

Has the American Economy Tanked? If so, what should the U.S. do?

Elliott Parker, Ph.D.
Professor of Economics
University of Nevada, Reno
September 9, 2011

Business is more than you think
COLLEGE OF BUSINESS
www.business.unr.edu



Unraveling the Mythology

“It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so.” – Mark Twain

Business is more than you think
COLLEGE OF BUSINESS
www.business.unr.edu



Myth 1: *This was a normal recession that government intervention made worse.*

- This was a depression averted, not a recession extended.
- Depressions are serious recessions caused by financial crises. They tend to be associated with price deflation and interest rates near the zero lower bound.
- Government may have failed to do enough, but acts of omission are not the same as acts of commission.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



The Great “Balance-Sheet” Recession

- Depressions were common in U.S. before 1945, deeper and longer.
- A recession caused by a financial crisis leads government to become the borrower of last resort (Minsky).
- A “balance sheet” recession causes banks to collect reserves to offset bad debt, rather than lend (Koo).
- Internationally, recessions caused by financial crises tend to be more severe, though fiscal intervention may reduce severity. After seven years, on average, GDP is still down 10% or more.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



Myth 2: *The U.S. government tried fiscal policy to stimulate the economy, and it failed.*

- A fiscal policy intervention attempts to make up for decreased private demand by increasing government demand.
- After 2007, the federal government did increase the goods and services it purchased, mostly due to the 2008 Surge in Iraq.
- The increase in federal purchases was canceled out by the decrease in state and local government purchases. Real per-capita government purchases fell from 2007 to 2011.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



Putting the Rise and Fall of GDP into Real Per-capita Terms

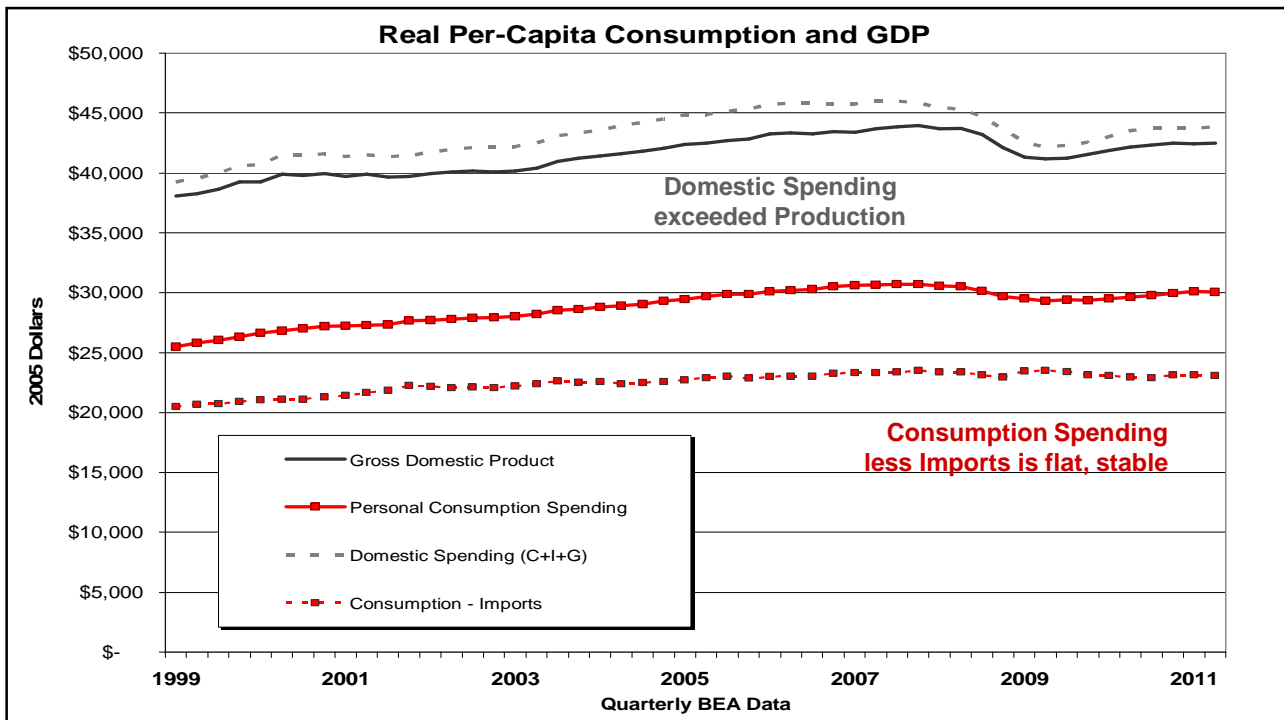
	2007:4	2009:2	2011:2	2007-09 Change	2009-11 Change	2007-11 Change
Gross Domestic Product (B)	14,253	13,854	14,997	-2.8%	8.2%	5.2%
GDP Deflator (2005=100)	107	110	113	2.5%	3.2%	5.7%
Population (millions)	303	307	312	1.3%	1.7%	3.0%
Real Per-capita GDP	\$43,956	\$41,163	\$42,469	-6.4%	3.2%	-3.4%

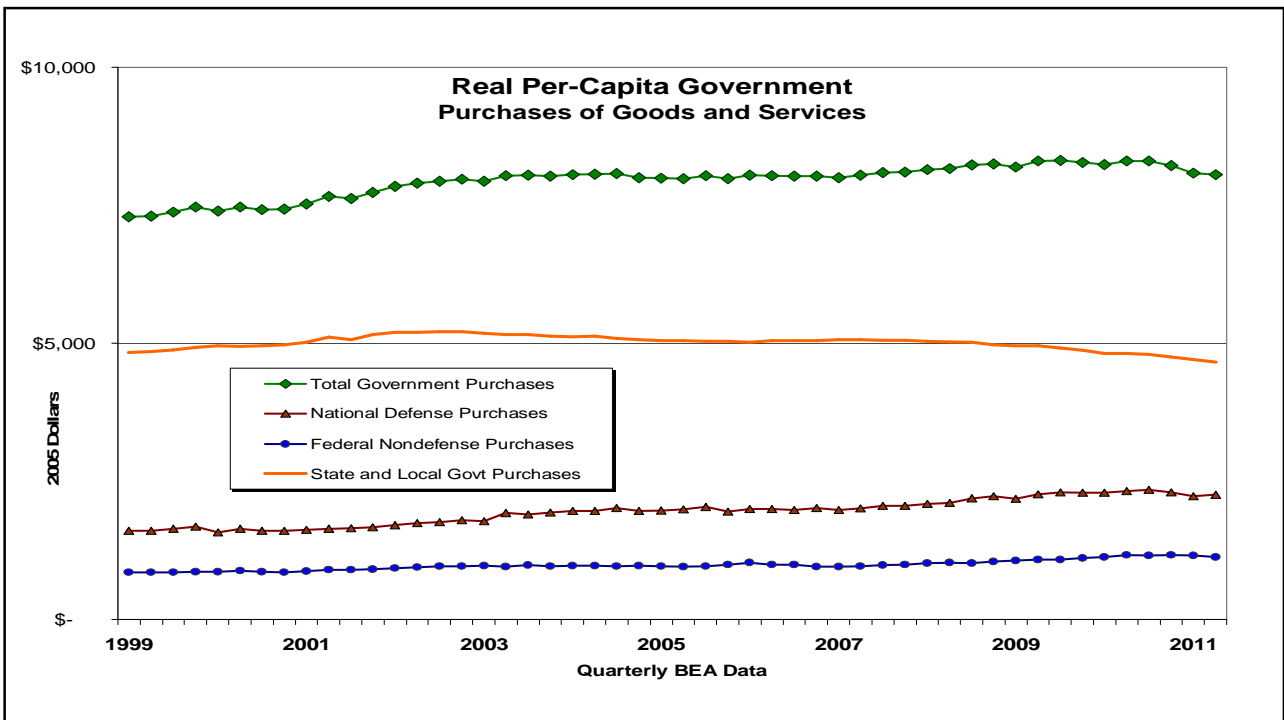
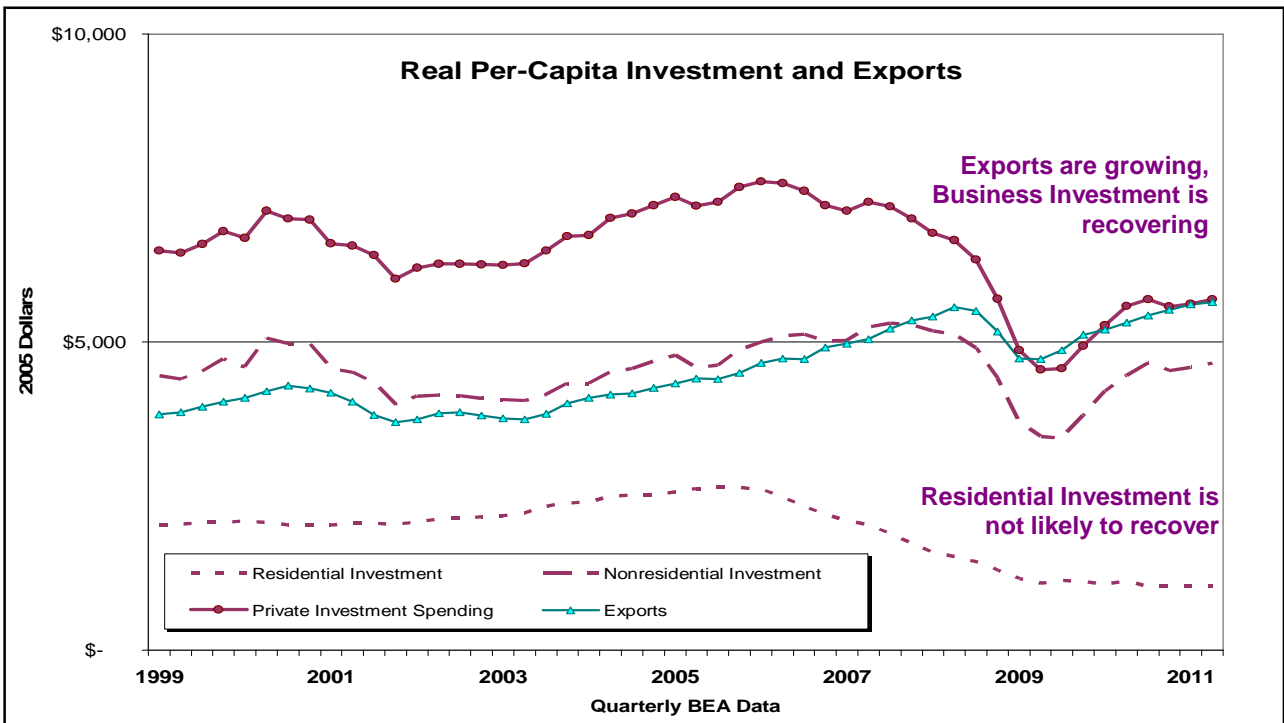
- From 1999-2007, average *annual* growth rates were: nominal GDP = 5.1%, price level = 2.6%, population = 1.0%, and real per-capita GDP = 1.4%.
- From 2007-2011, average *annual* growth rates were: nominal GDP = 1.5%, price level = 1.6%, population = 0.8%, and real per-capita GDP = -1.0%.

Consumption and Investment sank, Trade too. Federal Government purchases rose, but State & Local Government spending fell.

Billions of 2005 Dollars	2007:4	2009:2	2011:2	2007-09 Change	2009-11 Change	2007-11 Change
Gross Domestic Product	13,326	12,641	13,261	-5.1%	4.9%	-0.5%
Personal Consumption	9,313	8,999	9,387	-3.4%	4.3%	0.8%
Residential Investment	523	334	324	-36.1%	-3.1%	-38.1%
Nonresidential Investment	1,600	1,063	1,454	-33.6%	36.8%	-9.1%
Exports	1,622	1,449	1,763	-10.6%	21.6%	8.7%
Imports	2,187	1,781	2,184	-18.5%	22.6%	-0.1%
National Defense Purchases	622	696	706	11.8%	1.5%	13.4%
Fed. Nondefense Purchases	300	333	353	11.2%	5.7%	17.6%
State & Local Govt Purchases	1,533	1,521	1,456	-0.8%	-4.3%	-5.0%

Remember, population grew 3.0% from 2007-2011.





Total Government Purchases fell, while Transfer Payments jumped.

<i>Real Dollars Per Capita</i>	2000:4	2007:4	2009:2	2011:2	2007-09 Change	2009-11 Change	2007-11 Change
National Defense Purchases	1,577	2,011	2,193	2,196	9.1%	0.1%	9.2%
Federal Nondefense Purchases	866	949	1,039	1,075	9.6%	3.4%	13.3%
State and Local Govt Purchases	4,985	5,139	5,058	4,763	<u>-1.6%</u>	<u>-5.8%</u>	<u>-7.3%</u>
Total Government Purchases	7,427	8,099	8,290	8,033	2.4%	-3.1%	-0.8%
Transfers (Net)	5,074	5,263	6,039	6,430	<u>14.7%</u>	<u>6.5%</u>	<u>22.2%</u>
Total Government Expenditures	12,501	13,362	14,329	14,463	7.2%	0.9%	8.2%
Total Government Revenues	13,351	12,482	10,412	10,991	-16.6%	5.6%	-11.9%
Net Surplus/Deficit	849	-880	-3,917	-3,472			

Why *did* government spending increase?

- The increase in *net* government spending is entirely due to increased transfer payments. The lion's share of this was due to increased spending on unemployment benefits.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



Change in Federal Budget, 2007-2010

Budget Function Area	Change in Millions	Real Growth Per Capita
Income Security	256,235	+59%
National Defense	142,315	+18%
Social Security	120,584	+13%
Healthcare	102,672	+30%
Medicare	76,229	+12%
<u>Everything Else</u>	<u>29,492</u>	<u>-2%</u>
Change in total outlays	727,527	+18%

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



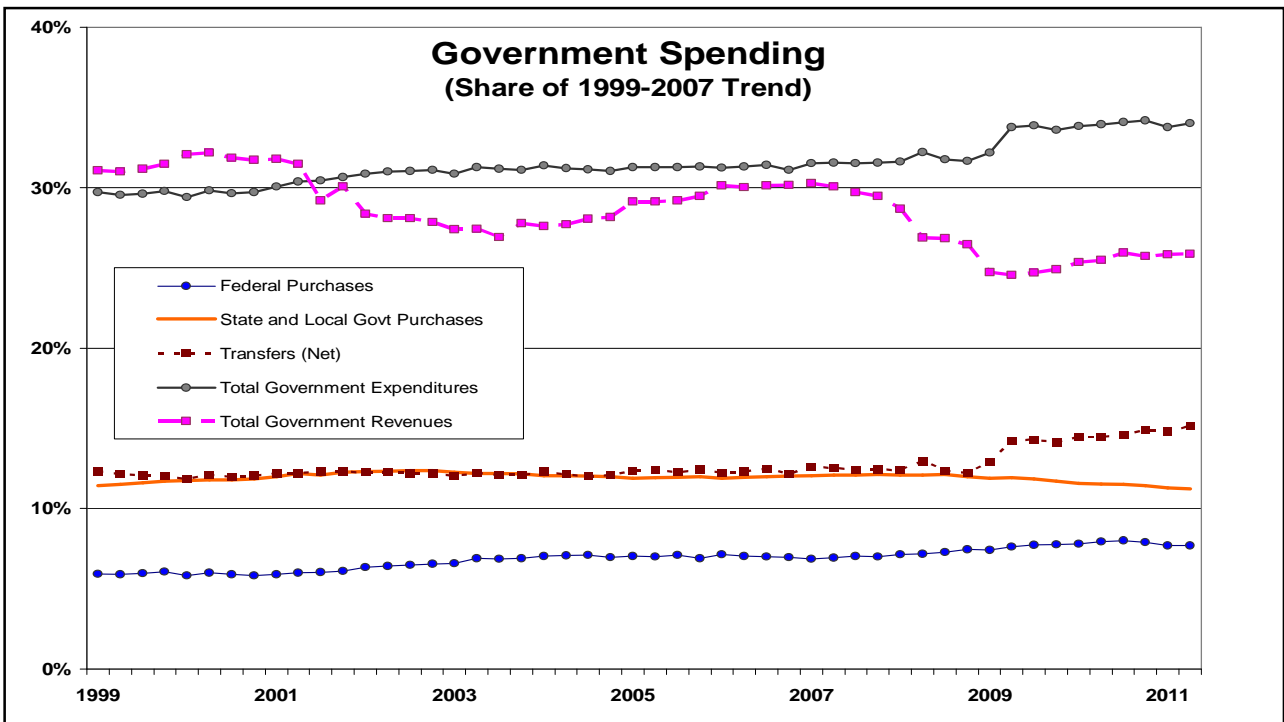
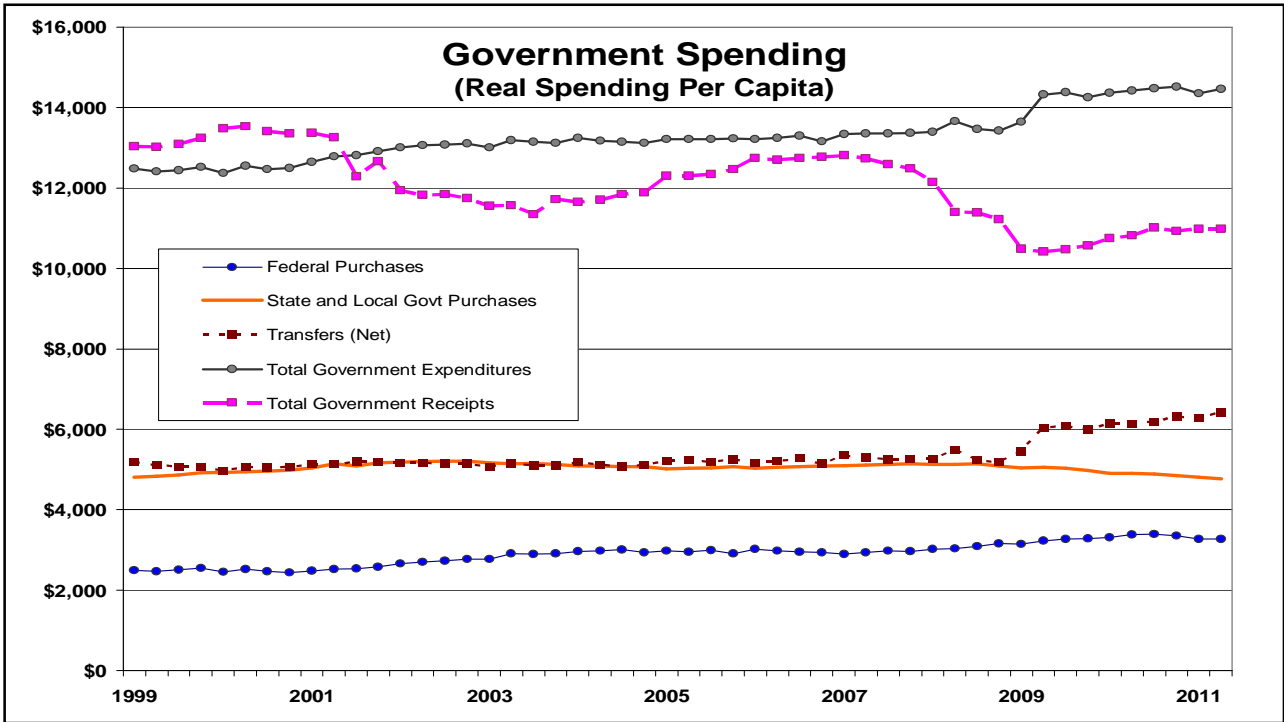
Myth 3: *The Budget deficit resulted primarily from increased government spending.*

- Perhaps if you divide by GDP, but GDP fell: ratios look bigger.
- Whether you measure it in real per-capita terms or divided by the 1999-2007 trend in GDP, the decrease in taxes collected was much larger than the increase in transfer payments.
- Taxes collected fell due to (a) the 2001-2003 tax cuts, (b) the recession, (c) the 2008 ESA, and (d) the 2009 ARRA.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu





Has The American Economy Tanked?

(A little perspective, please)

- In Jan. 2001, Alan Greenspan testified, “The most recent projections from the OMB indicate that, if current policies remain in place, the total unified surplus will reach \$800 billion in fiscal year 2011... despite the budgetary pressures from the aging of the baby-boom generation, especially on the major health programs.” He cautioned against paying off the entire federal debt.
- With good (or bad) policies, things can turn around within a few years.
- The U.S. has had a privileged position for decades, in terms of our disproportionate share of world GDP and the primacy of our financial markets. This is not sustainable even in the best of circumstances.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



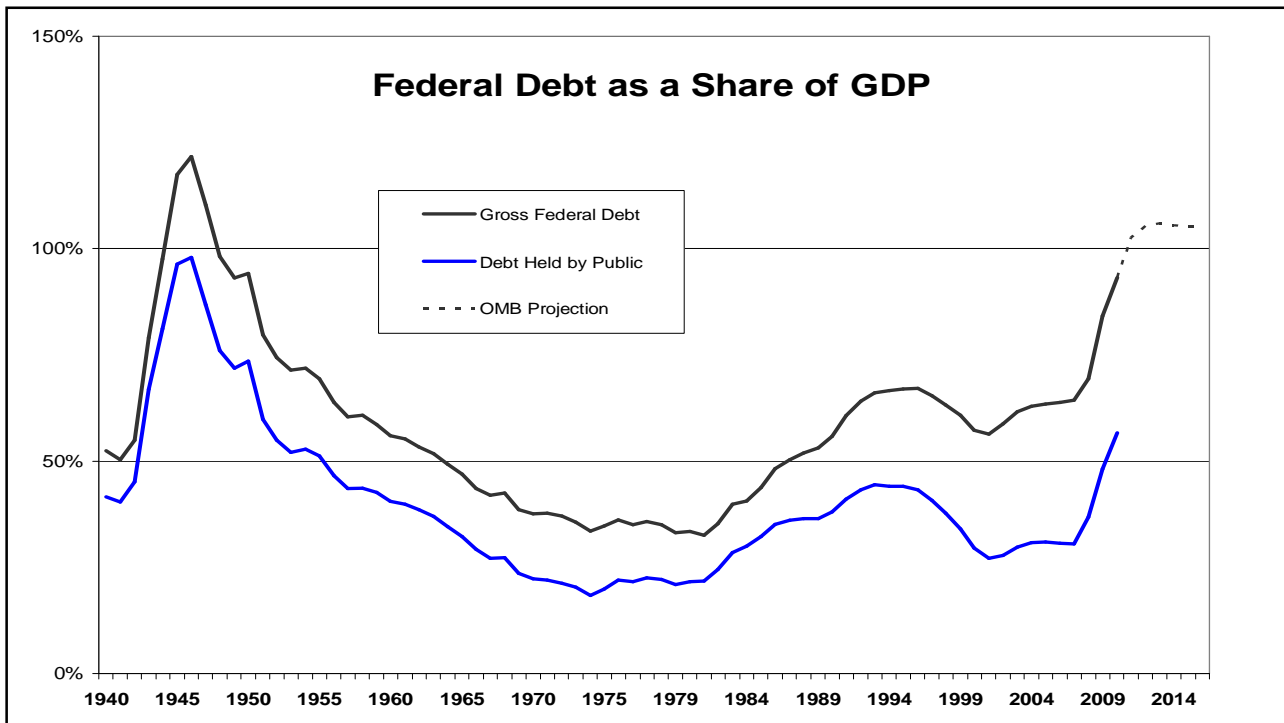
Myth 4: *The growth of the federal debt is unprecedented, at least in peacetime.*

- We are not in peacetime.
- As a percentage of GDP, the growth in the federal debt from 2007-2010 is less than the growth from 1981-1993. It is only larger if we include the increase from 2001-2007 and the projections for the next few years.
- The debt includes what we owe to government agencies (mostly the Social Security Administration) and the Federal Reserve System. The debt held by the public is about half as much (half of *that* is owed to foreigners).

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu





Myth 5: *Borrowing is bad.*

- Borrowing for investment makes sense, if the return on investment exceeds the cost of borrowing.
- Borrowing in bad times, to smooth out consumption, makes sense.
- Borrowing in good times for consumption is dumb.
- Many of the same voices opposed to borrowing now were silent before 2007, while we were funding two wars while cutting taxes and borrowing from abroad. Why?

[Business is more than you think]

COLLEGE OF BUSINESS
www.business.unr.edu

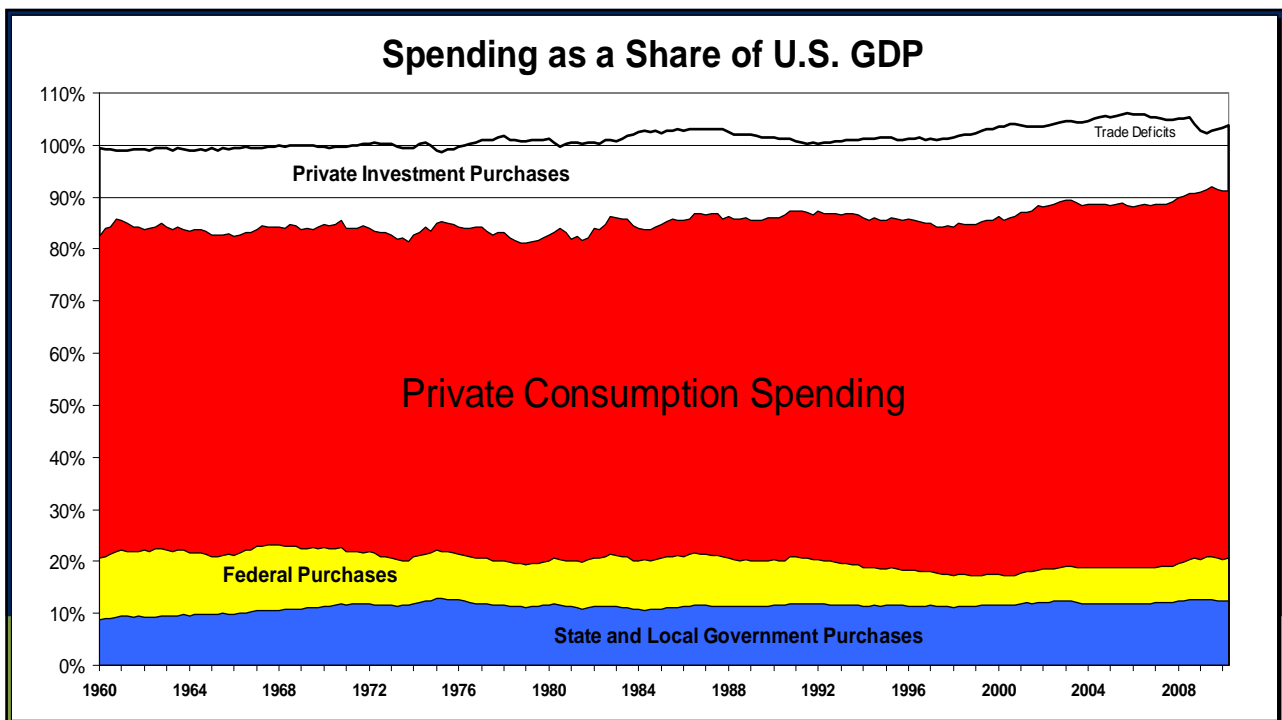


Myth 6: *We need to recover back to where we were.*

- There is a conflict between the short-run goal of stabilizing the economy and fighting unemployment, and the long-run goal of having a sustainable economy.
- Through 2007, Americans saved too little and consumed too much. We borrowed from abroad, causing trade deficits.
- We don't want consumption to fall – that makes income fall too – but we don't want it to be our engine of recovery either.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



So What Shall We Do?

- First, get real. Distorting facts may make you politically popular, but it doesn't help us find answers that work. Hyperpartisanship is ruining our country.
- We need investment (both public and private), in factories, infrastructure and education.
- We need banks to start lending again; exports to catch up with imports; the federal debt to stop growing faster than the economy; and finally, we need confidence.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



Is cutting taxes again a good idea?



Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



Possible policies? I am more comfortable with facts than opinions, but here are some possibilities: temporary investment tax credits, incentives to lend for investment purposes, a tax on excess bank reserves, expiration of past tax cuts after two years, ending the wars, public-private investment partnerships, reforms to reduce growth of healthcare costs (esp. for Medicare, Medicaid), higher retirement age, increase cap on social security contributions, restoration of meaningful financial regulation, lower dollar, et cetera.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



Appendix

- Economic Stimulus Act of Feb. 2008.
- Emergency Economic Stabilization Act, 2008.
- American Recovery and Reinvestment Act, 2009.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



Bank Bailouts

- Emergency Economic Stabilization Act:
 - \$700 billion authorized in October 2008. Only \$550B used.
 - TARP funds began with plan for purchase of troubled MBS, but changed to an equity purchases approach, with restrictions over executive pay.
 - \$270B went to AIG, GM, Wells Fargo, Citigroup, BoA, JPMorgan Chase, Morgan Stanley, and Goldman Sachs.
 - \$27B went to over 600 banks (\$300K-\$968M)
 - Majority has already been paid back, with interest.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu



Fiscal Intervention

- Economic Stimulus Act of Feb. 2008:
 - Tax rebates for 2008, estimated \$150B cost (about 1% of GDP) in 2008.
- American Recovery and Reinvestment Act of 2009:
 - Estimated \$800B cost over several years, with less than \$200B spent in FY 2009, and \$400B in FY 2010 (about 3% of GDP).
 - About 40% in tax credits, 30% in state fiscal support, and 30% in infrastructure investment (education, energy, health care) plus some extended benefit support.
 - Some parts were more effective than others, but there is a big difference between slowing the decline and turning the whole ship around.

Business is more than you think

COLLEGE OF BUSINESS
www.business.unr.edu

