Keynes vs. Hoover: Finding the Path to Prosperity Amidst the Ruins of the Global Economic Crisis

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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
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?
United States Stimulus Packages (1)

• Economic Stimulus Act (Bush, 2008)
  – Total spent/Total committed: $168 b/$168 b
  – Paid in the form of income tax rebates
  – Much of the assistance saved, not spent

• American Recovery & Reinvestment Act: $787 b (Obama, 2009)
  – Must maximize speed and magnitude of stimulus, assist those most vulnerable, and invest in future capacity to compete
  – ≈ $500 b in spending: aid to poor and unemployed ($107 b), aid to state governments ($169 b), infrastructure ($224 b)
  – ≈ $288 b in tax breaks: general credit ($116 b), AMT ($70 b), college tax credit ($14 b), child tax credit ($15 b), renewable energy tax incentives ($20 b), other ($53 b)
  – 92% of funds, excl. tax benefits, made available (12/11/10)
American Recovery & Reinvestment Act

Spending, $501 b

- Tax Credit, $116 b
- Other Taxes, $102 b
- ATM, $70 b

Aid to Local, $74 b
Aid to State, $95 b
Unempl. Aid, $69 b

Energy, $86 b
Transportation, $64 b
Health, $30 b
Education, $18 b
Other Spending, $26 b
Aid to Poor, $39 b
United States Stimulus Packages (2)

- Tax Cut/Unemployment Benefits Package: $858 b (Obama, 2010)
  - $801 in tax cuts (effective for next two years)
    - Extends all of lowered personal income tax rates enacted under Bush
    - Extends 15% rate on capital gains and dividends enacted under Bush
    - Introduces new estate tax parameters (higher exemptions, lower rates)
    - Includes many additional tax credits and deductions
    - Provides temporary patch for alternative minimum tax
    -Reduces social security payroll tax from 6.2% to 4.2%
    - \( \approx \frac{1}{4} \) of total tax savings will go to the wealthiest 1% of the population
  - $57 b in extended unemployment benefits
    - Continues benefit extensions another 13 months that allow long-term jobless to collect for up to 99 weeks
Fiscal Policy:
National Stimulus Packages/2007 GDP

- United States: $955 b → $1.8 tr ($168 b + $787 b + $858 b) [6.8% → 12.9%]
- China: $586 b (4 trillion yuan) [13.5%] [≈1.8% net]
- Japan: $270 b ($116 b + $154 b) (¥27 trillion) [5.5%]
- Germany: $69 b [1.9%]
- France: $33 b [1.2%]
- United Kingdom: $30 b [1.1%]
- Spain: $14 b [0.9%]
- South Korea: $11 b [1.2%]
Design of Stimulus Packages

• Size
  – Too big → inflation, crowding out of private sector
  – Too small → negligible impact

• Timing
  – Too fast → overwhelm absorptive capacity
  – Too slow → counterproductive time lag

• Structure
  – Wrong form → saving > consumption & investment
  – Mistargeting → economic inefficiency, corruption
Fiscal Policy:
National Austerity Packages

• United Kingdom
  – £83 b ($130 b) in cuts by 2015
  – 5.6% of 2010 GDP (£1.474 trillion)
  – Deepest spending cuts in more than 60 years
  – Deficit 10-12% of GDP
  – Reduction an average of 19% for government departments
  – Sharp curtailment of welfare benefits, especially for the unemployed
  – Elimination of 490,000 public sector jobs (20% of total employment, about 6 million jobs, now public sector)
  – Increase in VAT from 17.5% to 20.0% in January 2011

• Other examples include Greece and Ireland

• Protagonists
  – U.S. vs. Europe; Dems vs. Reps vs. Tea Party; Federal vs. Subnational

• Short-term countercyclical stimulus vs. investor confidence and long-term economic competitiveness
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.

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

1930  '40  '50  '60  '70  '80  '90  '00  '10  '19

WHITE HOUSE PROJECTIONS

125% 100  75  50  25
At the end of October, 36 percent of the debt held by the public was due within a year.

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<th>DUE:</th>
<th>Within a year</th>
<th>1 to 2 years</th>
<th>2 to 3 years</th>
<th>3 to 5 years</th>
<th>5 to 10 years</th>
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<td>0 to 1%</td>
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<td>1% to 2%</td>
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<td>4% to 5%</td>
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<td>5% or more</td>
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## The creditors

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<td>2009</td>
<td>22%</td>
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<td>1999</td>
<td>17%</td>
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Monetary Policy: Expansionary or Contractionary

• Quantitative Easing 2 (QE2)
  – On 3 November 2010, U.S. Federal Reserve announced it would pump another $600 b into the economy over next 8 months to assist recovery
  – In addition to $1.7 tr of QE already completed
  – This time will buy US government bonds instead of corporate debt and mortgage-back securities
  – Existing QE will be rolled over, but into treasuries

• Fostering domestic growth or depreciating currency for international trade advantage?
Current Controversies in the Context of Japan’s “Lost Decades”

• The crisis was precipitated by a collapse of real estate and stock market asset bubbles
• Despite repeated, extended attempts at fiscal and monetary stimulus, GDP has declined and debt has increased in two decades since crisis
• Also deflationary spiral and near-zero interest rates
• Debt/GDP ≈ 200%, economy stagnating
• Example: Impact of Hiroshi Kato’s increase of NCT from 3% to 5% in early 1997?
• Restore growth before worrying about deficits?