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U.S. ECONOMIC RECOVERY STALLED IN THREE MARKET SYSTEMS

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Until very recently, there was a disconnect between the financial market and the real economy, the one booming, the other languishing. That disconnection no longer exists. All three market systems--financial, product, and labor--are deeply troubling. The performance of the financial market that is measured moment to moment has been truly alarming. Product market performance that is measured on a quarterly basis of late has been disappointing. Labor market performance that is measured monthly has been lackluster for more than two years. Taken together, the performance of these three market systems indicate that the U.S. economy is not in recovery.

The two private sources of aggregate demand are stalled. Private corporations are holding huge amounts of cash that could be applied to new investments in capital plant and equipment, but they and other businesses will not invest until personal consumption expenditures increase. At the same time, consumers are holding back on spending in order to reduce some of their debt load. Additionally, due to falling prices in the housing market and substantial losses in the stock market, consumer net worth has plummeted making them hesitant to open their wallets. They are stymied by the so-called wealth effect. America is caught in the grip of a producer/consumer syndrome in which neither one will act until the other makes a move.

The other two sources of aggregate demand also are stalled. Government has tried both fiscal and monetary measures to stimulate the economy. The results have been lackluster unless you are willing to accept the argument that the economy would have been even worse off without those measures. Conservative politicians are insisting that the government must take aggressive steps to rein in spending and reduce the burden on the public debt that is climbing toward \$15 trillion and beyond. Liberals respond that cuts to spending at this time would block economic recovery.

Due to their relatively small contribution to aggregate demand, along with serious economic problems elsewhere notably in Europe, exports by themselves are unable to fuel an economic recovery. Moreover, the United States continues to import oil and manufactured goods because those goods are cheaper than U.S. produced goods. Ask any shopper at Wal Mart or Lowe's. Given the way it is estimated, an excess of imports over exports has a negative impact on GDP.

If we are headed toward a double-dip recession, it wouldn't be the first time. It happened in 1957-58/1960-61. President Kennedy's remedy, though Keynesian, did not involve boosting government spending. Instead his administration ordered a rollback of marginal tax rates. The remedy worked so well that university students were taught that "all economics is Keynesian

economics.” The wheels came off the Keynesian revolution in the 1970s when the inflation side of stagflation called for dampening aggregate demand and the unemployment side dictated stimulating aggregate demand. Even though Keynes has lost favor especially among academic economists, the 2009 stimulus package was grounded in Keynesian economics but fell well short of its promise to limit unemployment to 8 percent.

Supply-side economics is attacked by Washington liberals because it targets tax cuts for the rich and those tax breaks they argue do not trickle down to lower-income families and households. As for the laissez-faire economics inspired by libertarian Ayn Rand that informed Alan Greenspan as chairman of the Federal Reserve, Greenspan’s own sheepish admission in Congress regarding its gross failure cautions against trying it again.

As to more recent monetary policy, the Federal Reserve has driven interest rates to historical lows, loaded up its balance sheet with the toxic assets of the financial sector, and padded the excess reserves of banks in order to make possible more credit creation. None of these three initiatives has produced the intended results.

What can be done to turn the U.S. economy around? First, even though it is no panacea, adopt the Milton Friedman’s MONETARY RULE that offers promise of bringing greater stability to financial markets that sorely need stability. Second, PATIENCE. It took from September 1983 to June 1997 for the jobless rate to drop from 9.2 percent to 5.0 percent and stay at that level or lower for the next four years.

PATIENCE until the huge housing inventory is cleared. PATIENCE until Washington lifts its restrictions on domestic oil exploration that would boost jobs, reduce imports, and strengthen national output. PATIENCE until Congress finally acts aggressively and effectively to reduce the budget deficit and adopts a plan to deal with entitlement spending and shrink the public debt. PATIENCE while American households work off their debts, cope with foreclosure, and turn to bankruptcy to settle what they can’t otherwise handle. PATIENCE until goods produced in America replace cheap imports from China. PATIENCE as the banking system restructures itself to absorb the assets of the hundreds of failed banks since the start of the Great Recession. PATIENCE until economic recovery produces more jobs, especially year-round full-time jobs where the poverty rate is below 3 percent.

The second remedy demands much of Americans who insist on instant results. But PATIENCE is necessary to heal the damage to the economy that can be traced to a federal government and householders who borrowed and spent recklessly with little regard for when the bills would come due and to a financial sector that sold risky products to unsuspecting customers.

The bigger the binge, the worse the hangover. A pity there is no prohibition to keep governments and economic agents from their own intemperance.

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