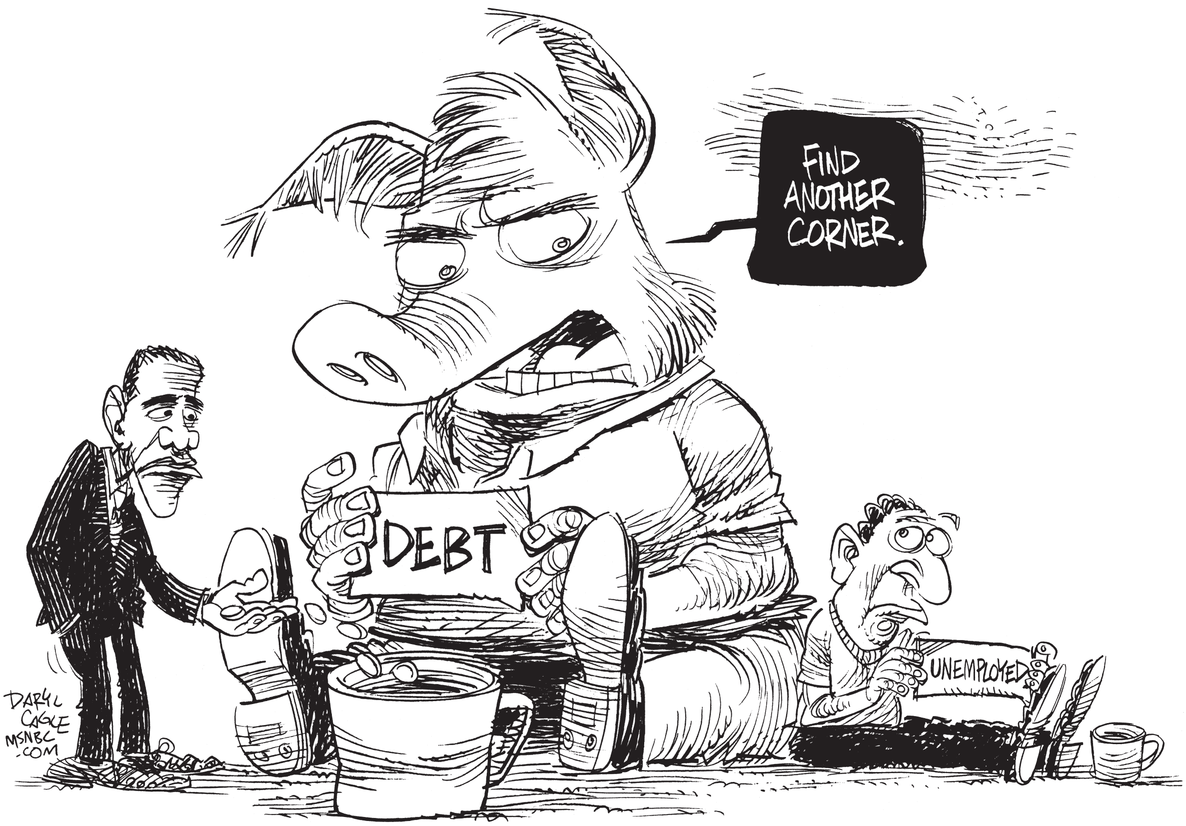
Resource 3 (1 of 4)

Balancing the Budget in the Short Term

Cartoon: "Debt and Unemployment"



by Daryl Cagle, politicalcartoons.com

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Balancing the Budget in the Short Term

What Is Fiscal Stimulus?

Why might a country want to *deliberately* spend more money than it receives in taxes? It may be understandable that, in any given year, the federal budget is not balanced because politicians are reluctant to address deficits by raising taxes or cutting spending, because both tend to be politically unpopular. Nonetheless, would there be any reason to take on additional debt by running a deficit on purpose? Economist John Maynard Keynes argued that, under certain economic conditions, the government should purposely spend more money than it receives (called deficit spending or fiscal stimulus) to help "jump start" the economy.

> Keynes' idea, radical when he proposed it, was that a government could pull a country out of a deep recession by spending money—a lot of money. Congress followed Keynes' advice. In February 2009, it passed a $787 billion stimulus bill.
>
> —David Kestenbaum (2010)

Examples of fiscal stimulus can include tax cuts to individuals, to encourage them to spend more money, or to businesses, to encourage them to produce more and hire more people. It can also include government spending on things like public works (such as the Works Progress Administration during the New Deal) to create jobs, or social services like increasing or extending unemployment benefits to stimulate aggregate demand and ease the short-term pain of an economic recession.

Source: Kestenbaum, D. (2010, August 6). Economists question Keynes-inspired stimulus. Retrieved from http://www.npr.org/templates/story/story.php?storyId=129031780

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Balancing the Budget in the Short Term

Perspectives on Short-Term Stimulus and Borrowing

Perspective 1

Fiscal stimulus is appropriate as insurance because it is the fastest and most reliable way of encouraging short run economic growth at a time when a serious recession downturn would pressure American families, exacerbate financial strains, raise protectionist pressures and hurt the global economy.

Poorly provided fiscal stimulus can have worse side effects than the disease that is to be cured. This suggests close attention to three issues:

First, to be effective, fiscal stimulus must be timely. To be worth undertaking, it must be legislated by the middle of the year and be based on changes in taxes and benefits that can be implemented almost immediately.

Second, fiscal stimulus only works if it is spent so it must be targeted. Targeting should favour those with low incomes and those whose incomes have recently fallen for whom spending is most urgent.

Third, fiscal stimulus, to be maximally effective, must be clearly and credibly temporary—with no significant adverse impact on the deficit for more than a year or so after implementation. Otherwise it risks being counterproductive by raising the spectre of enlarged future deficits pushing up longer-term interest rates and undermining confidence and longer-term growth prospects.

Source: Summers, L. (2008, January 6). Why America must have a fiscal stimulus. Retrieved from http://belfercenter.ksg.harvard.edu/publication/17845/why_america_must_have_a_fiscal_stimulus.htm

Perspective 2

. . . there is no successful example of Keynesian economics. It didn't work for Hoover and Roosevelt in the 1930s. It didn't work for Japan in the 1990s. It didn't work for Bush in 2001 or 2008, and it didn't work for Obama. The reason, . . . is that Keynesian economics seeks to transform saving into consumption. But a recession or depression exists when national income is falling. Shifting how some of that income is used does not solve the problem.

This is why free market policies are the best response to an economic downturn. Lower marginal tax rates. Reductions in the burden of government spending. Eliminating needless regulations and red tape. Getting rid of trade barriers. These are the policies that work when the economy is weak. But they're also desirable policies when the economy is strong. In other words, there is no magic formula for dealing with a downturn. But there are policies that improve the economy's performance, regardless of short-term economic conditions. Equally important, supporters of economic liberalization also point out that misguided government policies (especially bad

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Balancing the Budget in the Short Term

monetary policy by the Federal Reserve) almost always are responsible for downturns. And wouldn't it be better to adopt reforms that prevent downturns rather than engage in futile stimulus schemes once downturns begin?

Source: Mitchell, D. (2010, September 13). Keynes was wrong on stimulus, but the Keynesians are wrong on just about everything. Retrieved from http://www.cato-at-liberty.org/keynes-was-wrong-on-stimulus-but-the-keynesians-are-wrong-on-just-about-everything

Perspective 3

In 1980, I had the privilege of advising Prime Minister Margaret Thatcher to ignore the demands of 360 British economists who made the outrageous claim that Britain would never (yes, never) recover from her decision to reduce government spending during a severe recession. They wanted more spending. She responded with a speech promising to stay with her tight budget. She kept a sustained focus on long-term problems. Expectations about the economy's future improved, and the recovery soon began.

That's what the U.S. needs now. Not major cuts in current spending, but a credible plan showing that authorities will not wait for a fiscal crisis but begin to act prudently and continue until deficits disappear, and the debt is below 60% of GDP. . . .

Source: Meltzer, A. (2010, June 30). Why Obamanomics has failed. *Wall Street Journal*. Retrieved from http://online.wsj.com/article/SB10001424052748704629804575325233508651458.html?mod=djemEditorialPage_h