The Ailing U.S. Economy in 2012:

Rehab or Relapse?

Jay K. Rosengard, Kennedy School of Government, Harvard University
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
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?
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 Stimulus Packages Work? (1)

Sources: U.S. Bureau of Economic Analysis; and Moody’s Analytics.
Did the Stimulus Packages Work? (2)
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
Prior to Reagan: $1 tr.
End of GHW Bush: $4.4 tr.
Prior to GW Bush: $5.8 tr.
After GW Bush: $11.9 tr.
Today: $14.3 tr.

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

Prior to Reagan: $1 tr.
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

[Bar chart showing GDP components from 2009-Q1 to 2011-Q1]

- Gross domestic product
- Personal consumption expenditures
- Gross private domestic investment
- Net exports of goods and services
- Government consumption expenditures and gross investment

Source: U.S. Bureau of Economic Analysis