From: "The Real State of the Union - Will Kaydos" <wkaydos@rstu.org>
Subject: **Government Stimulus: Fact or Fantasy?**
Date: October 29, 2010 11:35:35 AM EDT
To: mariotti@usit.net

The Economy and You REPORT

THE REAL STATE of the UNION

ESSENTIAL FACTS • OBJECTIVE ANALYSIS • CRITICAL THINKING • THOUGHTFUL COMMENTARY

October 29, 2010

Does Government Stimulus Work? With our economic recovery going nowhere fast, the stimulus package's effectiveness has been the subject of much debate. The Democrats claim significant success and the Republicans call it a failure, but putting the political propaganda aside, let's consider two important questions.

1. **Did the $814 billion stimulus package (includes add-ons) create or save some jobs?** Of course it did. I would defy anyone to spend as little as $10 million and not create or save some jobs, especially if that was your objective.
2. **How many jobs did the stimulus package save or create?** History cannot be repeated, so there is no way to determine what would have happened without the stimulus spending. My calculations indicate 2-4 million jobs were saved or created – at least temporarily.

But these questions aren't very important. The critical question no one has asked is "Will the stimulus result in a stronger economy?"

The short answer to the question is "**No!**" More than thirty years of stimulus with tax cuts and government spending funded with borrowed money has not strengthened our economy. Instead, it has weakened it and put our government's finances in a perilous position. The facts leading to this conclusion follow.

If Government Stimulus Created a Stronger Economy, What Results Would We See? If our economy was growing stronger, I would expect to see the same results we saw during most of the '50s, '60s and '70s:

- A healthy and fairly stable, or increasing, real GDP growth rate [1]
- Increasing real private wages because we are producing more high-value goods and services
- Shrinking national debt as a percentage of GDP, because GDP is growing faster than debt
- Increasing trade surpluses or shrinking trade deficits because American companies are more competitive in world markets
- Private debt growing at a pace consistent with the growth of GDP and personal income

Whether by intention or negligence, government figures for GDP growth are very misleading because they don't account for the impact of government and private borrowing on GDP. GDP growth of 3% without a federal budget deficit is clearly much better than 3% growth with a budget deficit. A 3% increase in GDP with a federal budget deficit of 3% of GDP means all of the growth came from spending government-borrowed money, not from the underlying or core growth of our economy.

Similarly, GDP growth accelerates when private debt [2] increases faster than personal income. When this happens, current consumer spending increases, but future spending will be reduced as consumers pay back their debt. There is no free lunch.

Government figures significantly overstate the GDP growth that really counts. To correct government figures for the impact of budget deficits and private debt on GDP, I developed a measure called the Core GDP Growth Rate [3], which indicates how much GDP would have grown without our government propping up consumer spending with borrowed money and without excessive growth [4] of private debt.

What Has Thirty Years of Government Stimulus Produced? The table below shows the dismal record of trying to strengthen our economy by injecting borrowed government money into its veins with tax cuts and/or government spending.

		A	B	C	D	E	F
Period	Average Budget Deficit (% GDP)	Average Real GDP Growth (% GDP)	Average Core GDP Growth (% GDP)	Trade Balance End of Period (% GDP)	Private Debt End of Period (% Personal Income)	National Debt End of Period (% Personal Income)	Real Hourly Wage - End of Period (2005 $)

1960-69	0.8	**4.4**	**4.0**	**+0.1**	**73**	**29**	**15.50**
1970-79	2.0	3.3	2.6	(-0.9)	82	26	**17.30**
1980-89	3.9	3.1	1.5	(-1.6)	96	41	15.04
1990-99	2.1	3.2	2.4	(-2.8)	98	39	15.72
2000-07	1.3	**2.6**	**(-0.6)**	**(-5.11)**	**143**	**36**	**16.87**
						2008: 40	17.07
						2009: 53	16.96
						2010: 64	?

From the '60s, when budget deficits were less than 1% of GDP to 2000-2007, when private debt exploded, real GDP growth, core GDP growth, our trade balance, private debt and our national debt have deteriorated. Real hourly wages in 2007 were slightly better than in 1969, but in 1969 real wages were increasing, whereas in 2008 they peaked and were decreasing. What happens in 2010 and beyond remains to be seen, but it probably won't be good.

Core GDP growth (column B) gives a more accurate picture of our economy's decline than our government's figures for real GDP growth. From a 4.0% growth rate in the '60s, core GDP growth plunged to 1.5% during the '80s, recovered slightly in the '90s, and then crashed to a recession-level (-0.6%) from 2000-07, when all GDP growth came from a staggering increase in private debt and modest government budget deficits.

Our trade balance (C) has gone from a slight surplus in the '60s, to the largest trade deficits in U.S. history. Without the growing trade deficits of the past 30+ years, our economy would undoubtedly be much stronger than it is today. Our GDP growth, personal income and government tax receipts would have been much larger, making our budget deficits, private debt and national debt much smaller.

Trade deficits should have lowered our standard of living, but our government offset their negative impact by increasing spending, cutting taxes to increase disposable personal income, and then borrowing to fill the gap between tax revenue and spending. That is why the growth of our budget deficits strongly coincides with the growth of our trade deficits.

We also compensated for shrinking personal income by increasing private debt. **From 1969 to 2007, private debt (D) shot up from 73% to 143% of personal income, with almost two-thirds of the increase taking place from 2000-2007.**

Never before has private debt exploded like this unless it was just before the Great Depression. This huge increase in private debt (primarily mortgages) fueled our economy and government tax receipts, keeping our national debt (E) in check until the private debt bubble burst in 2008. Since then, government debt has been used to pay off bad private debt, which is why our national debt rose sharply from 2007-2009 and is expected to rapidly increase for several more years.

So there you have it. **Stimulating our economy by cutting taxes and increasing government spending hasn't strengthened our economy, even when this was supplemented with a huge increase in private debt.** Not all the government stimulus after 1980 was wasted, but it hasn't even come close to paying for itself - and the fundamentals of our economy are worse now than they were in the '60s and '70s.

The idea that our government can "stimulate" our economy back to health is a fantasy politicians have promoted to create the illusion of a strong economy so they could avoid confronting our economy's decline, make themselves look good, and reward their supporters while they were buying taxpayer votes with borrowed money that taxpayers will have to repay. Some politicians and economists may have thought government stimulus would work, but by 1990 it should have been obvious that it wasn't working and the theory should have been given a merciful death.

Stimulating our economy with government spending and tax cuts worked politically for Reagan, Bush41, and Bush43, but it didn't work for the average American or our economy. Clinton gets a pass because he was in the right place at the right time and didn't have to resort to large budget deficits, but his administration didn't do any more than the Republicans did to address our economy's fundamental problems.

Government stimulus hasn't produced,
and won't produce, a stronger economy.

The current $814 billion stimulus has provided short-term relief and probably some marginal economic benefits, but it won't cure our economy's fundamental problems: increasing global competition, the loss of our industrial base that couldn't compete in world markets, government fiscal irresponsibility, and an ever-growing gap between what we consume and what we produce in everything from oil to most consumer goods.

We need to stop talking about "stimulus" like it works, because it doesn't work. No economist or politician has described how government stimulus will create a stronger economy and no one has produced any data that shows it works, other than carefully selected anecdotes that don't pass the tests of competent analysis and objectivity. If it worked, we would be rolling in money today, but we're buried in debt.

The best that can be said about government stimulus is that it can soften a recession's impact and buy some time to fix a broken economy, but that's about all it will do. My research and analysis says the crux of the problem with trying to strengthen our economy with government stimulus is found in four well-established economic truths:

1. Investing provides an economic return; spending does not.
2. If we want more goods and services, we have to produce more goods and services. We cannot keep buying them with borrowed money forever.
3. There are no simple and quick solutions to complicated long-term problems. Throwing money at our economy and hoping for a miracle is not a good strategy.
4. Our government cannot rebuild our economy. Our economy was built by the private sector and only the private sector can rebuild it.

Government stimulus – as it has been practiced – has been a failure. Whether you call it Keynesian economics, supply-side economics, Reaganomics, or pro-growth economics, it hasn't worked - and Obamanomics won't work either.

We need a viable national economic strategy that addresses the formidable realities of our economic situation, but it is extremely doubtful that Congress is capable of doing anything except playing political games and working at the margins.

If we keep following the path that led us to the Great Recession, we will find ourselves in the Second Great Depression – and this could happen sooner than anyone thinks.

Footnotes

[1] "GDP" always means real or inflation-adjusted GDP; "gross GDP" means GDP before adjusting for inflation.
[2] Private debt is defined here as the sum of consumer credit, personal mortgage debt (including home equity loans), and commercial mortgage debt. It does not include business or financial sector debt.
[3] A sophisticated economic model might produce slightly different figures for core GDP growth, but the figures provided are consistent with the findings of other analysts and, most importantly, what has happened.
[4] "Excessive growth" occurs when private debt is growing faster than personal income and GDP.

Please bring this message to the attention of your representatives in Washington, the press, and any organizations that can help get our country on the path to a real economic recovery. This report is available at http://www.rstu.org/economy_and_you/report.

Next Issue: How Deep is the Economic Hole We're In?

If you want to be on our mailing list, please register at http://www.rstu.org/register/. There is no obligation and you can unsubscribe at any time.

Please visit www.rstu.org for additional information.