Half-Assed Keynesianism

> [This is a slightly edited letter I sent to friends on June 9, 2010, along with an article from the *New York Times*, appended below. –S.H.]

Hi everybody,

The federal government and U.S. ruling class are hopelessly confused about what to do about the still developing economic crisis. Their main approach to dealing with the crisis which took such a qualitative turn for the worse in 2008 has been through Keynesian "stimulus" policies. Both the Bush and Obama administrations got huge "stimulus" packages passed, in addition to spending hundreds of billions (or was it trillions?) bailing out the big banks and Wall Street firms.

In February 2008 there was a $114 billion reduction in individual and corporate income taxes. In February 2009 there was an $862 billion package which included infrastructure improvements, aid to states, unemployment insurance extensions, COBRA subsidies, tax cuts and tax rebates. And there were also 5 smaller "stimulus" packages through April 2010 which totaled about $52 billion, devoted to such things as additional unemployment insurance extensions, home buyer's tax credits, the cash-for-clunkers car scrapping scheme, food stamp funding, and further corporate tax rebates.

So that comes to more than $1 trillion dollars in official "stimulus" programs up through late May 2010. Actually, however, the true Keynesian economic "stimulus" has been much greater than that. The fact is that virtually any government deficits, whether caused by government borrowing or by simply printing money, help the economy whether they are called "stimulus" programs or not. So the easier (and more accurate) method of determining the size of the economic "stimulus" is to just look at the total government budget deficits over the past 2 or 3 years. And that comes to several trillion dollars.

You will have noted that I've put the word "stimulus" in scare-quotes. That is because there is an invalid theoretical assumption incorporated into the very concept. And that is that government deficit spending can not only stimulate the economy *short-term*, but that it can also "get the economy back on track"; i.e., "stimulate" its "return to good health". This is the notion of "pump-priming" which is central to the Keynesian theory. In a serious economic crisis deficit spending cannot actually end the crisis, but it can *mitigate* it while the deficits last, or—if the deficits are massive enough—even *interrupt the crisis for a while.*

There have been a number of cases in history where truly massive Keynesian deficits have interrupted an overproduction crisis. One example was in Nazi Germany during the mid-1930s where huge public works programs interrupted the Great Depression. The massive military Keynesianism (deficits caused by military expenditures) of World War II then interrupted the Depression in other capitalist countries (including the U.S.) and kept the interruption in place in Germany as well. But only the vast destruction of capital on a world-wide basis during WWII actually *ended* that Great Depression.

A more recent example of a massive Keynesian deficit (or "stimulus" program) that actually returned an economy to apparent good health (for *a while*!) has been that in China over the past couple years. Though the "stimulus" program in China was smaller in absolute terms than the one in the U.S., it was much bigger in terms of the size of the economy.

There have, however, also been many "stimulus packages" in various countries which have *not* succeeded in even fully *interrupting* an economic crisis. This was the case, for example, in the economies of the U.S. and most other advanced capitalist countries (other than Germany) during the 1930s. In the U.S., for example, the public works programs and other causes of government deficits, were big enough to somewhat lessen the impact of the Great Depression, but not big enough to completely interrupt it even temporarily. When FDR and Congress trimmed the deficits in the 1936-37 period the "recovery" faltered and a major relapse occurred in 1937-38. The U.S. and most other capitalist-imperialist countries didn't get really serious about deficit spending until World War began.

A more recent example of "half-assed Keynesianism" has been in Japan over the past two decades. Since the property and financial bubble burst there around 1990-91, Japan has been in and out of about 5 recessions. There have been 5 or 6 (depending on how you count them) major bouts of Keynesian deficit spending or "stimulus packages" in Japan during that period, which have eased the situation for a while. But invariably the deficits were then cut back (though not at all completely eliminated) and the economy sank back into another recession.

The U.S. is currently following the same half-assed approach as Japan. As big as the several trillion dollar deficits have been in recent years, they *have not been big enough* to really even fully interrupt the current crisis. And now both the Republicans and the Democrats have decided that the necessity of trimming the huge budget deficits has become more important than further "stimulating" the economy. (See the article "Stimulus Talk Yields to Calls to Cut Deficits" below.)

This is why the current "recovery" (pathetic as it has been) is already starting to falter, and will fail much more seriously over the next several months. Unless, as now seems politically impossible, a new round of hugely expanded government deficits and "stimulus" programs are put in place, a new recession will have clearly begun within the next year.

As that new recession (or maybe they will call it the "second dip" of the "Great Recession") gets more and more obvious and more and more serious, there will once again be at least some new "stimulus" programs, and substantially increased government deficits. But the theoretical economic ignorance of the ruling class will also once again guarantee that those increased deficits will be insufficient to bring the economy back to anything approaching "good health", even temporarily.

The ruling class is right to worry about the long-term result of ever increasing government debt. It will sink their system in the end. But for now they are trying to have it both ways: To further stimulate the economy through deficits, and to at least make a start toward cutting back those enormous deficits somewhat.

The trouble is that those two goals obviously conflict with each other. The U.S. rulers are like someone who wants to go both east and west at the same time. They end up wobbling to and fro, perhaps, but really going nowhere.

What is the real solution to this deep and growing crisis in the U.S. and world capitalist system? There are only two possibilities:

One, the unprecedentedly massive destruction of the mountain of excess capital that has accumulated since the last Great Depression. It took a world war to do this last time (even though the excess capital was much smaller than today), and it seems to me that it would take another world war (which would now likely wipe out humanity) to do it this time too. Fortunately a new world war is not on the immediate horizon (as it was in the 1930s).

Or two, get rid of capitalism completely. *Unfortunately*, this only good solution to the problem does not appear to be on the immediate horizon either.

Since neither solution is viable at the present time, we will be in continuing and deepening economic crisis until one of them does become viable.

Scott

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Stimulus Talk Yields to Calls to Cut Deficits

By David E. Sanger and Sewell Chan

WASHINGTON — At a moment when many economists warn that the American economic recovery is likely to be imperiled by prolonged high unemployment and slow growth, President Obama is discovering that the tools available to him last year — a big economic stimulus and action by the Federal Reserve — are both now politically untenable.

The mood in both parties of Congress has turned decidedly anti-deficit, meaning that the job-creation programs once favored by the White House and Democratic leaders in Congress have been cut back, then cut again. It is a measure of the mood that Mr. Obama on Tuesday hailed an initiative by his administration to cut the budgets of most major government agencies by 5 percent, at a time when conventional theory would call for more government spending to lift the economy.

Even the Federal Reserve is pulling in its horns. No one could expect it to cut interest rates further — they are at rock bottom. But spurred by inflation hawks in their midst, the Fed has gotten out of the business of buying Treasury securities and mortgage bonds, one of its main strategies over the last two years for pushing down long-term interest rates.

Over the last few weeks, the cautious optimism that the economy is on the mend has given way to more caution than optimism.

“My best guess is that we’ll have a continued recovery, but it won’t feel terrific,” Ben S. Bernanke, the Fed chairman, said at a dinner at the Woodrow Wilson International Center for Scholars on Monday night. “And the reason it won’t feel terrific is that it’s not going to be fast enough to put back eight million people who lost their jobs within a few years.”

One could almost envision the winces in the White House as Mr. Bernanke observed that the unemployment rate “will stay high for some time.” He went on to note that even if the economy grew at 3 percent, which would be considered a healthy pace, it would do little more than keep pace with the normal rate of growth of the work force.

Virtually every day of late, White House officials have struggled to explain how their strategies to provide economic stimulus to bring down the unemployment rate square with Mr. Obama’s oft-expressed commitment to tackle a record budget deficit. They talk about spending this year — in modest amounts — while waiting for the prescriptions of the president’s commission on debt reduction, which reports, conveniently, a few weeks after the midterm elections.

In the next breath, they say that the only long-term strategy that will get Americans back to work and bring the deficit under control is promoting rapid economic growth. That is the elixir that allowed the Clinton administration, where many members of Mr. Obama’s team cut their teeth, to briefly wipe out budget deficits. But for now, it is unclear where that growth will come from — and how soon.

So rather than promoting another broad stimulus package, the White House is pointing to a series of familiar-sounding, low-cost measures to create jobs: stimulating export-oriented manufacturing, subsidizing energy-efficiency improvements by homeowners, preventing layoffs of teachers and police officers and pressing for a new (and unpaid for) highway bill that could, like the Census, create a short-term burst in hiring.

Lawrence H. Summers, the director of the National Economic Council and the economic adviser at Mr. Obama’s elbow, argued that the effects of last year’s $787 billion spending program had not fully kicked in. “Given fiscal lag, the Recovery Act is still gaining force and having increasing impact,” he said, adding that the administration’s job approach “goes beyond spending programs” to include mortgage relief for homeowners and expanded lending to small businesses. “We will not let up on jobs as a priority until unemployment returns to normal levels.”

Although Congress has enacted or is likely to pass an estimated $200 billion worth of additional spending since last year’s stimulus package, the appetite for a big new fiscal boost has slackened.

The anti-deficit mood is not limited to Washington. Over the last two days, Britain and Germany have announced austerity plans, in contrast to what many in Europe were arguing for a year ago. Spain and France have announced similar moves. The politics of those moves vary from country to country: in Britain, it is explained by the election of a Conservative government; in Germany by the usual postwar German aversion to deficits.

But the crisis in Greece has focused minds across Europe, especially in Spain, Portugal and Ireland. So just two weeks ahead of a meeting of the Group of 20 economic powers in Toronto, there is a widespread consensus that grand stimulus programs are a thing of the past.

The box that Europe, the Obama administration and Congress find themselves in today — desperate to stimulate the economy and fearful of the political reaction — gives new meaning to Milton Friedman's famous line from the mid-1960s. "In one sense, we are all Keynesians now," he wrote to Time magazine, referring to the theories of John Maynard Keynes, who called for government spending to counter downward cycles in the economy. In a less-remembered continuation of that sentence, he added, "in another, nobody is any longer a Keynesian."

Today they are periodic Keynesians. The Senate has taken up a jobs bill that could cost $100 billion over the next decade, a fraction of last year's historic stimulus package, but significant by the standards of other such jobs packages over the last two decades. "Here in the Senate, jobs will remain priority No. 1," Senator Charles E. Schumer, a Democrat of New York, said Tuesday. "It'll be almost an obsession to us."

Not surprisingly, the parties cannot agree on the best path to satisfy their obsessions.

"The failure of this Congress to even produce a budget, let alone get spending under control, is doing direct harm to our economy," Representative Dave Camp of Michigan, the top Republican on the House Ways and Means Committee, said Tuesday, arguing that the $13 trillion national debt was choking off growth.

Although a growing number of economists now expect the Fed to start tightening monetary policy next year, rather than later this year, there is little sense that it will resume buying assets and printing money to do so — a strategy called quantitative easing.

Given that inflation is well below the Fed's unofficial target of about 2 percent, Joseph E. Gagnon, a former Fed economist at the Peterson Institute for International Economics, argued, "With both employment and inflation below desired levels over the foreseeable future, the case for more monetary ease is strong."

But Johan Van Overtveldt, an economist in Brussels and the author of a book on Mr. Bernanke, said he did not believe the Fed was ready to buy that argument just yet. "The Fed has already carried out monetary policies never seen before in American history," he said. "A second round of quantitative easing at the moment would substantially increase inflationary risks."