

UNDERSTANDING THE STIMULUS DEBATE

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The debate surrounding the stimulus package has become very heated as each side argues that their plan is best and the opposing party's proposal is reckless and irresponsible. Given that a stimulus package has been approved, it is important to put the debate into context and understand the ramifications of the plan.

There are essentially two schools of thought in regards to economic policy – Keynesian Economics and Supply Side Economics. Keynesian Theory, based on the ideas of John Maynard Keynes, argues the best way to stimulate the economy is through the reduction of interest rates and government investment in infrastructure – i.e. deficit spending. It focuses on affecting the demand side of economics by injecting income into the system via public works projects and reduced interest rates, thereby decreasing unemployment, increasing the amount of money in the hands of workers and ultimately stimulating demand. Keynesian Theory also encourages decreased taxes on lower income earners who are more likely to spend the additional dollars rather than save them. It is a bottom-up approach to fixing an economy that is in a recession or depression.

In the alternative, Supply Side Economics focuses (not surprisingly) on the supply side of economics by adjusting income tax rates and capital gains rates, and reducing regulation. By reducing regulation and the marginal tax rates of those with high incomes and capital investments, it allows these businesses and individuals to operate more efficiently and use the saved dollars to invest in new businesses, equipment, people, etc. The incentive to produce more goods and services (which increases the supply) leads to more employment and ultimately consumption – i.e. demand. This is a top-down approach to fixing an economy that is in a recession or depression and is known as “trickle-down economics.”

Conservative economists and Republicans favor supply side economics, taking the view that there is no better way to pump money into the system than to put it into people's hands directly via tax cuts. As a matter of justification of their theory, Republicans point to President Reagan's tax policy as the greatest example of supply side economics working. There is no debating that the economy came out of recession during the Reagan years. Ironically, Democrats point to President Reagan's policies as their ultimate proof that supply

*‘Give me a one handed economist!
All my economists say ‘On the one hand...but on the other hand.’*

Harry S. Truman

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UNDERSTANDING THE STIMULUS DEBATE

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side economics does not work. Democrats argue that President Reagan was able to pull the country out of recession by allowing the deficit to balloon to record levels, not by tax cuts.

Democrats largely dismiss supply side economics as inefficient, arguing that if you give tax breaks to the wealthy, there is no guarantee they will use the dollars needed to stimulate the economy, so much of it will be wasted. Economist John Kenneth Gailbraith said, "If you feed the horse enough oats, some will pass through to the road for the sparrows." He was not exactly a fan of supply side economics.

Liberal economists and Democrats favor Keynesian economics, believing the best way to pump almost a trillion dollars into the economy is to use the money to spend it on projects or programs that will put people to work or keep people employed. Democrats point to President Franklin Roosevelt's policies as the greatest example of Keynesian economics working. There is no debating that the economy came out of the Great Depression during the Roosevelt years. Also, ironically, Republicans point to President Franklin Roosevelt as the greatest example of the failure of this theory, arguing his policies did not work and left massive government programs in their wake. Republicans contend the depression gave way to expansion due to the side effects of World War II rather than due to stimulus spending.

Republicans largely dismiss Keynesian economics, stating that the government is famously inefficient, and most of the dollars would be wasted. The private sector, they argue, will make better decisions with the money. The government should 'give more money to the people and get out of the way.'

Given the Republican Party's distaste for government spending, it is a surprise to many people that President Obama was not the first to put forth a Keynesian plan in this market. In fact, President Bush did so in late 2008, when the government intervened with the Troubled Asset Relief Program (TARP). President Bush authorized setting aside \$700 billion dollars to purchase bad assets from banks, in what was at the time the greatest economic governmental intervention of all time. In doing so, President Bush famously said: "To make sure the economy doesn't collapse, I've abandoned free market principles to save the free market system." With the stimulus plan on the table, President Obama has followed President Bush's course of governmental intervention, also on a massive scale, but with a different philosophy.

It is important to note the common ground between the parties. The vast majority of the members of the Senate and the House, both Democrat and Republican, concur with the Administration that nearly a trillion dollars of 'stimulus' should be pumped into the economy. It is approximated that over 90% of economists agree on this point as well. While there are

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UNDERSTANDING THE STIMULUS DEBATE

Continued...

certainly very vocal exceptions to any type of stimulus, these voices are in the smallest minority.

Both parties are correct that stimulus plans can work, and both parties are right that the other party's theory is inefficient. It is true that the current Democratic Plan will waste billions of dollars. However, even if the dollars go to 'unnecessary' projects or programs, they still are ending up in someone's hands. Thus, the economy receives the full bang for the \$787 billion, it just won't really be buying \$787 billion worth of infrastructure. It is also true that under the proposed (and rejected) Republican Plan, billions of dollars would be wasted. Those that receive the tax cuts don't have a gun to their head to do anything with it, so some of the money won't work its way into the system. However, the majority of it will end up in the hands of individuals who will spend it.

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*President Bush,
2008*

Anytime the government gets involved, regardless of which theory, money will be wasted. Economists even have a term for this: they call it the 'Leakey Bucket' theory. Originally, it was used to describe the problem with supply side economics: by the time the bucket passes from the rich to the poor, it doesn't have as much in it. Now, many use it to describe the problem with any governmental intervention.

The number one rule of economics is the Law of Supply and Demand. No matter which stimulus plan is employed, the Democratic or Republican version, hundreds of billions of dollars will spill into consumers' hands. This increases the supply of dollars, which increases the demand for goods. This is not a debatable point. The only points that are debatable are: (1) Is enough money being spent to create the kind of demand necessary to stop the downward pressure? (2) Would we be better off 'getting to the bottom' quicker by having no plan at all, and letting the system work itself out over time?

So, is this enough money to stimulate the economy? There is much heated debate on this subject, with some equating it to giving a kid an extra dollar per month on top of a twenty dollar allowance. *What is clear is that the stimulus plan alone is not enough.* That is the main reason we are also seeing separate plans being prepared to address the banking system, lending, mortgages, and unemployment.

Would it be better to simply have no plan at all and let the free market decide? It is estimated that less than 5% of economists think this is a good idea. They believe that it interferes with the market fixing itself, thus delaying a recovery or adding to the deficit

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UNDERSTANDING THE STIMULUS DEBATE

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without accomplishing anything. Most politicians, on both the left and the right, think this is a bad idea as well. They simply disagree on the best way to direct the stimulus.

So what are we getting now? We are getting a Keynesian stimulus plan – one that puts government squarely in the middle, creating demand as much as possible. The package devotes 37% to tax cuts (mostly in the form of tax credits), 18% to state and local fiscal relief and 45% to federal social programs and federal spending programs. Ideally, Americans will ‘get something’ out of the spending, like roads and bridges, upgraded electrical grids and other infrastructure. Americans will probably get \$250 billion worth of it for their \$787 billion of spending.

In the short run, it doesn’t matter if the entire \$787 billion is left on street corners for people to just pick up and spend. But, it would be preferable to have something to show for it that will save or make the country money later. *In the long run*, we’ve just added another \$787 billion to our \$11 trillion dollar national debt. Both sides of the aisle agree that is a big problem, which must be dealt with in the not too distant future.