# Popular Economics Weekly

# Beware of Extraordinary Times

Yes, beware of extraordinary times is an overused saying, but it also applies to the extraordinary polarization of ideas as well as politics of the present. And in an election year, politics of the right and left have also distorted the debate on economic recovery.

Conservatives cry that debt is bad, for instance, but borrowed debt is worse, says Alan Greenspan. So allowing some of the Bush-era tax cuts to expire may be a good thing, since those tax cuts reduced revenues while increasing the budget deficit. And conservatives and liberals agree that one has to spend money to make money—so shouldn't that apply to government as well as the private sector? The just-ended Great Recession required government to borrow huge sums of money to make money—i.e., just to keep the U.S. economy afloat.

Government stepped in because the private sector downsized, shedding more than 8 million workers and shutting down whole sectors of the economy—both small businesses and large, from autos to airlines.

So it should be a no-brainer that government and the private sector need to find better ways to work together, rather than participating in the demonization that has caused such an extraordinary polarization of ideas—ideologues who maintain all government is inept, for instance, or all capitalists selfish and greedy. One area that all sides in the debate should agree on is how to stimulate the demand that grows an economy. Right now there is little agreement even on how to simulate economic growth.

Conservatives maintain we must pay down debt, and decrease government spending to stimulate economic growth—private business lives in eternal fear of debt and so won't choose to expand when they worry about higher debts and future inflation, they say. While so-called liberals (who were at one time Eisenhower Republicans) believe that without government intervention during recessionary times, economies will stagnate and unemployment remain unacceptably high.

But in fact both government and the private sector are a part of what is called aggregate demand, the demand that stimulates economic growth. It is a relatively simple formula:

$$AD = C + I + G + (X - M)$$

Where aggregate demand is *AD*,

- $C$ is consumption (may also be known as consumer spending) = $a_c + b_c(Y - T)$,
- $I$ is Investment,
- $G$ is Government spending,
- $NX = X - M$ is Net export,
    - $X$ is total exports, and

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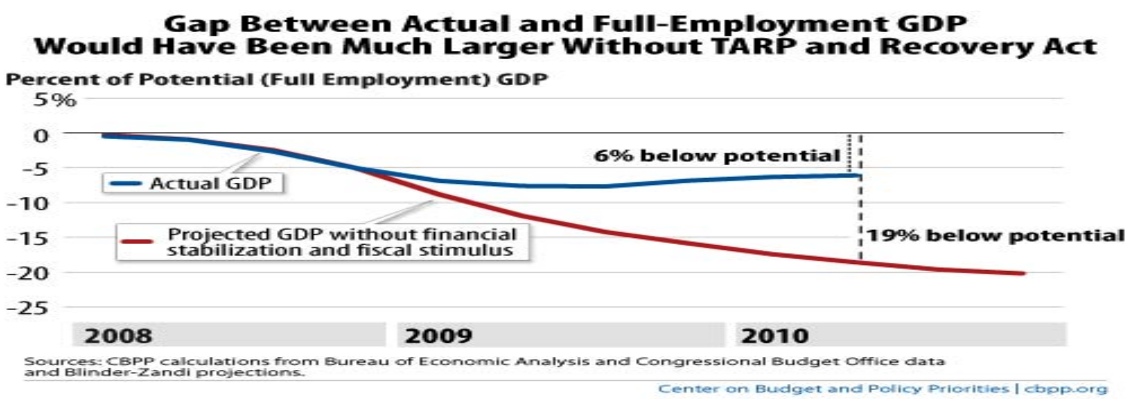
- $M$ is total imports = $a_m + b_m(Y - T)$.

Notice there is no mention of debt in the formula. Our Gross Domestic Product is its closest approximation, and the classical definition of a recession/depression is when GDP shrinks for at least 2 quarters. It shrank more than 4 quarters during this Great Recession, which is the main reason we are in such an extraordinary economic time.

The fact that we are fighting two wars with borrowed money, while recovering from a credit crisis and housing bubble that resulted from too much borrowed money, means that extraordinary measures are required. We must bury the hatchet between government and the private sector—doing nothing is not an option.

Historical hindsight tells us it was too little government regulation—both due to outmoded laws and lax oversight—and a private sector obsessed with profit over prudence that caused the Great Recession.

This has resulted in some $6 trillion in lost output of GDP, which could have been worse, if government had not come to the rescue.

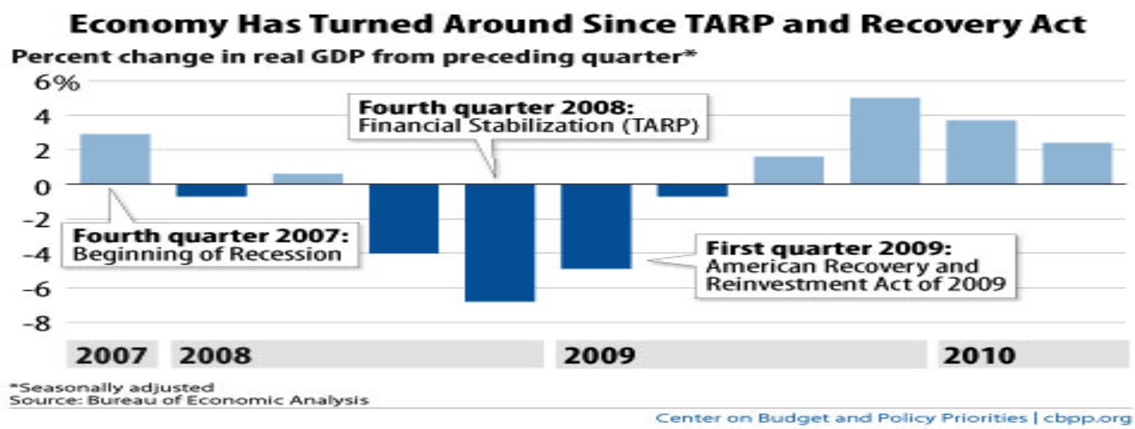



Zero interest rates are scary during ordinary times, certainly. It is scary to savers and lenders because it reduces their incomes. And it is scary to consumers because it signals falling prices, with lead to falling wages and fewer jobs.

But unless said aggregate demand begins to grow again, stagnation will continue. At present there is very uncertain growth, mainly because banks, investors and corporations are hoarding their assets. Corporations are hoarding their cash from a decade of record double-digit profits, investors are cautious from their stock and bond losses, and banks are reluctant to lend until their capital base has been restored. This is while consumers continue to pay down their debts and wait for businesses to hire again.

It has been left to government to provide some stimulus during these times to satisfy the most basic human needs of shelter and food, by borrowing from the almost $1 trillion in excess bank reserves held by the Federal Reserve (that banks are not using) and $1.8 trillion in cash that corporations are hoarding.

In other words, when $I + C + X\text{-}M$ falters, then the $G$ of government has to provide the stimulus. That was the lesson of the Great Depression. It began in 1929 when the Hoover Administration's tightened credit to combat inflation, and lasted until 1933 when Roosevelt instituted the modern government safety net—including social security, unemployment insurance, and the various government work projects that directly employed millions of the young and old. The Bush Administration's TARP and Obama's ARRA (Recovery) Acts have been the largest government stimulus programs since Roosevelt's New Deal, but whose results have benefited Wall Street more than Main Street to date. Hence the ongoing debate on what is best for our economic recovery.




The key is to find ways to unlock that demand. It makes sense that since consumers make up some 70 percent of economic activity at present, putting more money into consumers' pockets is a must. But if in the form of tax breaks, it must flow to those in the lower income brackets, where it gets spent. Most of the tax benefits to date have gone to the upper 1 percent in the form of investor benefits—such as lower capital gains and dividends taxes—i.e., to the investor class who tend to save rather than spend most of their income.

Another remedy is bond trader Bill Gross's suggestion of spending more on infrastructure. California is building its first high-speed rail service with some $8 billion of federal stimulus money. This would employ more blue-collar construction workers who have been hardest-hit by this recession.

Also, because homeownership is down from 70 percent to approximately 66 percent of households, with somewhere between 5 to 10 million of those households' loans in danger of default, government can do more to support housing. FDR's Administration actually took ownership of homes and rented them back to former homeowners in the 1930s, until they were able to buy them back. Today's various loan modification programs are pale imitations of what was done then.

Yet government can only do so much to stimulate growth. The private sector must step up and find ways to stimulate greater demand for its products. Madison Avenue has always found ways to stimulate both wanted and unwanted consumer needs that result in an excess of choices, while labor productivity is at record highs because corporations continue to push their existing workforce to produce more.

With corporations once again making record profits, there is no reason for them to resist hiring more workers, thus increasing demand for their products. Such are the lessons we should learn from the Great Recession.  Extraordinary times call for extraordinary measures.

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