

Popular Economics Weekly Optimists vs. Pessimists—Who wins?

It is a sad state of affairs when a recent NBC-Wall Street Journal poll said 58 percent of respondents want the president and Congress to worry less about bolstering the economy and more about keeping the deficit low. This means those who are pessimistic about an economic recovery are currently winning the debate. It is also a comment on the lack of public knowledge about what is needed to boost economic growth. Only 35 percent polled thought economic recovery was a higher priority.

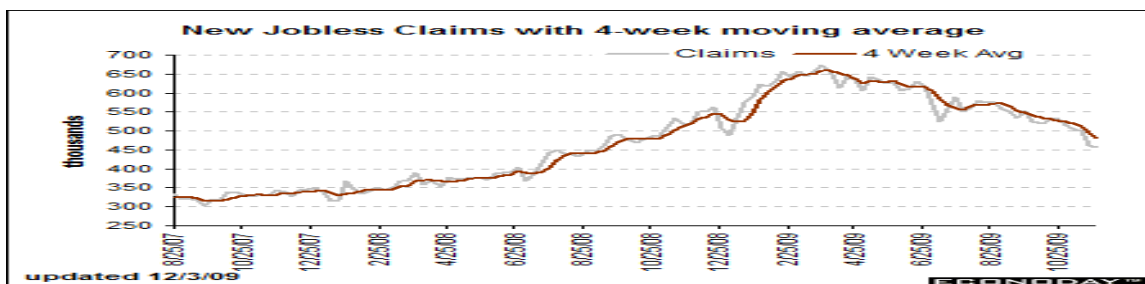
But the deficit will only be reduced if there is economic growth, and growth only occurs when demand is stimulated—whether it is by public or private means. At present, since private business is hiding in their foxholes, it is Federal deficit spending that is boosting consumers and investment spending—which in turn creates future demand.

Hence much of the talk about reducing the deficit comes from a misunderstanding. Economic growth only happens when what is called aggregate demand grows. It is expressed as the sum of consumption + Investment + Government spending + Net Exports. Our Gross Domestic Product is the best way to measure it. So it can't grow if none of its components are growing. And right now, only government spending is keeping growth positive.

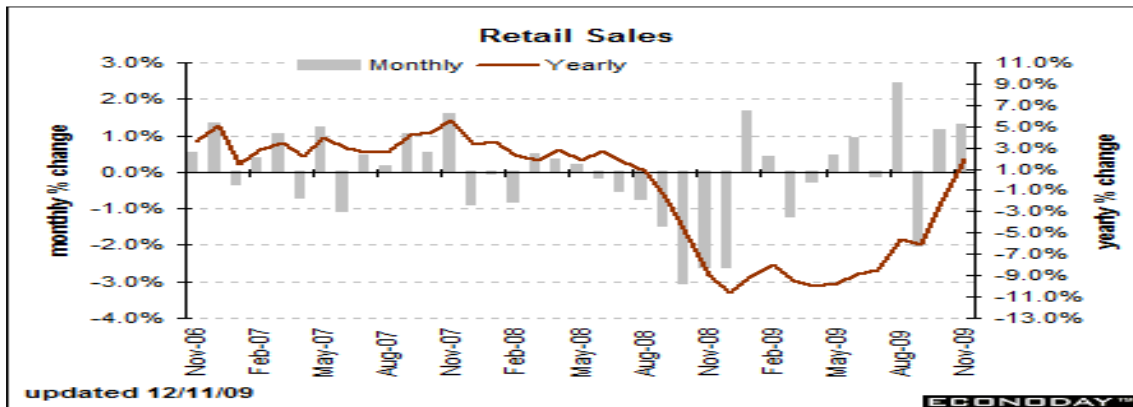
Tax cuts won't do it during this recession, because cuts don't directly stimulate demand. The money is hoarded by businesses, when too few are buying their products, and by consumers that have to pay down their debts.

There are a number of reasons we have such a large deficit—paying for 2 wars while cutting taxes was a big reason. And then the recession with reduced tax revenues added to it. So without such government support—in the form of direct subsidies to businesses, as well as consumers—the deficits of both federal and state governments would be much larger.

The latest drop in weekly jobless claims to 457,000 and a 10 percent unemployment rate show why government has to take up the slack in economic activity during such tough times. Only 11,000 nonfarm payroll jobs were lost in November and consumers are beginning to spend again—even though now saving more than 4 percent of their disposable incomes.



And consumers decided to come off the sidelines and jump back into the economy, boosting November retail sales—and beyond just autos and gasoline. Overall retail sales in November posted a 1.3 percent spike after a revised 1.4 percent gain in October. November's increase was well above the consensus estimate for a 0.9 percent increase. Excluding autos, sales gained 1.2 percent in the latest month after no change in October. The market consensus had expected a 0.5 percent gain in ex autos. Even excluding both autos and gasoline, November sales were up a healthy 0.6 percent, following a 0.1 percent uptick the month before.



The private business sector, meanwhile, has been hoarding their monies during recessions, so that more than \$9 trillion sits in MZM, zero maturity (and zero interest rate) accounts at present, as we have said.

There are good reasons why the huge budget deficit is worrisome. It puts downward pressure on the dollar, making imports more expensive. But it also boosts exports that are now cheaper—thus boosting domestic employment. Sure, foreign investors who have been buying so many Treasury bonds might one day be spooked, and so demand higher interest rates. But growing exports also helps to balance the huge trade deficit, thus bettering our balance of payments, and ultimately the dollar's foreign exchange value.

The other alternative—cutting back on government spending to balance the budget during a recovering economy—only prolongs the recession as we can see from the aggregate demand formula, until the private sector begins to hire again.

There is reason to be optimistic, in other words. Gross Domestic Product is growing again—up 2.8 percent in Q2. Weekly unemployment claims are falling and businesses are beginning to hire again. But confidence is still not high enough for the recovery to continue without government aid. That is why the federal government's support of business and consumers is so important.

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