



Money matters in slumping US Keynesians' advice to Obama comes unstuck

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The US recession officially ended in June 2009, but a normal post-recession boom failed to materialise. Instead, we have seen an unwelcome slump. Since the recession bowed out, the average annual GDP growth rate has been a paltry 1.6% – well below long-run trend growth of 3.1%. The Obama administration's policy prescriptions – contrary to the president's assertions – have failed to mitigate the damage from the Panic of 2008-09. Rather, they have kept the patient in sick bay.

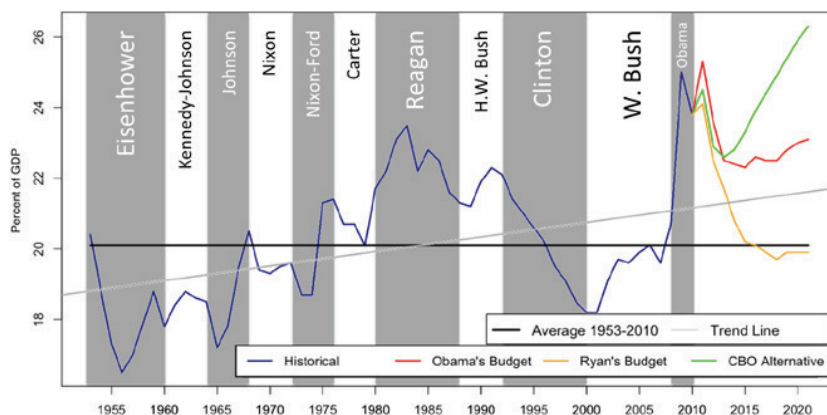
The first misguided advice was peddled by the Keynesian fiscalists who dominate the stage in Washington. According to them, increased government spending, accompanied by fiscal deficits, stimulates the economy. That dogma doesn't withstand factual verification – underlined by former President Clinton's massive fiscal squeeze. During his time in office between 1993 and 2000, government expenditures fell from 22.1% of GDP to 18.2%, as the chart shows. During his final three years, the federal government generated fiscal surpluses. Clinton was confident enough to claim in his January 1996 State of the Union address that 'the era of big government is over.'

President Clinton's squeeze didn't depress the economy. Instead, his display of Victorian fiscal virtues boosted confidence, and the economy boomed. Yet Clinton clearly didn't anticipate the uncontrolled government spending that accompanied George W. Bush's eight years in office and the truly shocking two years' worth of government spending under Obama. These two administrations have added a whopping 5.6 percentage points to government spending as a proportion of GDP. Current federal government outlays are at a high of 23.8%, well above the 20.1% average. The surge in government spending – coupled with President Obama's anti-market, anti-business and anti-bank rhetoric – does not inspire confidence.

In addition, it is important to stress what the fiscalists refuse to acknowledge: money dominates. When fiscal and monetary policies move in opposite directions, it is monetary policy that will dictate the economy's course. During the Clinton era, fiscal policy was tight, confidence was high and monetary policy was accommodative. The economy boomed. Since the Panic of 2008-09, fiscal policy has been ultra expansionary, while the growth in the money supply (M3) fell from a peak annual growth rate of over 15% to an annual rate of contraction of over 5%. No surprise that the economy suffered a serious recession and then only a modest and fragile recovery. In view of the current anaemic money supply growth rate (1.8%), it looks like the slumping economy will, unfortunately, be with us for the foreseeable future. Money matters. ☒

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Federal expenditures as % of GDP



Graphic applies to President Obama's 2012 budget compared with Congressman Paul Ryan's budget and Congressional Budget Office alternative