

Policy for a Strong Recovery

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September 29, 2009 DRAFT

Figure 1: (Nominal) Disposable Personal Income

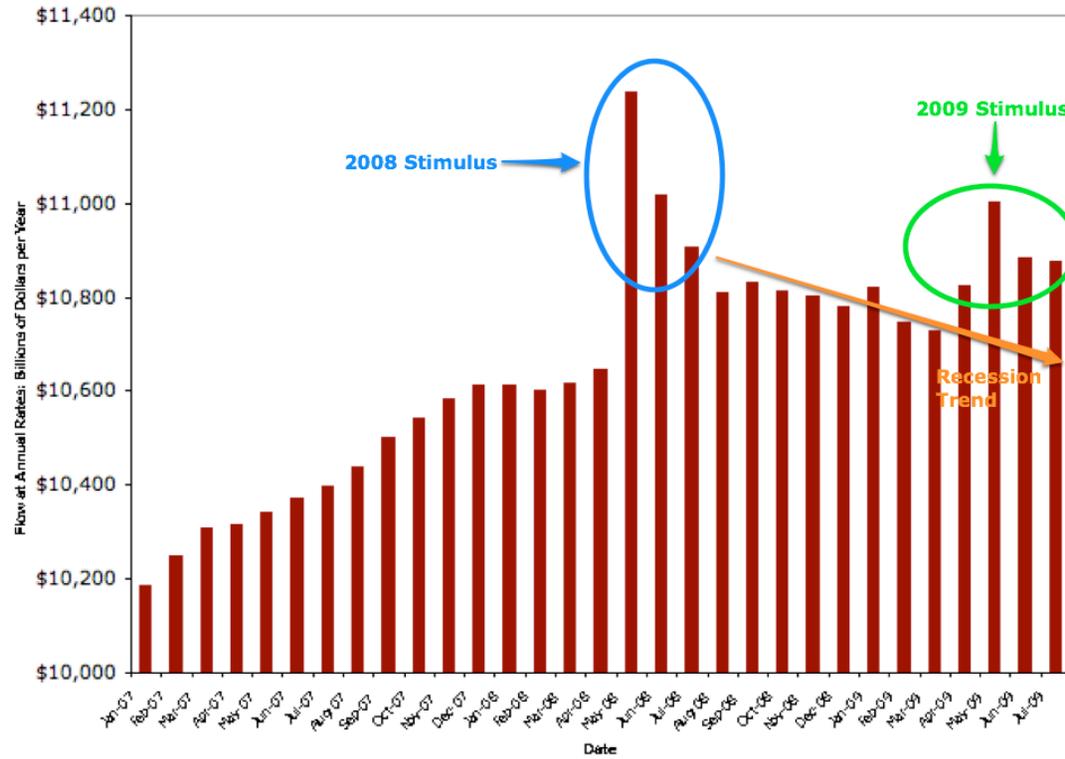
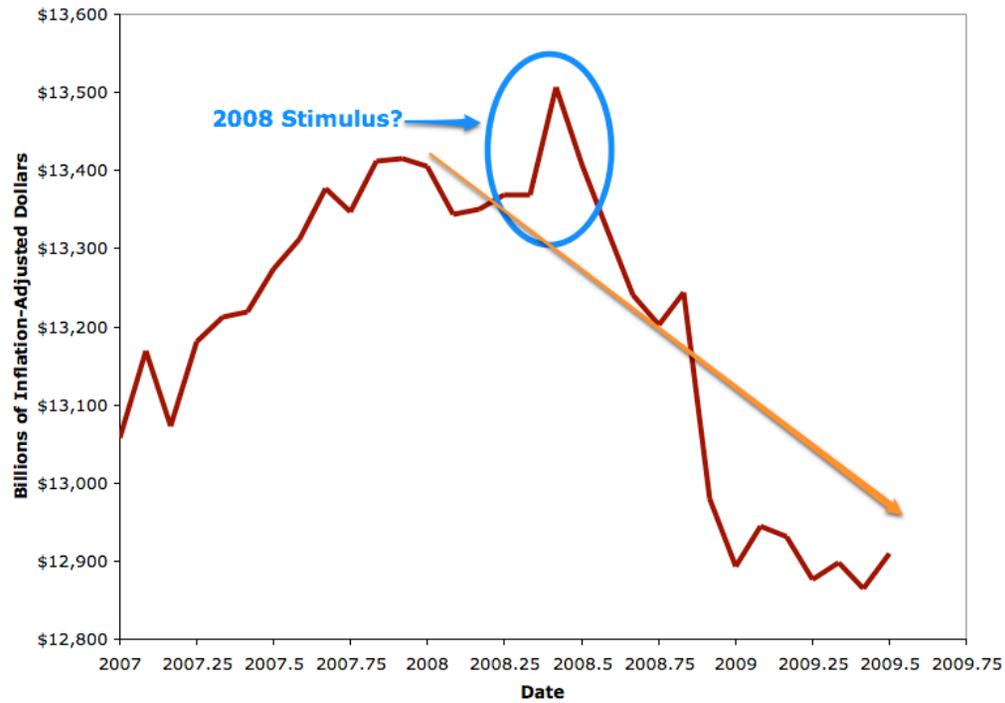


Figure 2: Monthly Real GDP Estimates from Macroeconomic Advisors

Seasonally Adjusted



Today's Arguments Against More Fiscal Expansion

1. This was the most that we could get sixty senators to vote for—and with a Senate that, in Majority Leader Harry Reid's words, takes forty-eight hours to flush the toilet we need to spend our time on legislative initiatives that might pass, rather than on those that certainly will not.
2. Further expansionary fiscal policy would be counterproductive in this current situation because of the long-run U.S. budgetary and global balance-of-payments imbalances. More short-run deficit spending would require the U.S. to issue more debt which would cause a sharp spike in U.S. long-term interest and a flight from the dollar that would generate a much bigger crisis and deeper depression—as Austria's issuance of huge amounts of additional debt in 1931 set off the wave of crises that turned the recession of 1929-1931 in Europe into the European half of the Great Depression.
3. Further expansionary fiscal policy would be counterproductive because it never works—because it is theoretically impossible for it to work—because it is a “fairy tale.”
4. The ARRA is only one of a large number of initiatives to stimulate the economy outside of the normal open-market operations monetary expansion framework. When you include the likely effects of all of the acronyms—TARP, PPIP, MMIFL, TALF, CPLF, TAC, etc.—you find that even though we have only \$600 billion of cumulative expansionary fiscal policy we have much more in terms of total non-standard-monetary stabilization policy.

Figure 3: Troika Forecast of the Unemployment Rate as of August 2009

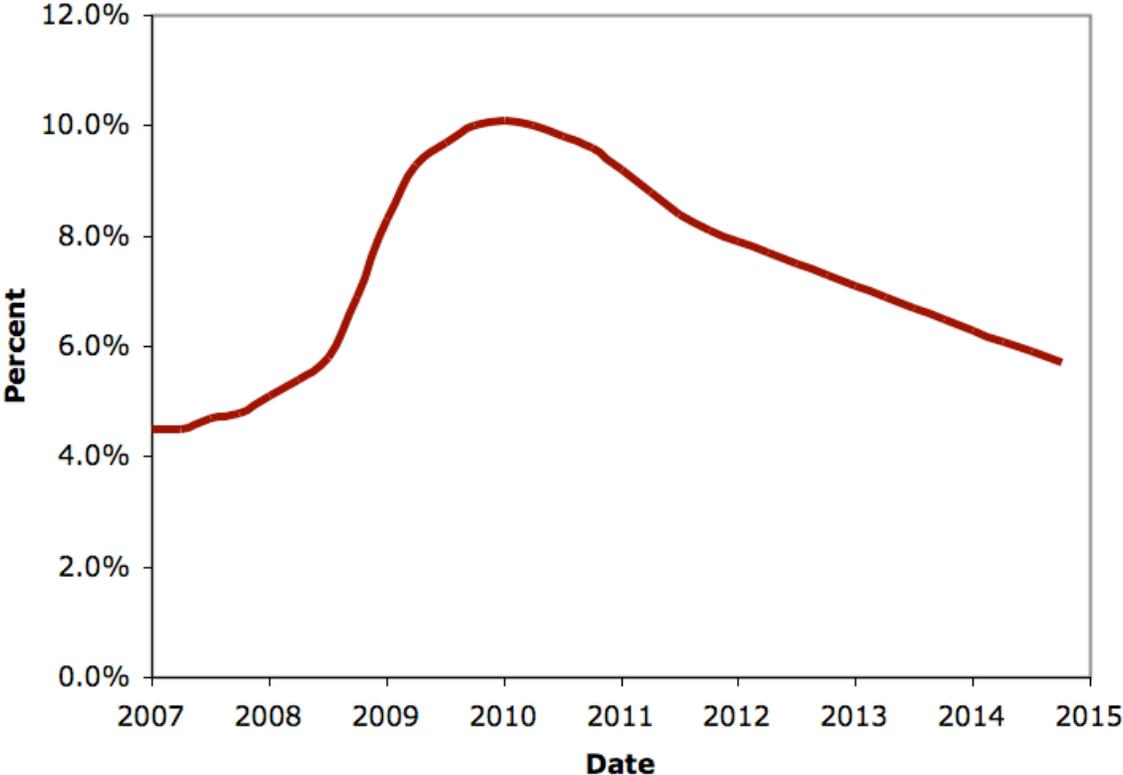
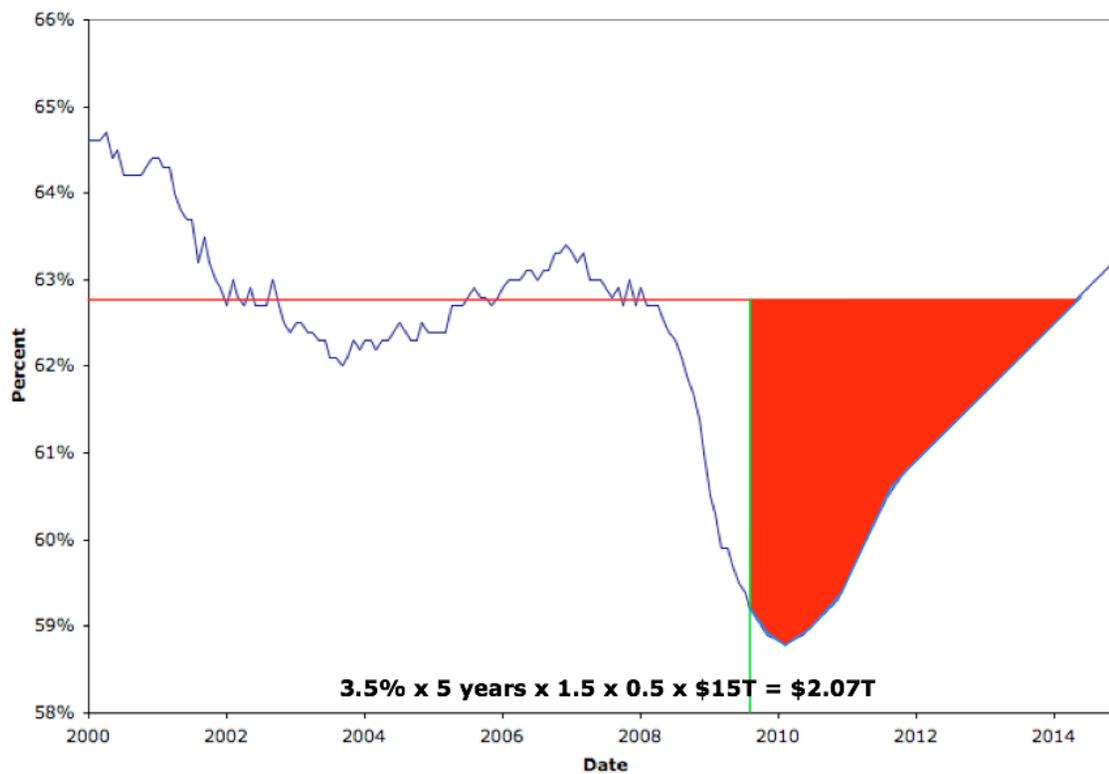


Figure 4: Past and Projected Employment-Population Ratio



What kind of action, however?

(1) Triggers to extend the existing expansionary fiscal policy measures should the unemployment rate not decline rapidly: since we remember the history of the 1937-1938 episode, we are hopefully not condemned to repeat it.

(2) An expansion not in length but in flow of the current fiscal boost package: last January a number of us were saying that an \$800 billion cumulative fiscal boost was OK—but that there also ought to be a trigger in the budget resolution so that if unemployment rose near 10% the fall reconciliation bill could be used to top off the program. That didn't happen. It ought to have happened. It would be nice to make it happen—and there is a deal to be struck with more deficit spending in the short-term and tax-increase or spending-cut triggers in the long term should the deficit not return to sustainable levels after the recession passes.

(3) Less obvious would be measures to aid useful deficit spending in other levels of government: the Treasury Department approving state fiscal policies as sustainable in the long term and thus qualifying for loan guarantees; the Federal Reserve offering to support the prices of state deficit-spending bonds that come attached to legislated sustainable state-level fiscal policies.

(4) Also a possibility: bringing forward long-term investments that we ought to be making over the next generation. The people I talk to at Berkeley who actually know what they are talking about say that over the past decade and a half since the Senate rejected Al Gore's BTU tax the 3 degree Fahrenheit warmer world in 2150 has probably slipped out of our grasp, and that the good possibility going forward is a 7 degree Fahrenheit warmer world in 2150...