Why Are Good Macro Policies Political Losers?

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Three points to serve as background:

- First of all, from the day after the collapse of Lehman Brothers, the policies followed by the U.S. Treasury and the U.S. Federal Reserve and the U.S. administrations have been very helpful. They have been good ones. The alternative--standing back and watching the markets deal with the situation--would have gotten us a much higher unemployment rate than we have now. Credit easing by the Fed and support of the banking system by the Fed and the Treasury have significantly helped the economy: have kept things from getting much worse.

- Second, the fact that investment bankers did not go bankrupt last December and are profiting immensely this year is a side issue. Each extra percentage point of unemployment lasting for two years costs us $400 billion. A recession twice as deep as the one we have had would have cost us as a country some $2 trillion--and cost the world as a whole four times as much. In that scale and context the bonuses of Goldman Sachs are rounding error. And any attempt to make investment bankers suffer more last fall and winter would have put the entire support operation at risk: as Federal Reserve Vice Chair Don Kohn said, ensuring that a few thousands investment bankers receive their just financial punishment is a non-starter when attempts to do so put the jobs of millions of Americans--and tens of millions outside the United States--at risk.

- Third, the Obama administration's fiscal boost program has also significantly helped the economy: aid to impacted states has been a big win, the jury is still out on the effect of the tax cuts in the stimulus, and the flow of government spending on a whole variety of relatively useful causes is in train and is boosting production and employment in the same way that everyone's boost to spending boosts production and employment. And the cost of carrying the extra debt incurred is extraordinarily low: $12 billion a year of extra taxes would be enough to finance the fiscal boost program at current interest rates, and for that cost American taxpayers will get an extra $1 trillion of produced goods and services and employment will be higher by about ten million job-years.

The big valid complaints about policy over the past fourteen months are not that it has run up the national debt and not that it has rewarded the princes of Wall Street, but rather that it has, if anything, been on too small a scale--that we ought to have done more.

Yet these policies appear, somehow, to be political losers in Washington right now: nobody is proposing to do more along the same lines. This is strange: usually when something works the natural impulse is to do it again.

So we have a big puzzle: Just what is going on in America? Good policies that are working to boost production and employment without causing inflation ought to be politically popular, right?

I think two different things are going on--one with respect to the Obama fiscal boost that is the ARRA, and a second with respect to the TARP and related banking-sector support policies.

With respect to the ARRA--the stimulus package, the Obama fiscal boost--it seems to me that what is going on on the American right is simply (a) an outbreak of extraordinary intellectual and political dishonesty that (b) the press refuses to see.

For two and a half centuries economists have believed that the flow of spending in an economy goes up whenever groups of people decide to spend more. Sometimes and to some degree these increases show up as increases in prices and sometimes and to some degree as increases in production and employment. Sometimes these increases come because there is more spendable cash in the economy and sometimes because changes in opportunity cost make people want to spend the cash they have more rapidly. But always it has been that spending goes up whenever groups decide to spend more--and the government's decisions to spend more are as good as anybody else's, as good as the decisions of the mortgage companies and new homebuyers to spend more buying new houses during the housing bubble of the mid-2000s or of the princes of Silicon Valley to spend more building new companies during the dot-com bubble of the late-1990s.

Chicago economists' arguments that fiscal stimulus can't work are at best incoherent and usually simply wrong. Republican politicians' arguments that fiscal stimulus isn't working are simply ripped out of the Newt Gingrich playbook: lie all the time. Remember that back in 1993 when the Democrats' analyses led them to seek to reduce the deficit and spend less--well, back then the Republicans said that would destroy the economy too. And they were very wrong. But how many media stories about Republican claims make even a small attempt to evaluate them?

A stronger--but not much stronger--argument is that the ARRA is boosting employment and production, but at too great a long-run cost because it has produced too large a boost in America's national debt. If interest rates on

U.S. Treasury securities were high and rising rapidly as the debt grew, I would agree with this argument. But that is not the case. Interest rates on U.S. Treasury securities are very low. They are not rising. The argument that the economy has too much debt--that the market does not want more debt--is belied by every single Treasury auction at which the market gobbles up huge new tranches of U.S. Treasury debt at high prices. What the market is telling us is that while the economy has too much private debt--prices of corporate bonds are low, and firms find financing expensive--the economy has too little public U.S. government debt, which everyone wants to hold. Those who claim that we have a debt problem, and you can't cure a debt problem with more debt suppress--sometimes deliberately--that since the start of the financial crisis private debt and U.S. Treasury debt have been very different animals, moving in different directions and behaving in very different ways.

That's what is going on on the fiscal policy side—with the stimulus package. But what is going on on the banking policy side—with the TARP and its siblings? I am out of space, so for the answer to that question you will have to wait an extra month.

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