obama regularly invokes the nearly three-decade initiative when talking about public works projects that could get the economy back on track. Unfortunately, the simplified story about the Highway System misses the fact that billions of dollars were likely wasted because we built a system too large to serve its core purposes, and we failed to ensure the investments were in the right place at the right time.

As it is, the Interstate Highway System was wildly over budget. The U.S. Department of Transportation reports that initial estimates put total construction costs at about $27 billion. By the time the system was completed in the 1980s, the federal government had spent more than $114 billion and the total cost accumulated to $129 billion.

Changing design standards, environmental review, and inflation all contributed to escalating costs, but another critical factor was also in play: No incentives existed to prevent overbuilding. This overbuilding may have resulted in tens of billions of dollars in excess federal and state government spending even though many economists suggest that the economic benefits of the system outweighed the costs of its construction. After all, the result of the project was a 46,876 mile long system that knitted together all major U.S. metropolitan areas, and economists have shown that the interstate system was a boon to business as intercity trucking became more efficient and less costly and urban congestion fell dramatically.

Nevertheless, billions of dollars were likely wasted because the users - commercial truckers as well as passenger cars - were never required to directly consider the costs and benefits of using these roads with a true user fee such as a toll. In the 1950s, Congress decided to eschew tolls altogether, opting instead for the politically expedient and administratively efficient (at the time) gas tax. The end result was a system where many roads were built to nowhere, or at the wrong time, and transportation subsidies became endemic**. A price sensitive private sector, in contrast, might have otherwise built roads elsewhere and for even more productive purposes.**

It is this reality of overbuilding that should sober ideas about infrastructure spending "paying for itself" or "filling a need," particularly in an advanced and mature economy such as the one within th United States. Certain parts of the Highway System certainly showed positive economic gains, but many other segments were unnecessary - or at least not necessary at the time the government built them. While spending federal dollars on road development is not the only arrow in the quiver of the pro-stimulus argument, a more sophisticated look at our experience with the Interstate Highway System at least suggests that **Washington should be careful about simply dropping billions more dollars on the economy without considering the potential inefficiencies they create.**

A critique of this argument might be that we're just knit picking on price. However, new research out of China of all places suggests that the waste may well have amounted to more than 20 percent of the total cost.

China is a particularly intriguing case study because its economy is going through many of the same challenges, fits, and starts as the U.S. economy in the early and mid-twentieth century. Roads, rails, bridges, ports, and airports have emerged as critical infrastructure for nurturing a burgeoning manufacturing economy, and facilitating national mobility.

China, however, didn't have the economic tax base to support a sprawling national highway system. While provinces were responsible for building the roads and expressways, they couldn't levy taxes to finance them. So, they relied on private capital to build their expressways and later established government-controlled toll authorities to fund many more.

The model worked reasonably well except that the primary purpose was to collect money to pay off the debt, not optimize the efficiency of the highway network. Tollroads were established based on whether the agencies could float bonds to finance them, not economic analysis of travel demand and willingness to pay.

The result? Expressway overbuilding.

Economists at the Institute for Regional and Transportation Economy at Chang'an University studied highway investments and toll rates in four provinces - Jiangsu, Hebei, Shaanxi, Jilin - and found that the expressways were overbuilt by about 20 percent. They concluded that road pricing that takes into account travel demand as well as the debt incurred to build the highways would substantially reduce the size of the highway network. In short, by making the true costs of building highways transparent to users through properly calibrated tolls, the expressway network would have been smaller and less expensive.

The implications for U.S. transportation policy and highway finance are important, particularly given the current gridlock over long-term transportation spending in Congress and the intransigence of some Congressman toward public private partnerships.

If China managed to overbuild its tolled expressways by 20 percent, the inefficiencies and overbuilding in the unpriced U.S. highway system are likely much larger. At the very least, this makes a strong case for expanding the scope of private involvement in American highways. And **it should provide a non-ideological pushback on the idea that stimulus spending on infrastructure is a good idea.**

### ineficiency

#### Federal government infrastructure spending fails- cost overruns, waste, fraud, and abuse.

**de Rugy 11** - Board of Directors of the Center for Freedom and Prosperity. She holds a Ph.D. from the University of Paris-Sorbonne and previously directed academic programs for the Institute for Humane Studies (Veronique, “More on Infrastructure Spending in the ‘American Jobs Act’”, National Review Online, September 13, 2011, <http://www.nationalreview.com/corner/277068/more-infrastructure-spending-american-jobs-act-veronique-de-rugy> //EH)

As Andrew highlighted this morning, the president is asking for some $50 billion additional infrastructure spending (grants and guaranteed loans, transportation infrastructure investments, on highway and rail projects, high-speed rail projects, Amtrak, and such).

In this new paper, my colleague Matt Mitchell and I lay out the arguments against infrastructure spending as a way to stimulate the economy.

Our argument boils down to three main points: First, despite the claims of stimulus proponents, the evidence is not at all clear that more stimulus would be helpful right now. Second, even if one adheres to the idea that more government spending can jolt the economy, spending — particularly infrastructure spending — cannot be implemented in the way Keynesians say it ought to be. This greatly undermines its stimulative effect. Third, while no one disputes the value of good infrastructure, this type of spending typically suffers from massive cost overruns, waste, fraud, and abuse. This makes it a particularly bad vehicle for stimulus, no matter what its merits otherwise.

But here are some striking facts about government run public work projects. The most comprehensive study of cost overruns examines 20 nations spanning five continents. The authors find that:

In 9 out of 10 transportation infrastructure projects, costs are underestimated.

For rail projects, actual costs are on average 45%higher than estimated costs.

For fixed-link projects (tunnels and bridges), actual costs are on average 34% higher than estimated costs

For road projects, actual costs are on average 20%higher than estimated costs.

For all project types, actual costs are on average 28% higher than estimated costs

These same cost overruns exist in all public work projects

Remember the Capitol Hill Visitor Center? This ambitious three-floor underground facility, originally scheduled to open at the end of 2005, was delayed until 2008. The price tag leaped from an estimate of $265 million in 2000 to a final cost of $621 million.

How can we explain these cost overruns? They authors explain:

These cost underestimation cannot be explained by error and seems to be best explained by strategic misrepresentation, i.e., lying.

What is the most common misrepresentation (lie)? In the case of rail projects a study of 208 projects in 14 nations on five continents shows that:

9 out of 10 rail projects overestimate the actual traffic.

84 percent of rail-passenger forecasts are wrong by more than 20 percent.

For rail, passenger traffic average 51.4 percent less than estimated traffic.

This means that there is a systematic tendency to overestimate rail revenues. Remember that when the president explains how much demand there is for these new rail projects he wants to pay for.

For roads, actual vehicle traffic is on average 9.5 percent higher than forecasted traffic and 50 percent of road traffic forecasts are wrong by more than 20 percent. In this case, there is a systematic tendency to underestimate the financial and congestion costs of roads.

The worst part may be that the political process rewards the misrepresentation about the costs and benefits of a project. This 2009 study shows that the political process is more likely to give funding to managers who underestimate the costs and overestimate the benefits. In other words, it is not the best projects that get implemented but the ones that look the best on paper. That’s what economist Bent Flyvbjerg called the survival of the unfittest.

Is it really what our country needs right now?

And of course, that’s on top of the billion in infrastructure increase that already took place in the last decade:

How can we have so much spending and yet such crumbling infrastructure?

#### Transportation infrastructure spending is inefficient and fails

**Merline 11 –** Contributor for Investor’s Business Daily (John, “5 Myths Behind Obama's Infrastructure Spending Push,” Investor’s Business Daily, September 15, 2011, <http://www.thomhartmann.com/users/ursel-twing/blog/2011/09/5-myths-behind-obamas-infrastructure-spending-push> //EH)

• More federal money means more jobs: Obama claimed in 2009 that the stimulus would "create or save" 400,000 construction jobs. But a study by economists Timothy Conley and Bill Dupor found that "the number of highway, bridge and street construction workers, nationwide, fell dramatically," despite the huge infusion of federal money.

Conley and Dupor, as well as Stanford economist John Taylor, found many states simply shifted money after getting the stimulus funds, but didn't increase infrastructure spending.

And in a new Mercatus Center paper, Veronique de Rugy and Matthew Mitchell conclude that " this type of spending typically suffers from massive cost overruns, waste, fraud and abuse. This makes it a particularly bad vehicle for stimulus."

• The money can be spent fast: In its jobs plan, the White House calls for $50 billion in "immediate" transportation projects.

But the original stimulus directed its $62 billion at "shovel ready" infrastructure projects, only to have Obama admit last October that "there is no such thing as shovel-ready projects."

The White House claims new processes will speed the work. Still, its new bill only requires that half the infrastructure money be spent in the first year.

Others note that money isn't infrastructure's only problem.

"Not only are we spending too little right now, but we're also not spending it wisely," the Brookings Institution's Robert Puentes recently wrote. "The nation lacks a clear-cut vision for transportation, and no way to target spend ing to make sure all those billions of dollars help achieve our economic and environmental goals.

#### Federal infrastructure fails- takes lots of time and inefficient with funds

**de Rugy 11** - Board of Directors of the Center for Freedom and Prosperity. She holds a Ph.D. from the University of Paris-Sorbonne and previously directed academic programs for the Institute for Humane Studies (Veronique, “Why Infrastructure Spending Is a Bad Bet,” National Review Online, September 8, 2011, [http://www.nationalreview.com/corner/276636/why-infrastructure-spending-bad-bet-veronique-de-rugy#](http://www.nationalreview.com/corner/276636/why-infrastructure-spending-bad-bet-veronique-de-rugy) //EH)

No one disputes that American public works need improving, and economists have long recognized the value of infrastructure. Roads, bridges, airports, and canals are the conduits through which goods are exchanged. However, whatever its merits, infrastructure spending is unlikely to provide much of a stimulus — and it certainly won’t provide the boost that the president will promise the American people tonight.

For one thing, even though Mark Zandi claims that the bang for the buck is significant when the government spends $1 on infrastructure ($1.44 in growth), that’s just his opinion. The reality is that economists are far from having reached a consensus on what the actual return on infrastructure spending is. As economists Eric Leeper, Todd Walker, and Shu-Chum Yang put it in a recent paper for the IMF: “Economists have offered an embarrassingly wide range of estimated multipliers.” Among respected economists, some find larger multipliers and some find negative ones. (Thanks Matt Mitchell for this great paper).

Second, according to Keynesian economists, for spending to be stimulative, it has to be timely, targeted, and temporary. Infrastructure spending isn’t any of that. That’s because infrastructure projects involve planning, bidding, contracting, construction, and evaluation. Only $28 billion of the $45 billion in DOT money included in the stimulus has been spent so far.

We know that the stimulus money wasn’t targeted toward the areas that were hit the most by the recession, but even if the funding were targeted, it still might not be stimulative. First, the same level of job poaching from existing jobs would have happened; construction workers tend to be highly specialized, and skilled workers rarely suffer from high unemployment. Many of the areas that were hardest hit by the recession are in decline because they have been producing goods and services that are not, and will never be, in great demand. The overall value added by improving their roads is probably a lot less than that of new infrastructure in growing areas that might have relatively little unemployment but do have great demand for more roads, schools, and other types of long-term infrastructure.

As for being temporary — which stimulus spending needs to be to work — what the president will propose tonight is likely to cost the American people money for a very long time.

Infrastructure spending tends to suffer from massive cost overruns, waste, fraud, and abuse. A comprehensive study examining 20 nations on five continents (“Underestimating Costs in Public Works Projects: Error or Lie?” by Bent Flyvbjerg, Mette K. Skamris Holm, and Søren L. Buhl) found that nine out of ten public-works projects come in over budget. Cost overruns routinely range from 50 to 100 percent of the original estimate. For rail, the average cost is 44.7 percent greater than the estimated cost at the time the decision was made. For bridges and tunnels, the equivalent figure is 33.8 percent, for roads 20.4 percent.

#### Government stimulus spending fails- money doesn’t reach the lower income households, instead mishandled by bureaucracy

**Ritenour 09-** professor of economics at Grove City College (Shawn, “The Stimulus Does Not Work,” Free Market Magazine produced by the Mises Institution, July 2009, <http://mises.org/journals/fm/july09.pdf> //EH)

A majority of Americans now give President Obama’s handling of the economy a negative rating, and many economists and city ofﬁ cials are concerned that Obama’s gargantuan stimulus effort has not given the expected quick boost to the economy. Some argue this is because funds have been slow in coming owing to bureaucratic red tape meant to ensure that the money spent will not be wasted. Jared Bernstein, chief economist for the ofﬁ ce of Vice President Joe Biden (who knew that the vice president needed a chief economist?), is quoted as saying “We’re hitting the right balance between speed and oversight.” Unfortunately for the American public, sound economics teaches that, regardless of how fast the money is spent or how much oversight is provided by bureaucrats, the money doled out by the stimulus plan will be wasted and will have a detrimental impact on the economy in the long term, because that is the nature of proﬂ igate government spending. From an economic perspective, Obama’s stimulus plan is equivalent to a giant welfare scheme. Instead of the money going to lower income Americans, however, it is meant to go to municipal bureaucrats of various stripes. Instead of productive American citizens determining what to do with their own scarce resources, the state is stepping in and dictating how they will be used. Consequently, such spending is essentially government consumption, which is what vulgar Keynesians think we need now more than ever. Such economists are shocked— shocked!—to ﬁnd out that Americans are now saving any increases in income instead of blowing them on even more consumer goods. Not to worry, however. If private citizens do not consume enough for ofﬁcial tastes, the government always can.

#### Stimulus fails- government spending is inefficient

**Ritenour 09-** professor of economics at Grove City College (Shawn, “The Stimulus Does Not Work,” Free Market Magazine produced by the Mises Institution, July 2009, <http://mises.org/journals/fm/july09.pdf> //EH)

The moral of the story is that we are right to be concerned that the Obama stimulus plan will not stimulate economic progress and will not usher in the next age of prosperity. Government spending merely directs scarce factors of production away from their most productive uses. Taxation, government borrowing, and monetary inﬂation all produce negative economic consequences. Real economic expansion is the product of wise entrepreneurs using capital that is funded by real savings. Such economic progress results in more goods that can be purchased for lower prices. As we are seeing play out before our eyes, the only thing that government stimulus plans stimulate is capital consumption and fewer goods available for higher prices—not a recipe for economic recovery

#### Studies prove stimulus fails- inefficient and ineffective

**Taylor 11** - Mary and Robert Raymond Professor of Economics at Stanford University (John B., “An Empirical Analysis of the Revival of Fiscal Activism in the 2000s,” Stanford Research Paper, September 2011, <http://www.stanford.edu/~johntayl/JEL_Taylor_Final%20Pages.pdf> //EH)

In sum, this empirical examination of the direct effects of the three countercyclical stimulus packages of the 2000s indicates that they did not have a positive effect on consumption and government purchases, and thus did not counter the decline in investment during the recessions as the basic Keynesian textbook model would suggest. Individuals and families largely saved the transfers and tax rebates. The federal government increased purchases, but by only an immaterial amount. State and local governments used the stimulus grants to reduce their net borrowing (largely by acquiring more financial assets) rather than to increase expenditures, and they shifted expenditures away from purchases toward transfers. Some argue that the economy would have been worse off without these stimulus packages, but the results do not support that view. According to the empirical estimates of the impact of ARRA, if there had been no temporary stimulus payments to individuals or families, their total consumption would have been about the same. And if there had been no ARRA grants to states and localities, their total expenditures would have been about the same. The counterfactual simulations show that the ARRA-induced decline in state and local government purchases was larger than the increase in federal government purchases due to ARRA. In terms of the simple example of model A versus model B presented above, these results are evidence against the views represented by model A, and thus against using such models to show that things would have been worse. Others argue that the stimulus was too small, but the results do not lend support to that view either. Using the estimated equations, a counterfactual simulation of a larger stimulus package—with the proportions going to state and local grants, federal purchases, and transfers to individuals the same as in ARRA—would show little change in government purchases or consumption, as the temporary funds would be largely saved. Of course, the story would be different for a stimulus program designed more effectively to increase purchases, but it is not clear that such a program would be politically or operationally feasible. More generally, the results from the 2000s experience raise considerable doubts about the efficacy of temporary discretionary countercyclical fiscal policy in practice. In this regard, the experience with the stimulus packages of the 2000s adds more weight to the position reached more than thirty years ago by Lucas and Sarg.

### states cp net-benefit

#### Federal infrastructure investment fails- state spending is more cost effective

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Infrastructure spending tends to suffer from massive cost overruns, waste, fraud, and abuse. A comprehensive study examining 20 nations on five continents (“Underestimating Costs in Public Works Projects: Error or Lie?” by Bent Flyvbjerg, Mette K. Skamris Holm, and Søren L. Buhl) found that nine out of ten public-works projects come in over budget. Cost overruns routinely range from 50 to 100 percent of the original estimate. For rail, the average cost is 44.7 percent greater than the estimated cost at the time the decision was made. For bridges and tunnels, the equivalent figure is 33.8 percent, for roads 20.4 percent. I should also add that I think it’s a mistake to assume that it is the role of the federal government to pay for roads and highway expansions. With very few exceptions, most roads, bridges, and even highways are local projects (state projects at most) by nature. The federal government shouldn’t have anything to do with them. In fact, I would argue that taxpayers and consumers would be better off if these activities were privatized. And if states aren’t ready for privatization, they can do what Indiana did a few years back when it leased its main highways to a private company for $4 billion. The state was $4 billion richer, and it was still the owner of the highway. Consumers in Indiana were better off, because the deal saved money. Experiences in other countries have also shown that privatization leads to innovation and reduced congestion. (I really like this paper by Randy O’Toole on these issues.) Spending more on infrastructure right now, and expecting miracles from it, is a very risky bet.

### crowd-out

#### Government spending in infrastructure fails- ruins future job growth and private sector investment

**Foster 12-** the Norman B. Ture Senior Fellow in the Economics of Fiscal Policy at The Heritage Foundation.(J.D., “WaPo Admitting Keynesian Stimulus Failed?,” The Foundry, March 6, 2012, <http://blog.heritage.org/2012/03/06/wapo-admitting-keynesian-stimulus-failed/> //EH)

Does unprecedented deficit-spending such as on highways stimulate the economy? For the last few years, some have argued it could. Some have argued it might. Some have argued it would if done right.

We have consistently argued that deficit spending on highways or anything else intended to lift aggregate demand, and therefore jobs, must and would fail. The economic evidence that we were right has now been joined by the illustrious trio of The Washington Post, the Associated Press, and the esteemed Alice Rivlin, former director of the Congressional Budget Office and the Office of Management and Budget.

Monday’s edition of the Post carries a story sourced to the Associated Press entitled, “Highway bills pitched as by lawmakers as job creators, but are they really? Economists say no.”

Notice especially the subject of the piece: federal highway spending. If ever there was a sympathetic topic for stimulus, it is infrastructure spending, especially highway funding. Remember, these were some of President Obama’s “shovel-ready” projects that turned out to be not so shovel ready, as he later admitted.

So what went wrong? Why is this not short-term stimulus? The widely respected Rivlin explained it clearly and succinctly: “Investments in infrastructure, if well designed, should be viewed as investments in future productivity growth.”

Exactly right—future productivity growth.

She went on to say that if investments in infrastructure “speed the delivery of goods and people, they will certainly do that. They will also create jobs, but not necessarily more jobs than the same money spent in other ways.”

Exactly right—a dollar spent is a dollar spent. A job gained here, a job lost there.

This speaks to a longstanding flaw of highway spending arguments. Proponents argue that this spending creates tens of thousands of jobs, and they are half right. The other half is the tens of thousands of jobs not created (or saved) by shifting spending to highways from other areas in the economy. The valid argument about infrastructure spending is: If done right, it will lift future productivity growth, not current job growth.

The central failing—the essential fiscal alchemy of Keynesian stimulus—is the belief that government can increase total spending in the economy by borrowing and spending. What Keynesians ignore is that we have financial markets whose job in good times and bad is first and foremost to shift funds from savers to investors, from those who have money they do not wish to spend today to those who have a need to borrow to spend as much as they’d like, whether on new business equipment, a home, or a car.

There are no vast sums of “excess funds” just sitting around in bank tellers’ drawers waiting for government to borrow and spend them. Government borrowing means less money available to the private sector to spend. So government deficit spending goes up, and dollar-for-dollar private spending goes down. America’s resources are generally speaking spent less wisely, and the federal debt is unequivocally higher.

If past is prologue, the current infatuation with Keynesian deficit spending as stimulus will fade, just as it always has in the past, in this country as elsewhere. Perhaps this simple WaPo article marks the beginning of the end for the latest incarnation of this fiscal folly.

### underestimation

#### Transportation infrastructure projects are wasteful spending- terrible estimates

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We conclude that the patronage estimates used by planners of rail infrastructure development are highly, systematically, and significantly misleading (inflated). This results in large benefit shortfalls for rail projects. For road projects the problem of misleading forecasts is less severe and less one sided than for rail. But even for roads, for half the projects the difference between actual and forecasted traffic is more than ±20%. On this background, planners and decision makers are well advised to take with a grain of salt any traffic forecast that does not explicitly take into account the uncertainty of predicting future traffic. For rail passenger forecasts, a grain of salt may not be enough.
The risks generated from misleading forecasts are typically ignored or downplayed in infrastructure planning, to the detriment of social and economic welfare. Risks, therefore, have a doubly negative effect in this particular type of planning, since it is one thing to take on a risk that one has calculated and is prepared to take, much as insurance companies and professional investors do, while it is quite another matter-one that moves risk-taking to a different and more problematic level-to ignore risks altogether. This is especially the case when risks are of the magnitude we have documented here, with many demand forecasts being off by more than 50% on investments that measure in hundreds of millions of dollars. Such behavior is bound to produce losers among those financing infrastructure, be they tax payers or private investors. If the losers or, for future projects, potential losers, want to protect themselves, then our study shows that the risk of faulty forecasts, and related risk assessment and management, must be placed at the core of planning and decision making. Our goal with this article has been to take a first step in this direction by developing the necessary data and approach.
The policy implications of our findings are clear. First, the findings show that a major planning and policy problem-namely misinformation-exists for this highly expensive field of public policy. second, the size and perseverance over time of the problem of misinformation indicate that it will not go away by merely pointing out its existence and appealing to the good will of project promoters and planners to make more accurate forecasts. The problem of misinformation is an issue of power and profit and must be dealt with as such, using the mechanisms of transparency and accountability we commonly use in liberal democracies to mitigate rent-seeking behavior and the misuse of power. To the extent that planners partake in rent-seeking behavior and misuse of power, this may be seen as a violation of their code of ethics-that is, malpractice. Such malpractice should be taken seriously by the responsible institutions. Failing to do so amounts to not taking the profession of planning seriously.

#### Massive amounts of cost underestimation exists in infrastructure spending

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The main findings from the study reported in this article – all highly significant and most likely conservative – are as follows:

* In 9 out of 10 transportation infrastructure projects, costs are underestimated.
* For rail projects, actual costs are on average 45% higher than estimated costs (sd=38)
* For fixed-link projects (than estimated costs (sd=62). tunnels and bridges), actual costs are on average 34% higher
* For road projects, actual costs are on average 20% higher than estimated costs (sd=30).
* For all project types, actual costs are on average 28% higher than estimated costs (sd=39)
* Cost underestimation exists across 20 nations and 5 continents; it appears to be a global phenomenon.
* Cost underestimation appears to be more pronounced in developing nations than in North America and Europe (data for rail projects only).
* Cost underestimation has not decreased over the past 70 years. No learning that would improve cost estimate accuracy seems to take place.
* Cost underestimation cannot be explained by error and seems to be best explained by strategic misrepresentation, i.e., lying.
* Transportation infrastructure projects do not appear to be more prone to cost underestimation than are other types of large projects.

We conclude that the cost estimates used in public debates, media coverage, and decision making for transportation infrastructure development are highly, systematically, and significantly deceptive. So are the cost-benefit analyses into which cost estimates are routinely fed to calculate the viability and ranking of projects. The misrepresentation of costs is likely to lead to the misallocation of scarce resources, which, in turn, will produce losers among those financing and using infrastructure, be they taxpayers or private investors.

 We emphasize that these conclusion should not be interpreted as an attack on public (vs. private) spending on infrastructure, since the data are insufficient to decide whether private projects perform better or worse than public ones regarding cost underestimation. Nor do the conclusions warrant an attack on spending on transportation vs. spending on other projects, since other projects appear to be as liable to cost underestimation and escalation as are transportation projects. With transportation projects as an in-depth case study, the conclusions simply establish that significant cost underestimation is a widespread practice in project development and implementation, and that this practice forms a substantial barrier to the effective allocation of scare resources for building important infrastructure.

 The key policy implication for this consequential and highly expensive field of public policy is that those legislators, administrators, bankers, media representatives, and members of the public who value honest numbers should not trust the cost estimates presented by infrastructure promoters and forecasters. Another important implication is that institutional checks and balances - including financial, professional, or even criminal penalties for consistent or foreseeable estimation errors – should be developed to ensure the production of less deceptive cost estimates. The work of designing such checks and balances has been begun elsewhere, with a focus on four basic instruments of accountability: (1) Increased transparency, (2) the use of performance specifications, (3) explicit formulation of the regulatory regimes that apply to project development and implementation, and (4) the involvement of private risk capital, even in public projects (Bruzelius et al., 1998; Flyvebjerg et al., in press).

#### Political reasons for cost underestimation- lying, selfishness, money

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 Political explanations construe cost underestimation in terms of interests and power (Flyvbjerg, 1998). Surprisingly little work has been done that explains the pattern of misleading forecasts in such terms (Wachs, 1990, p. 145). A key question for political explanations is whether forecasts are intentionally biased to serve the interests of project promoters in getting projects started. This question again raises the difficult issue of lying. Questions of lying are notoriously hard to answer, because in order to establish whether lying has taken place, one must know the intentions of actors. For legal, economic, more, and other reasons, if promoters and forecasters have intentionally fabricated a deceptive cost estimate for a project to get it started, they are unlikely to tell researchers or others that this is the case (Flyvbjerg, 1996; Wachs, 1989).

 When Eurotunnel, the private company that owns the tunnel under the English Channel, went public in 1987 to raise funds for the project, investors were told that building the tunnel would be relatively straight-forward. Regarding risks of cost escalation, the prospectus read:

 Whilst the undertaking of a tunneling project of this nature necessarily

 involves certain construction risks, the techniques to be used are well

 proven…. The Directors, having consulted the Maitre d’Oeuvre, believe

 that 10%.... would be a reasonable allowance for the possible impact of

 unforeseen circumstances on construction costs. (“Under Water,” 1989, p. 37)

Two hundred banks communicated these figures for cost and risk to investors, including a large number of small investors. As observed by *The Economist* (“Under Water,” 1989), anyone persuaded in this way to buy shares in Eurotunnel in the belief that the cost estimate was the mean of possible outcomes was, in effect, deceived. The cost estimate of the prospectus was a best possible outcome, and the deception consisted in making investors believe in the highly unlikely assumption – disproved in one major construction project after another – that everything would go according to plan, with no delays; no changes in safety and environmental performance specifications; no management problems; no problems with contractual arrangements, new technologies, or geology; no major conflicts; no political promises not kept; etc. The assumptions were, in other words, those of an ideal world. The real risks of cost escalation for the Channel tunnel were many times higher than those communicated to potential investors, as evidenced by the fact that once built, the real costs of the project were higher by a factor of two compared with forecasts.

 Flyvbjerg, Bruzelius, and Rothengatter (in press) document for a large number of projects that the Everything-Goes-According-to-Plan type of deception used for the Channel tunnel is common. Such deception is, in fact so widespread that in a report on infrastructure and development, the World Bank (1994, pp. ii, 22) found reason to coin a special term for it: the “EGAP principle.” Cost estimation following the EGAP-principle simply disregards the risk of cost escalation resulting from delays, accidents, project changes, etc. This is a major problem in project development and appraisal, according to the World Bank.

 It is one thing, however, to point out that investors, public or private, were deceived in particular cases. It is quite another to get those involved in the deceptions to talk about this and to possibly admit that deception was intentional, i.e., that it was lying. We are aware of only one study that actually succeeded in getting those involved in underestimating costs to talk about such issues (Wachs, 1986, 1989, 1990). Wachs interviewed public officials, consultants, and planners who had been involved in transit planning cases in the U.S. He found that a pattern of highly misleading forecasts of costs and patronage could not be explained by technical issues and were best explained by lying. In case after case, planners, engineers, and economists told Wachs that they had had to “cook” forecasts in order to produce numbers that would satisfy their superiors and get projects started, whether or not the numbers could be justified on technical grounds (Wachs, 1990, p. 144). One typical planner admitted that he had repeatedly adjusted the cost figures for a certain project downward and the patronage figures upward to satisfy a local elected official who wanted to maximize the chances of getting the project in question started. Wachs’ work is unusually penetrating for a work on forecasting. But again, it is small-sample research, and Wachs acknowledges that most of his evidence is circumstantial (Wachs, 1986, p. 28). The evidence does not allow conclusions regarding the project population. Nevertheless, based on the strong pattern of misrepresentation and lying found in his case studies, Wachs goes on to hypothesize that the type of abuse he has uncovered is “nearly universal” (1990, p. 146; 1986, p.28) and that it takes place not only in transit planning but also in other sectors of the economy where forecasting routinely plays an important role in policy debates.

 Our data give support to Wachs’ claim. The pattern of highly underestimated costs is found not only in the small sample of projects Wachs studied; the pattern is statistically significant and holds for the project population mean (i.e., for the majority of transportation infrastructure projects). Howver, on one point, Wachs (1986) seems to draw a conclusion somewhat stronger than is warranted. “[F]orecasted costs always seem to be *lower* than actual costs” (p. 24) he says (emphasis in original). Our data show that although “always” (100%) may cover the small sample of projects Wachs chose to study, when the sample is enlarged by a factor of 20-30 to a more representative one, “only” in 86% of all cases are forecasted costs lower than actual costs. Such trifles – 14 percentage points – apart, the pattern is identified by Wachs is a general one, and his explanation of cost underestimation in terms of lying to get projects started fit our data particularly well. Of the existing explanations of cost development in transportation infrastructure projects, we therefore opt for political and economic explanations. The use of deception and lying as tactics in power struggles aimed at getting projects started and at making a profit appear to best explain why costs are highly and systematically underestimated in transportation infrastructure projects.

#### Economic self-interest and public interest contributes heavily to cost underestimation

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Economic explanations conceive of cost underestimation in terms of economic rationality. Two types of economic explanation exist; one explains in terms of economic self-interest, the other in terms of the public interest. As regards self-interest, when a project goes forward, it creates work for engineers and construction firms, and many stakeholders make money. If these stakeholders are involved in or indirectly influence the forecasting process, then this may influence outcomes in ways that make it more likely that the project will be built. Having costs underestimated and benefits overestimated would be economically rational for suck stakeholders because it would increase the likelihood of revenues and profits. Economic self-interest also exists at the level of cities and state. Here, too, it may explain cost underestimation. Pickrell (1990, 1992) pointed out that transit capital investment projects in the U.S. compete for discretionary grants from a limited federal budget each year. This creates an incentive for cities to make their projects look better, or else some other city may get the money.

 As regards the public interest, project promoters and forecasters may deliberately underestimate costs in order to provide public officials with an incentive to cut costs and thereby to save the public’s money. According to this type of explanation, higher cost estimates would be an incentive for wasteful contractors to spend more of the taxpayer’s money. Empirical studies have identified promoters and forecasters who say they underestimate costs in this manner and with this purpose (i.e. to save public money; Wachs, 1990). The argument has also been adopted by scholars, for instance Merewitz (1973b), who explicitly concludes that “keeping sots low is more important than estimating costs correctly” {p. 280}.

 Both types of economic explanation account well for the systematic underestimation of costs found in our data. Both depict such underestimation as deliberate, and as economically rational. If we now define a lie in the conventional fashion as making a statement intended to deceive others (Bok, 1979, p. 14; Cliffe et al., 2000, p. 3), we see that deliberate cost underestimation is lying, and we arrive at one of the most basic explanations of lying, and of cost underestimation, that exists; Lying pays off, or at least economic agents believe it does. Moreover, if such lying is done for public good (e.g. to save taxpayers’ money), political theory would classify it in that special category of lying called the “noble lie,” the lie motivated by altruism. According to Bok (1979), this is the “most dangerous body of deceit of all” (p. 175)

 In the case of cost underestimation in public works projects, proponents of the noble lie overlook an important fact: Their core argument – that taxpayer’ money is saved by cost underestimation – is seriously flawed. Anyone with even the slightest trust in cost-benefit analysis and welfare economics must reject this argument. Underestimating the costs of a given project leads to a falsely high benefit-cost ratio for that project, which in turn leads to two problems. First, the project may be started despite the fact that it is not economically viable. Or, second, it may be started instead of another project that would have yielded higher returns had the actual costs of both projects been known. Both cases result in the inefficient use of resources and therefore in waste of taxpayers’ money. Thus, for reasons of economic efficiency alone, the argument that cost underestimation saves money must be rejected; underestimation is more likely to result in waste of taxpayers’ money. But the argument must also be rejected for ethical and legal reasons. In most democracies, for project promoters and forecasters to deliberately misinform legislators, administrators, bankers, the public, and the media would not only be considered unethical but in some instances also illegal, for instance where civil servants would misinform cabinet members or when cabinet members would misinform the parliament. There is a formal “obligation to truth” built into most democratic constitutions on this point. This obligation would be violated by deliberate underestimation of costs, whatever the reasons may be. Hence, even though economic explanations fit the date and help us understand important aspects of cost underestimations, such explanations cannot be used to justify it.

#### Technical explanations for underestimation are false- empirics

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 Most studies that compare actual and estimated cost of infrastructure projects explain what they call “forecasting errors” in technical terms, such as imperfect techniques, inadequate data, honest mistakes, inherent problems in predicting the future, lack of experience on the part of forecasters, etc. (Ascher, 1978; Flyvbjerg et al., in press; Morris & Hough, 1987; Wachs, 1990). Few would dispute that such factors may be important sources of uncertainty and may result in misleading forecasts. And for small-sample studies, which are typical of this research field, technical explanations have gained credence because samples have been too small to allow tests by statistical methods. However, the data and tests presented above, which come from the first large-sample study in the field, lead us to reject technical explanations of forecasting errors. Such explanations simply do not fit the data.

 First, if misleading forecasts were truly caused by technical inadequacies, simple mistakes, and inherent problems with predicting the future, we would expect a less biased distribution of errors in cost estimates around zero. In fact, we have found with overwhelming statistical significance (p<0.001) that the distribution of such errors has a nonzero mean. Second, if imperfect techniques, inadequate data, and lack of experience were main explanations of the underestimations, we would expect an improvement in forecasting accuracy over time, since errors and their sources would be recognized and addressed through the refinement of data collection, forecasting methods, etc. Substantial resources have been spent over several decades on improving data and methods. Still our data show that this had had no effect on the accuracy of forecasts. Technical factors, therefore, do not appear to explain the data. It is not so-called forecasting “errors” or cost “escalation” or their causes that need explaining. It is the fact that in 9 out of 10 cases, costs are underestimated.

 We may agree with proponents of technical explanations that is, for example, impossible to predict for the individual project exactly *which* geological, environmental, or safety problems will appear and make costs soar. But we maintain that it is possible to predict the risk, based on experience from other projects, that some such problems will haunt a project and how this will affect costs. We also maintain that such risk can and should be accounted for in forecasts of costs, but typically is not. For technical explanations to be valid, they would have to explain why forecasts are so consistent in ignoring cost risks over time, location, and project type.

## indicts

### at: reich

#### Reich is stupid

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Today we pick a fight with Robert Reich. You remember him, Bill Clinton’s outspoken Labor Secretary, Berkeley professor, political commentator, and, most recently, Occupy protest apologist. Why should we worry about his opinion? Because Reich, unlike shrill Johnny-one-note Paul Krugman, is a master of the art of persuasive writing. (William, " Let's Not Be Bamboozled By Robert Reich's Stuff" CEI.org, 12/6/11, <http://cei.org/op-eds-articles/lets-not-be-bamboozled-robert-reichs-stuff>)//AP

Like most of his work, Reich’s recent piece in The San Francisco Chronicle, “[Instead of New Deal, Workers Get Raw Deal](http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2011/12/04/INF41M5J53.DTL),” is very well composed, taking the reader on an emotional journey meant to deliver him into the ranks of the howling mob. It is also stuffed with so much twisted history, economic fallacy, and dangerous recommendations that it cries out to be patiently deconstructed.

Reich promotes the classic Marxist shibboleth that economic downturns are created when employers don’t pay employees enough to “buy their own products.” According to Reich, Exhibit A is Ford Motor. He lauds its founder, Henry Ford, for paying his workers above market wages. In contrast, he castigates today’s Ford for trying to reduce its bloated union labor costs in order to stay competitive with government-subsidized General Motors and Chrysler, which were conveniently allowed to stiff their bond holders and dump their pension obligations when they were guided through bankruptcy and partial nationalization by the Obama administration.

Besides browbeating employers to increase wages, Reich’s broad economic remedy is to juice up “aggregate demand” by extending unemployment benefits and making the federal government the employer of last resort, by creating a new Works Progress Administration and Civilian Conservation Corps. This is all to be paid for by taxing the rich, both individuals and corporations. Doing this, Reich claims, will rescue us from our current malaise by giving consumers more money to spend, bringing back a golden era of prosperity.

Let’s start with Henry Ford, whose most important invention was the assembly line. What Ford did was to dramatically increase the productivity of his workers, allowing him to build more cars than his competitors while using less labor. This helped Ford put many of his competitors out of business, commandeering enough market share to get him branded a monopolist were this to happen today. Over 15 million Model Ts were sold, giving birth to the car culture Americans have come to know and love. This made Ford one of the richest men in the world.

If Robert Reich wants to praise Ford for his relentless effort to reduce labor costs, drive his competitors out of business, make horse-drawn transport obsolete, and become fabulously wealthy by offering the best valued products to the largest number of customers, sign me up. But he doesn’t. Instead he praises Ford’s radical decision to pay his workers $5 a day, more than twice the prevailing wage, claiming that this “higher wage turned Ford’s autoworkers into customers who could afford to buy Model Ts.”

Think about this claim for five seconds. Then spend five minutes taking a Wikipedia [history lesson](http://en.wikipedia.org/wiki/Henry_ford) to understand why Ford really paid above-market wages. During the time in which 15 million Model Ts were produced, total company employment never exceeded 100,000.  To what extent could paying his workers higher wages have contributed to booming sales?

Ford raised wages to reduce turnover, which was running at 300% per year during the hypercompetitive infancy of the auto industry. Lower turnover reduced training costs and improved both throughput and quality. Ford was able to afford this higher wage not because he was less greedy but because he figured out how to get more output from each worker. While the rate per hour that Ford paid his assembly line workers was high enough to steal them away from competitors, the rate he paid per car was actually a lot less.

The virtuous circle which Henry Ford mastered—which was driven by, yes, greed—didn’t end there. By relentlessly reducing his costs through increased worker productivity, Ford was able to share his profits with the consumer by cutting prices. Sure, this threw competitors’ workers out on the street, but then the market grew rapidly as more and more customers across the country could afford to buy cars, allowing Ford to hire those displaced workers. All the while Henry plowed his profits back into the company to make it grow bigger and richer.

Compare this supply-side approach to the Keynesian solution recommended by Reich that puts artificial job creation and demand-side government stimulus first. Had Reich been around in Henry Ford’s day, he would have excoriated automation as a threat to the working man. He would have insisted that workers from car companies driven out of business by Ford be given 99 weeks of unemployment insurance. And we can only imagine the antitrust campaign Reich would have unleashed when Ford’s market share passed 50%.

Space does not allow a refutation of Reich’s additional claim that the 1929 stock market crash was caused by a consumer credit bubble—long before credit cards, no-money down home mortgages, debt securitization, and abominations like Fannie and Freddie. Nor his circular reasoning that jacking up corporate taxes will magically create jobs after that money is redistributed to the unemployed, who will rush out to spend it thereby encouraging companies to hire them to accommodate the increased demand. Once the good professor works up a good rant there is no stopping him—except with facts, history, and reason.