

The Ailing U.S. Economy in 2012:

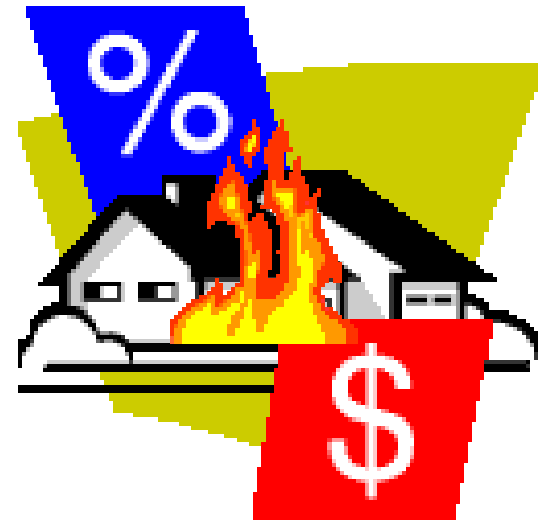


Rehab or Relapse?

Jay K. Rosengard, Kennedy School of Government, Harvard University

2010 Canon Institute Presentation

The Global Economic Crisis: Mitigating the Impact and Preventing a Recurrence



- Accumulation of fuel for the fire:
Underlying causes of the crisis
- Lighting the fire: Short-term triggers for the crisis
- Pouring fuel on the fire: Accelerants for the crisis
- Scorched earth and unburned terrain:
Current and potential magnitude of the crisis
- Responses to the crisis: Liquidity, solvency, and trust
- A new global financial architecture:
A post-Bretton Woods world order

2011 Canon Institute Presentation

Keynes vs. Hoover: Finding the Path to Prosperity Amidst the Ruins of the GEC



Hottest Issues at Present

- Fiscal Policy:
Deficit (Keynes) or Balanced Budget (Hoover)
 - Monetary Policy:
Expansionary (Keynes) or Contractionary (Hoover)
- *Like U.S. after Great Depression or Japan today?*

2012 Canon Institute Presentation

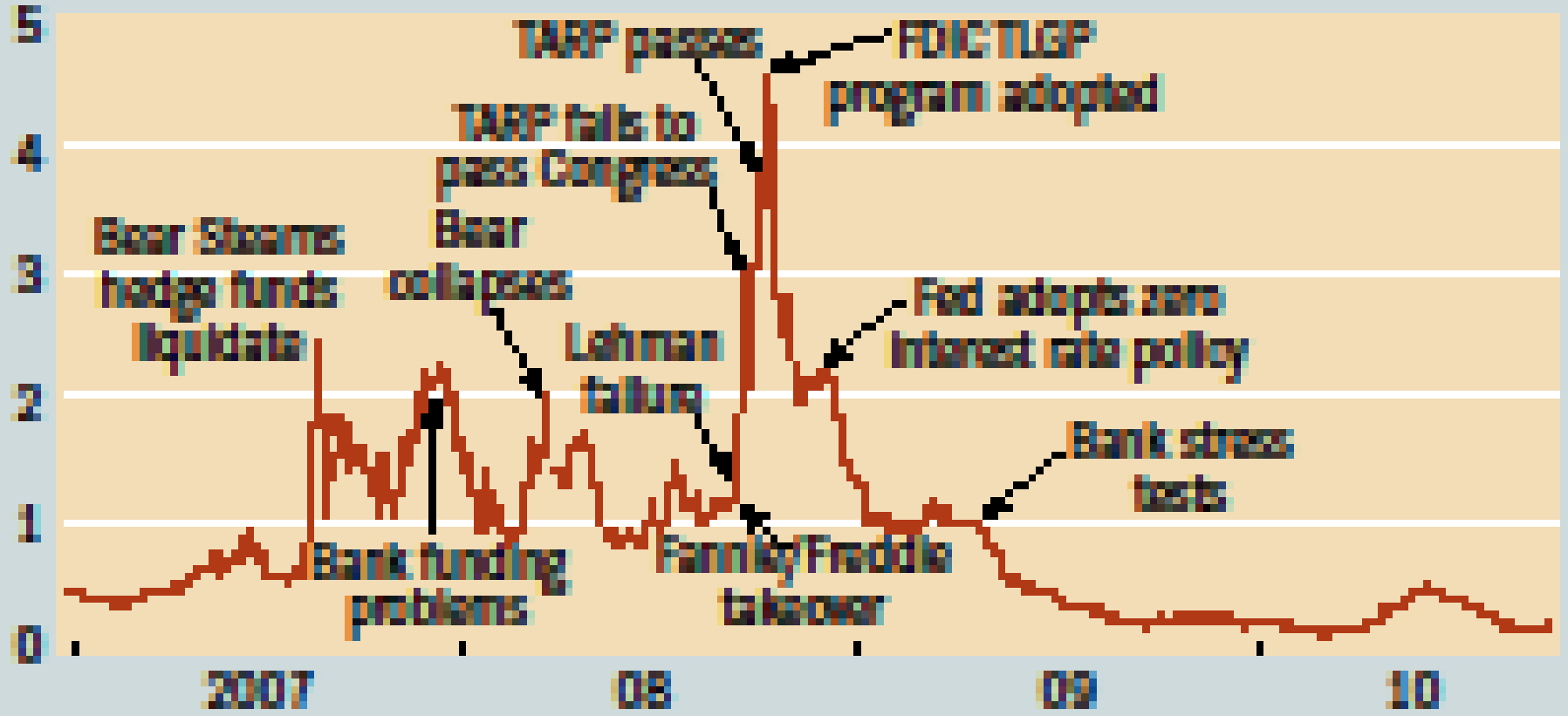
The Ailing U.S. Economy in 2012: Rehab or Relapse?



- Results to Date:
 - Did the monetary stimulus work?
 - Did the fiscal stimulus work?
 - Does austerity foster growth?
 - The Road Ahead:
 - Balancing long-term concerns with short-term needs?
 - Context of the upcoming presidential election?
- *Is the U.S. on the path of a slow and painful recovery (rehab) or will the U.S. end up back in the ICU with a double-dip recession (relapse)?***

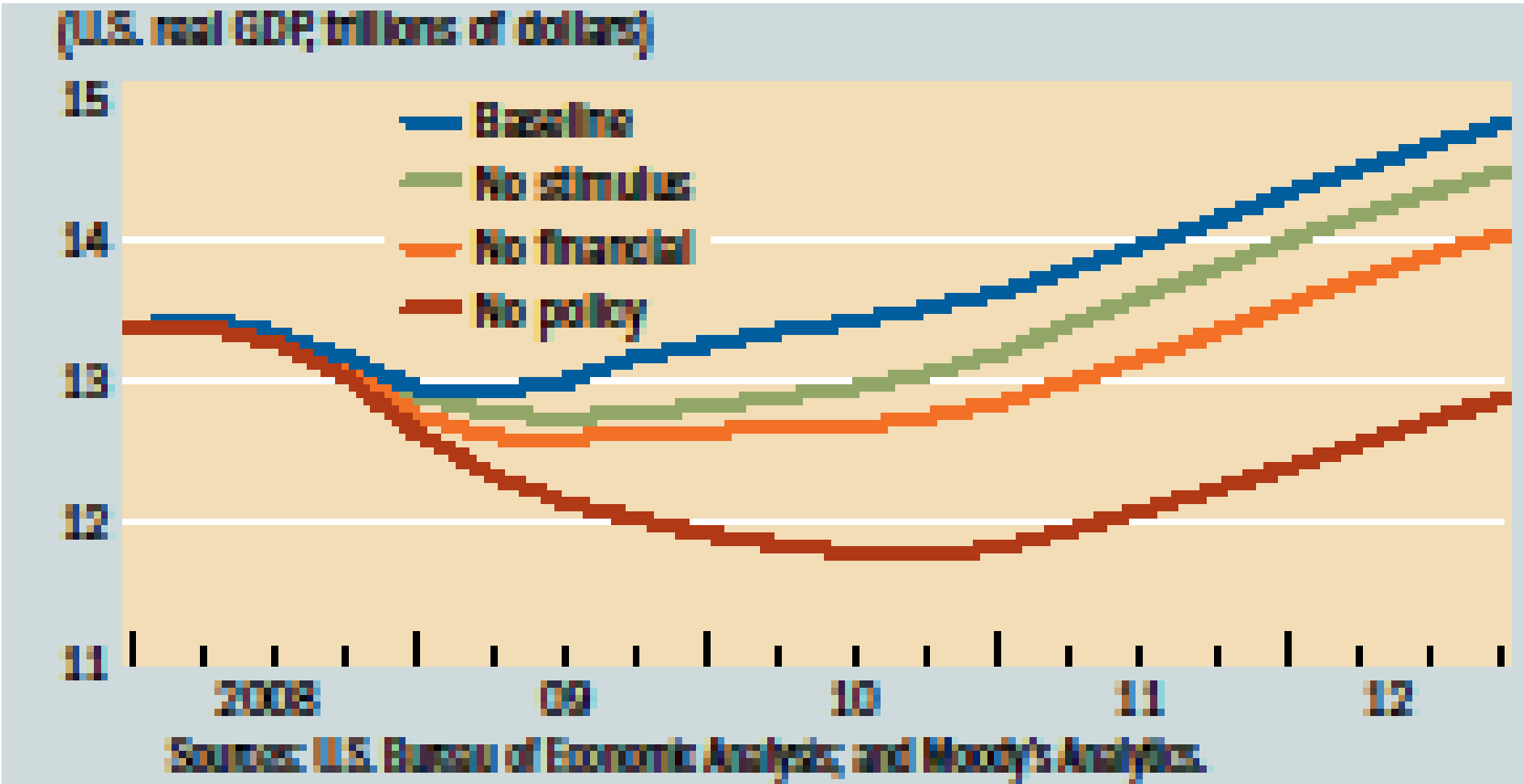
Did the Monetary Stimulus Work?

(difference between yield on three-month LIBOR and U.S. treasury bills, percentage points)



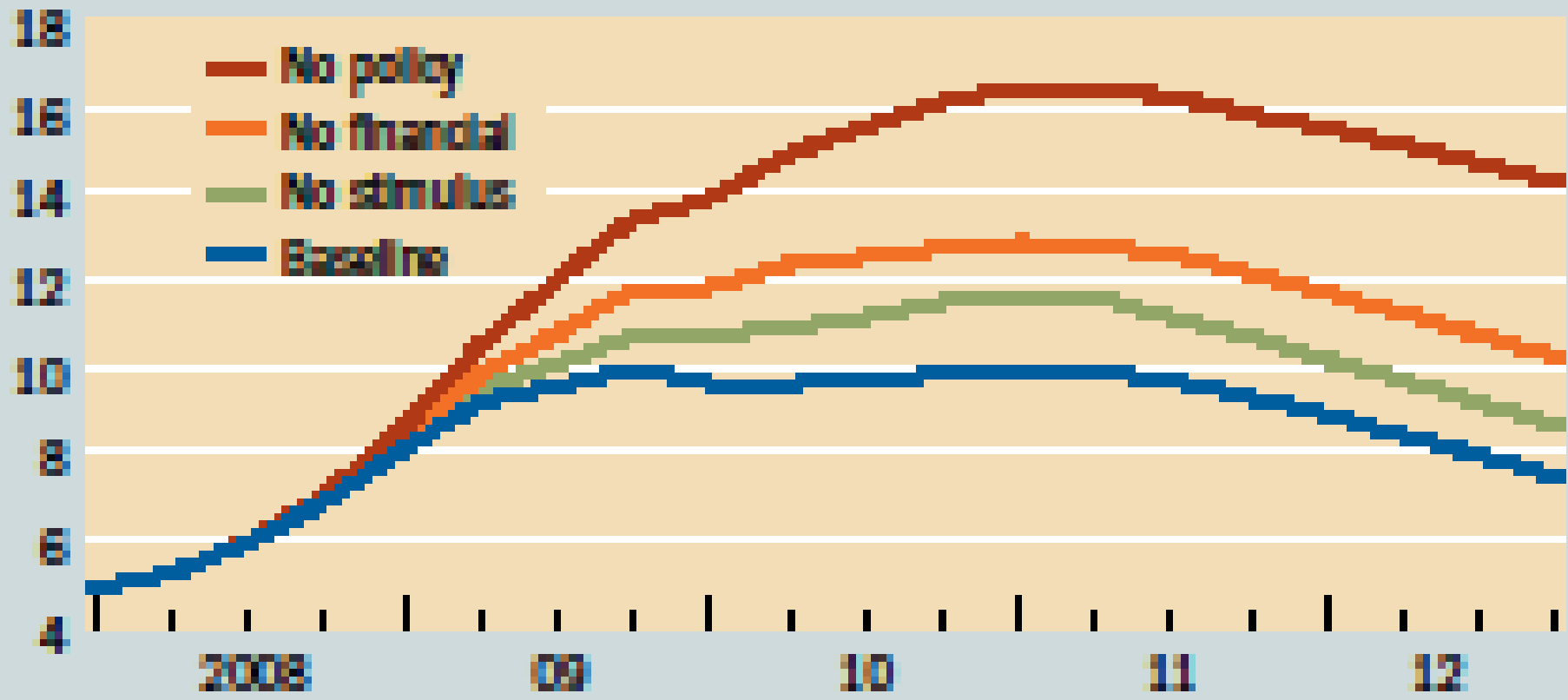
Sources: U.S. Federal Reserve, and Moody's Analytics.

Did the Stimulus Packages Work? (1)



Did the Stimulus Packages Work? (2)

(unemployment rate, percent)



Sources: U.S. Bureau of Economic Analysis, and Moody's Analytics.

Does Austerity Foster Growth?

- IMF study of 173 fiscal policy changes in high income countries from 1978-2009 found that cutting budget deficit by 1% of GDP → reduction of real output $\frac{2}{3}$ of a percent, increase in unemployment rate by $\frac{1}{3}$ of a percent
- Exceptions (“expansionary austerity”)
 - Start with strong economy, very high interest rates (Denmark 1983-86)
 - Start with overvalued currency (Ireland 1987-89 and Italy during 1990s)

Long-Term Concerns: Deficit and Debt

- Since 2007, 9-fold increase in federal budget deficit as share of GDP (now 10.9%) and 59.3% increase in gross federal debt as a share of GDP (now 102.6%)
- Interest in the federal debt as a share of GDP will also increase (projected to reach 2.8% in 2016, or \$562 b and 12.6% of expenditures)
- Need for fiscal consolidation combining increased revenue and decreased expenditures
 - 2011 fed receipts 14.4% of GDP, lowest since 1954, decreased 22.2% since 2007
 - 2011 fed outlays 25.3% of GDP, highest since 1945, increased 29.1% since 2007

Running up the tab

Debt as a percentage of gross domestic product

The federal debt fell steadily after World War II.

In the early 1980s, the government increased spending while cutting taxes and the debt began to rise.

An economic expansion in the 1990s briefly reversed the debt's growth.

125%

Today: \$14.3 tr.

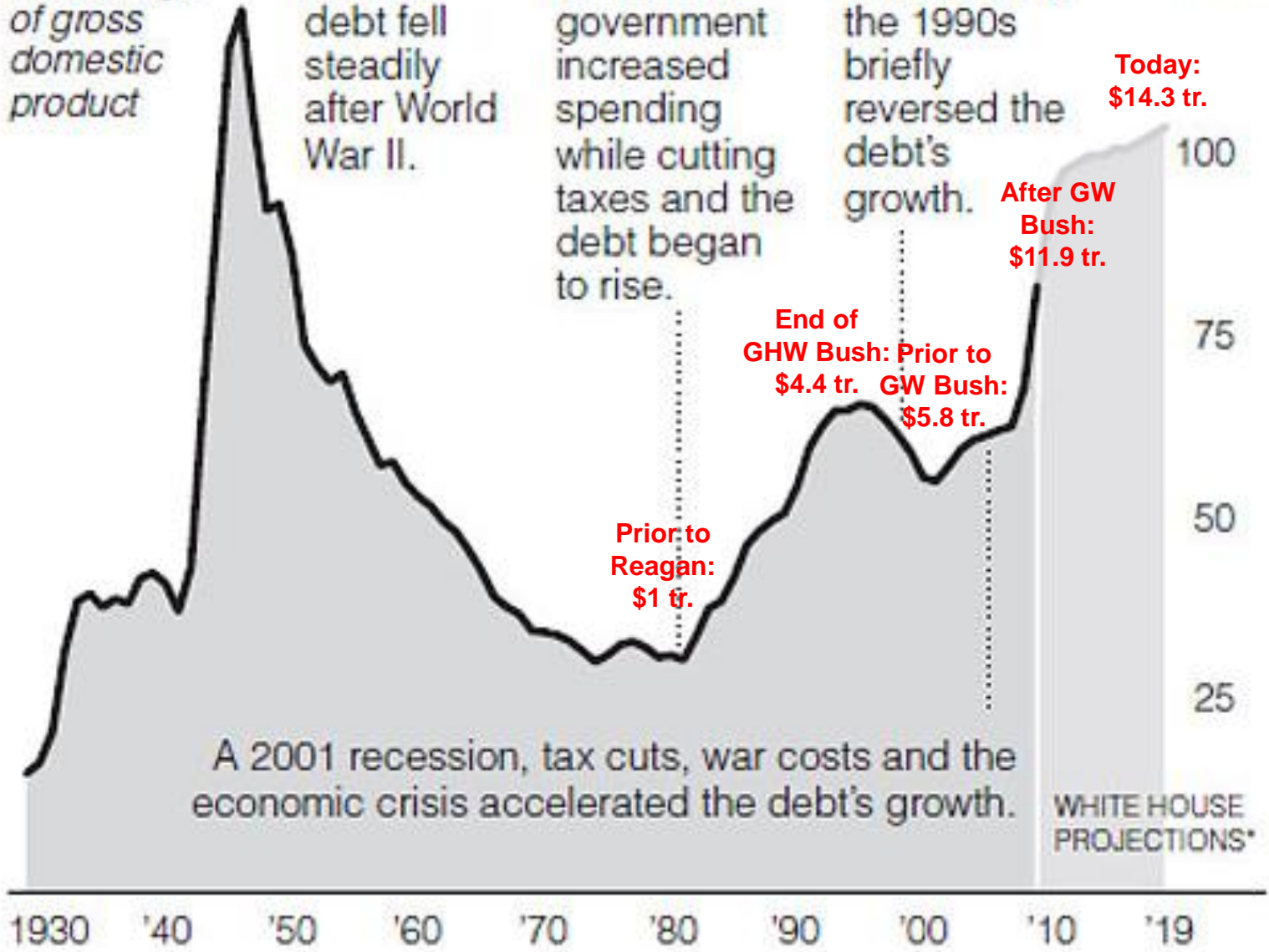
After GW Bush: \$11.9 tr.

End of GHW Bush: Prior to \$4.4 tr. GW Bush: \$5.8 tr.

Prior to Reagan: \$1 tr.

A 2001 recession, tax cuts, war costs and the economic crisis accelerated the debt's growth.

WHITE HOUSE PROJECTIONS*



More Fiscal Stimulus?

- Direct expenditures?
 - Extended unemployment compensation?
 - Aid to states?
 - Investments in infrastructure?
- Tax expenditures?
 - Extend 2% reduction (from 6.4%) in employee share of social security payroll tax?
 - Introduce reduction in employer share?
 - Tax credit to businesses for new employees?
- Or opposite?
 - Mandated expenditure cuts?
 - Expiration of Bush tax cuts?

Comparison of House & Senate Bills

House Bill

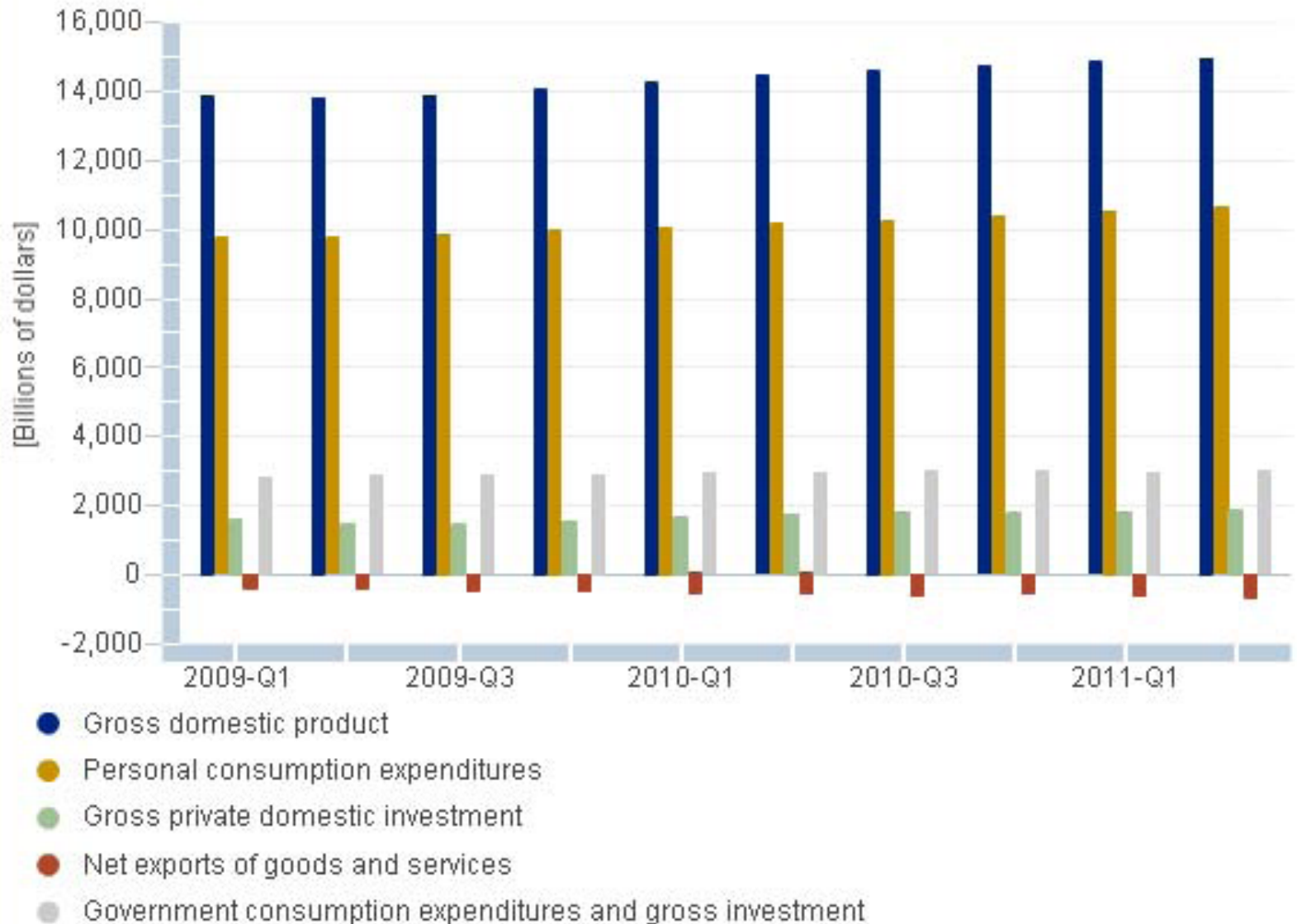
- Total > \$180 b
- Extends 2% cut in SS payroll tax thru 2012
- Extends long-term jobless benefits thru 2012, but 79 weeks & restrictions
- Prevents 27% cut in Medicare payments
- Requires approval in 60 days of Keystone XL pipeline
- Blocks curbs in industrial boiler pollution
- Paid for by budget cuts, pay freeze for fed govt workers

Senate Bill

- Total \$33 b
- Extends 2% cut in SS payroll tax thru Feb 2012
- Renews long-term jobless benefits at current levels w/o restrictions thru Feb 2012
- Prevents 27% cut in Medicare payments
- Requires approval in 60 days of Keystone XL pipeline
- Paid for by increasing 0.1% home loan guarantee fees charged to mortgage lenders by Fannie, Freddie, FHA¹²

Table 1.1.5. Gross Domestic Product

Last Revised on: August 26, 2011 - Next Release Date September 29, 2011



Source: U.S. Bureau of Economic Analysis

