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Spring / Summer 2009

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Welcome!

Our Spring / Summer 2009 issue of *Canadian Student Review* features articles written by students, for students, addressing and challenging the public policy matters of today.

This issue offers perspectives on the regulation of financial markets, the efficacy of Canada's recent GST cuts, and why students shouldn't worry about their co-op job prospects during the economic downturn. This issue also includes a special feature, "Understanding economics in the news" (pg. 4), which provides a critical analysis of the media's representation of the recession.

CSR welcomes all students to submit articles on economics and public policy—no experience necessary! Check out the back cover of this issue to find out how you can get published in *CSR*.

Best Wishes,

Courtenay Vermeulen
Assistant Editor

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UNDERSTANDING Economics in the news

What is a recession?

by **Carlos A. Murillo**

Canada Faces Recession – and a Political Crisis Too
– Time Magazine, December 15, 2008

Brutal Arrival of Recession in Canada
– Financial Post, December 5, 2008

Worst Crisis Since 30s, with No End in Sight
– Wall Street Journal, September 18, 2008

With sensationalist headlines like these, it is easy to believe that Canada may have entered a recession as early as the third quarter of 2008. GDP,[1] an important economic indicator, and the unemployment rate[2] are both objective measures that can tell us whether we have entered a recession. However, the media often applies a subjective definition of recession to their economic assessments—a "few" months of contracting GDP (Economist, 2009)—which does not allow for meaningful analysis or comparisons.

Growth in GDP means that the economy is expanding, whereas contraction in GDP means the economy is shrinking. To measure economic recession, we need an objective definition. The Oxford Dictionary of Economics defines recession as "a situation when demand is sluggish, real output is not rising, and unemployment is increasing. A recession is usually identified when **real GDP falls for two successive quarters**" (Black, 2003; emphasis added).

So did Canada or the US really reach recession in 2008? Figure 1 shows that changes in Canadian GDP (2008, Quarter 1 to Quarter 4) remained positive up until the fourth quarter when the economy contracted by 3.52%. Unemployment increased by half a percentage point over the year.

The United States also maintained positive growth in GDP up until the fourth quarter of 2008. The increase in unemployment was sharper in the United States than in Canada, with almost a 2 percentage point increase from Q1 to Q4. However, in both countries GDP fell during only one quarter in 2008: the fourth quarter.

However, the 1.47 percentage point drop in US GDP in Q4 was still significant. In real dollar values [3], the effect of the contraction in the United States' GDP translates into CA$261,375 million - almost CA$300 billion – which is larger than the annual GDP of many nations! The enormous effect that the falling US GDP has had on all economies may have seemed to justify the use of words like "recession" and "crisis" in news headlines throughout the fourth quarter of 2008. The 3.52% contraction in Canada's GDP over the same time period translates into CA$57,560 million (OECD, 2009).

Economic analysis in the media can be very subjective. Neither the Canadian nor the US economy had technically entered a recession as of the last quarter of 2008. A better understanding of how basic economic indicators are properly used to measure an economic recession provides us with a critical eye for news headlines, and makes it easier for us to perceive the true costs and benefits of public policy initiatives intended to respond to economic circumstances. ■

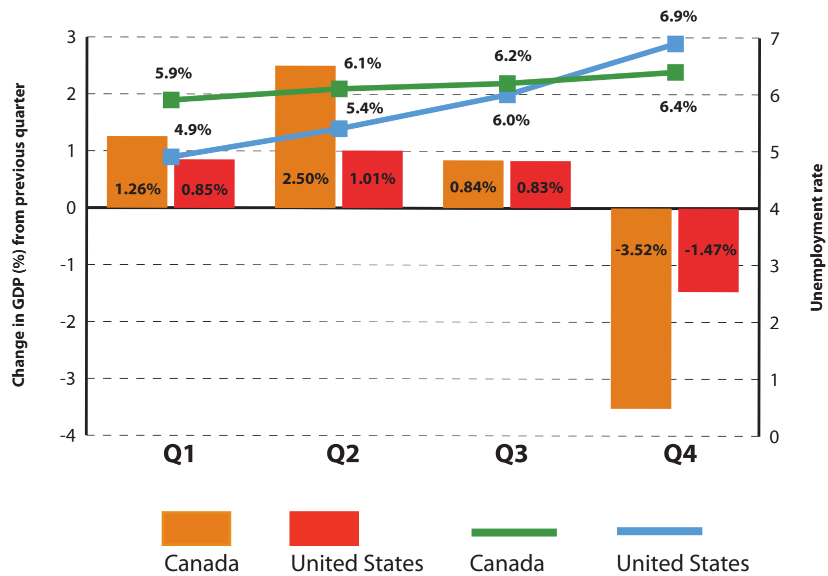

Figure 1: Quarterly employment rates and percentage (%) change in real GDP, Canada and the United States, 2008*

*Note: Most recent data available at the time of publication. In 2009 Q1 we will likely see a contraction in GDP.
Source: OECD, 2009.

Notes

1 GDP is the unduplicated value of all goods and services produced in a year within a nation's borders, measured at market prices. It is the standard measure of the overall size of the economy (Canada, 2007a).

2 The unemployment rate is the percentage of the labour force that is actively seeking work but is unable to find work at a given time. Discouraged workers—persons who are not seeking work because they believe the prospects of finding it are extremely poor—are not counted as unemployed or as part of the labour force (Canada, 2007b).

3 The effects of inflation have been removed.

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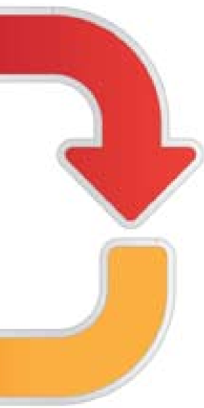
Breaking the cycle of financial

by **Thomas Thorn**

It seems as though financial markets are caught in an endless loop. Each scandal or crisis that rocks financial markets is inevitably followed by calls for more regulation. New regulations are then rushed into place without care for their efficacy, enforceability, or their impact on markets. And while the public's radar becomes narrowly tuned to the old types of scandals, new, unseen genres of fraud inevitably crop up. At some point this cycle needs to end.



After the collapse of Enron in 2001, the American government answered calls for increased regulation with the Sarbanes-Oxley Act. In an effort to increase market transparency, this act ratcheted up reporting requirements for public corporations, forcing a large number of firms to restate their past earnings (*Boston Business Journal*, 2003, July 29).

But was the burden imposed on corporations by the Sarbanes-Oxley Act necessary?

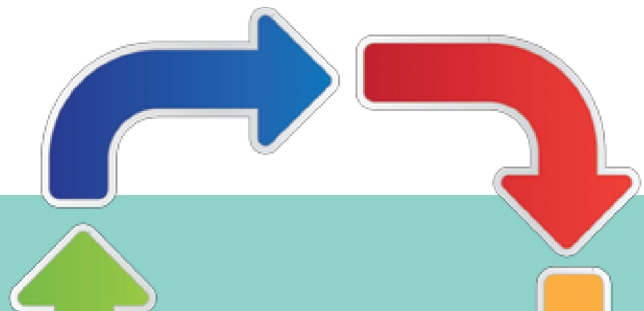
After the scandals that rocked Enron, Tyco, WorldCom, and Global Crossing, investors were forced to take another hard look at the financial statements of the companies they owned, rather than simply relying on an auditor's report. In the case of the Enron scandal, the fraud was uncovered by journalists and analysts who were taking a *first* look at Enron's books; in many cases, this was the *first* review of the company's financial statements done by someone other than a hired auditor (Gladwell, 2007, Jan. 8). Furthermore, in the wake of these scandals, accounting firms were forced to change the way they interacted with their clients during audits in order to maintain the credibility that makes their services valuable to clients.

Simply put, market participants would have found their own way of dealing with the problem. While it may be the case that the Sarbanes-Oxley Act ended up helping investors, it is unclear whether the problem would have persisted in the absence of new regulation. Nor was new regulation needed to discourage similar crimes; existing regulations proved stringent enough to put the key players in these scandals behind bars, creating a strong disincentive for potential copy-cats.

The biggest problem with Sarbanes-Oxley, however, is not its efficacy; it is a problem that is inherent to all regulation. Regulators act like bad generals: they always fight the last war. After Enron, regulators were on the lookout for similar kinds of accounting fraud. They were not, however, looking for Ponzi schemes, mortgage fraud, or any of the other problems that ended up plaguing the markets. So diverted was the Securities and Exchange Commission's (SEC) attention that when a financial fraud investigator, Harry Markopolos, handed the SEC overwhelming evidence of a major Ponzi scheme, he was ignored (Markopolos, 2005). Similarly, the SEC recently shut down the Stanford Bank after reportedly investigating it for two to three years, and yet had not pressed charges for a fraud (Bernard, 2009, Feb. 17) that took the blogging community mere minutes to uncover (Dalmady, 2009).

But despite the obvious shortcomings of regulators, this is not an argument against regulation; some level of regulation may be necessary or appropriate. Regulation is not, however, a cure-all that can be haphazardly applied to every problem. It is possible that poorly crafted or poorly enforced regulation is worse than no regulation at all. Consider the Bernard Madoff Ponzi scheme, through which a rogue funds manager scammed nearly $50 billion from investors (Zambito and Smith, 2008, Dec. 13). A video circulating the internet shows Mr. Madoff telling a room of investors that "in today's regulatory environment, it's virtually impossible to violate rules … It's impossible for you, for a violation to go undetected, certainly not for a considerable period of time" (Madoff, 2007). Madoff was effectively telling investors that because the market was regulated, they no longer had to pursue due diligence. Although this was poor investment advice, it does accurately describe a potential hazard created by regulation. Investors see less need to investigate the companies they own if they think those companies are bound by a well-enforced, well-crafted set of regulations. Since the regulations supposedly applying to Madoff were not enforced (Weidner, 2008, Dec. 16), they made the problem worse by giving investors a false sense of security.

Another example of regulation gone awry comes from the European Union. European banks face a far higher level of regulation than American banks do, yet they are suffering far greater losses than their American counterparts in the current economic crisis. Bad loans to Eastern European and South American countries, coupled with large purchases



of subprime-backed mortgage securities, have left the European Union's banking system on the verge of collapse (Evans-Pritchard, 2009, Feb. 15). The decline in the value of these assets was compounded by large amounts of leverage. International Monetary Fund data shows that European banks were effectively twice as levered as their American counterparts (Evans-Pritchard, 2008, Oct. 10). Twice as much leverage means that asset prices need to decline by half as much before a bank becomes insolvent. High levels of regulation gave these banks false credibility and cultivated the expectation of bailouts, prompting them to take enormous amounts of risk.

It is unclear whether regulation in either the United States or Europe helped or hindered investors. However, the fact that new forms of fraud continue to appear in financial markets suggests that our society should rethink its knee-jerk regulation increases. In the very least, market regulators like the SEC or the Office of the Superintendent of Financial Institutions (OSFI) in Canada, along with provincial securities regulators, should only implement regulations they can enforce.

Regulators should investigate and alert the public to new scandals as they emerge, but if we do not change the way we approach regulation, our financial markets will slowly lose efficiency. Each subsequent scandal will result in more ineffective and ill-considered regulation. In order to ensure the health and efficiency of our financial markets, we must take care to only adopt regulations that are effective and enforceable, while avoiding those which prompt investors to abandon due diligence. ■

Thomas Thorn is pursuing a Master's degree in Economics this fall at the University of Victoria, with a focus on financial economics. He is also pursuing the Chartered Financial Analyst designation.

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How effective are GST cuts?

by **Patrick Gervais**

Recent cuts to the goods and services tax (GST) rate have resulted in a significant loss of federal government revenue. Although politically popular, these cuts are not the most efficient way of stimulating the economy. Research shows that consumption taxes are the least damaging type of tax in terms of their effect on economic activity (Baylor and Beausejour, 2004). Other taxes, such as corporate and personal income tax, are far more damaging to the economy (Baylor and Beausejour, 2004) and thus should have been the focus of recent tax reductions.

The federal government reduced the GST from 7% to 5% over the past three years through two one percentage point cuts in July 2006 and January 2008 (Canada, Department of Finance, 2007). While this provides some tax relief for Canadians, cutting the GST is not the most efficient way to stimulate economic growth and wealth creation. A better approach would have been to reduce personal income tax rates.[1]

The reduction in federal government revenue resulting from the July 1, 2006 GST cut was an estimated $3.52 billion in 2006/07 and $5.17 billion in 2007/08, for a total loss of $8.67 billion in the first two years following the cut (Canada, Department of Finance, 2006). The second GST cut, which came into effect on January 1, 2008, cost an additional $6 billion in federal government revenue in its first year, a figure that will increase to $7.1 billion by 2012/13, for a total loss of $34.2 billion in the five years following the cut (Canada, Department of Finance, 2007). The combined GST cuts are estimated to amount to $72.7 billion in lost revenue between 2007 and 2013 (Canada, Department of Finance, 2007) (see table 1).

Although the cuts have the noticeable benefit of reducing the cost of day-to-day consumer transactions, economic evidence suggests that they are not the most efficient way of reducing taxes (Clemens et al., 2007). Taxes act as incentives that influence individual behaviour. Thus, the main objective of fiscal policy should be to reduce the types of taxes that impose the greatest impediment to economic growth and wealth creation.

One method of quantifying the cost associated with specific taxes is through an analysis of marginal efficiency costs[2] (Clemens et al., 2007). Several studies show that consump ciency cost while capital-based taxes, such as corporate and personal income taxes, have a higher marginal efficiency cost (Clemens et al., 2007).[3]

For example, a recent federal Department of Finance study estimated that the marginal efficiency cost to the economy for each additional dollar of tax revenue from a consumption tax in Canada is $0.10, while it is $0.45 for the corporate income tax and $0.30 for personal income taxes (Baylor and Beausejour, 2004). Thus, consumption taxes are three times less damaging to the economy than personal income taxes, and 4.5 times less so than corporate income taxes. This suggests that in order to maximize the economic efficiency of the tax system, tax reductions should focus on taxes that impose the highest marginal efficiency cost.

A practical example can help illustrate why the marginal efficiency cost is lowest in consumption taxes and highest in corporate and personal income taxes. Because capital is mobile, companies can choose where to make their investments. High capital taxes act as a deterrent to investment in highly taxed jurisdictions, while acting as an incentive to investment abroad where costs are lower. Labour is also mobile, although to a lesser extent. High personal taxes not only deter Canadians from working more, but they also act as an incentive for high salaried employees to seek ways of

The federal government missed a unique opportunity to provide real stimulus to the economy

YEAR	07/08	08/09	09/10	10/11	11.12	12/13	TOTAL
Tax relief provided by combined GST cuts	7.1	12.0	12.6	13.2	13.7	14.2	72.7

Table 1: Lost federal government revenue due to recent GST cuts, 2007/2008 to 2012/2013 (in $ billions)

reducing taxes—namely, by seeking opportunities abroad. Consumption taxes are less influenced by mobility because shopping for goods and services is limited by physical constraints. Other than the small fragment of the population that is highly mobile, the vast majority of Canadian consumers will not be influenced by minor sales tax fluctuations because the alternative option of consuming abroad is not easily available.

Therefore, the federal government would have better served Canadians by using the billions of dollars in lost revenue resulting from the GST cuts to reduce personal income taxes. Cutting personal incomes taxes would have improved the incentives for individuals to work, invest, and engage in entrepreneurial activity. Unfortunately, politics trumped sound economic policy as the federal government missed a unique opportunity to provide real stimulus to the economy. ■

Notes

1 A personal income tax cut is more effective than a GST cut, but there are other tax reforms that are also more effective, including corporate income tax cuts and the harmonization of provincial sales taxes (PST) with the GST. The latter types of tax reductions are not discussed in this article for brevity's sake.

2 An analysis of marginal efficiency costs calculates the cost of raising one additional dollar of tax revenue using different types of taxes.

3 When analyzing the cost of taxation, one should also consider the compliance and administration costs, borne by taxpayers and governments, that are associated with particular taxes (Clemens et al., 2007: 11-14).

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Things folks know that just ain't so

Making welfare programs less generous creates more poverty

Why it ain't so…

by **Courtenay Vermeulen**

For employable individuals living in poverty,[1] the cash and in-kind benefits available through welfare programs are intended to provide temporary relief until an individual can support him- or herself independently. However, when these programs fail to help people out of poverty, some blame the welfare system and argue that it is not generous enough. A study completed in 2002 by Chris Schafer and Jason Clemens, *Welfare Reform in British Columbia: A Report Card,* tells a different story.

In the late 1990s, welfare reforms were necessary in both Canada and the United States due to ballooning social assistance costs (Schafer and Clemens, 2002). The 1990s saw unprecedented numbers of both Canadian and US citizens on the welfare rolls. Welfare dependency peaked in both countries in 1994 with 3.1 million (10.7% of the population) and 14.2 million (5.5% of the population) people receiving social assistance in Canada and the United States, respectively (Schafer and Clemens, 2002). While reforms were necessary, many people were skeptical and feared reforms would result in an increased incidence of poverty.

Unsustainable financial burdens led governments in both Canada and the United States to move forward with social assistance restructuring. By 1996, many US and Canadian welfare systems had introduced various reforms that reduced and limited the public's access to welfare. The systems were redesigned to become work-focused, temporary assistance programs. Several measures, including time limits, diversion strategies,[2] and work requirement sanctions,[3] among other reforms, were implemented to achieve this goal (Schafer and Clemens, 2002). Following these reforms, the number of people who were dependent on social assistance decreased in both countries, demonstrating that reducing the generosity of welfare programs does *not* lead to increased poverty levels. In fact, the data tell us just the opposite: making welfare programs less generous actually *lowers* the incidence of poverty (Schafer and Clemens, 2002).

The report by Schafer and Clemens (2002) examined several follow-up studies on the reforms. A 1999 study by the US General Accounting Office (GAO) found that, after the reforms, between 61% and 87% of those leaving the welfare system obtained employment (GAO, 1999). That finding is similar to other exit surveys conducted in Canada (Levy-Coughlin Partnership, 1996; Ekos Research Associates Inc., 1998). Another study done in 2000 found that the average earnings of former welfare recipients rose steadily in the year after welfare benefits were reduced (Issacs and Lyon, 2000), a finding consistent with other studies, which suggests that earning the minimum wage or being in a state of low income is largely a temporary experience, and that individuals go on to earn more once they gain experience and job-related skills (Long, 1999; Godin and Veldhuis, 2009).

Perhaps most surprisingly, another follow-up study found that those groups traditionally considered most disadvan-

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taged—young mothers, mothers with young children, high school dropouts, black and Hispanic single mothers, and those who have never been married—experienced the greatest decline in welfare dependency after leaving social assistance, with employment gains being the largest for disadvantaged single mothers (O'Neill and Hill, 2002).

In a 2002 study, the US Department of Health and Human Services found that, along with falling dependency rates spurred by welfare reforms, the poverty[4] rate actually dropped from 13.7% in 1996 to 11.3% in 2000, the lowest rate since 1979 (USHHS, 2002). What happened? Why did making welfare programs less generous correspond with a lower incidence of poverty? The answer lies in a basic economic principle that can explain virtually *all* individual choices and behaviours: incentives.

Welfare is just like any other good or service bought and sold in the economy: when it is associated with a low cost or high benefit, it will experience higher demand. If welfare is more generous than a low-paying job and is unlimited, the incentive for people to work and eventually achieve upward financial mobility is diminished. In contrast, a system with limited benefits and stiffer eligibility rules increases the costs of welfare use; if you use welfare this month, you forego the opportunity to use it another month in the future. This creates an incentive for people to use the system only when they need it most.

The facts suggest that a generous welfare system alone cannot diminish poverty. But welfare reform that increases the "price" of using the system can alter individuals' incentives and encourage behaviour that will lead to a successful job search. An incentive to find work is the first step to climbing out of poverty and obtaining a better standard of living.

Notes

1 The word "poverty" does not on its own suggest any particular definition of the term. People often use the term to refer to relative measures of poverty, which measure the proportion of the population earning less than a particular share of the national average income. By this definition, there will always be people living in relative poverty. On the other hand, absolute poverty can, in theory, be eradicated. In this article, "poverty" refers to absolute poverty—which is defined as an inability to access resources to provide for the basic essentials of food, clothing, and shelter—because measures of relative poverty tend to overestimate the number of people without basic essentials.

2 Diversion strategies are attempts to divert potential welfare recipients to other types of assistance before they enter the welfare system.

3 Those who are able to work must do so or face penalties through reduced benefits.

4 The US Census Bureau measures poverty using a set of income thresholds that vary by family size and composition. This measure is more inclusive and may not reflect the true proportion of people living in *absolute* poverty.

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Co-ops are worth your time

by **Alicia Woodside**

At a recent information session entitled "Co-op jobs in today's economy," co-op students from the University of British Columbia's Sauder School of Business voiced their concerns about how the economy may affect their work opportunities. Students anxiously asked, "Will the opportunities come?" and "Will my job still be there in the summer?" There was considerable concern in the room.

But what these students didn't know is that they are arguably in a great position to deal with the crisis. According to Jobpostings, a student-focused career magazine, "a recent survey by the Canadian Association of Career Educators and Employers (CACEE) projects graduate recruitment will decline in 2009…[however] roughly forty percent of survey respondents also reported plans to increase co-op hiring" (CACEE, 2008).

The magazine also points to the University of Waterloo's experience during the recessions of the 1980s and 1990s, which brought a decrease in overall graduate recruitment but an increase in co-op opportunities.

Though companies are employing fewer staff than they were previously due to cutbacks, projects still need to be completed. This is where the co-op student comes in. With co-op students, employers get keen students who are ready to prove themselves in a work environment. They are motivated and they are comparatively cheap: co-op employers aren't required to pay students benefits and are able to avoid the long-term financial commitment of a permanent employee.

In addition, using the co-op system saves companies in recruitment costs—they are targeting a more defined group, and the co-op office can even help locate appropriate students for a specific role.

Chevron Canada recently filled a temporary hire position with a co-op student, rather than going through a staffing agency—their traditional route. "We had a supervisor who had a temporary position available, and because we were trying to cut costs wherever possible, she chose to hire a co-op student instead," said Diane Chung, human resources administrator for Chevron Canada (Woodside, 2009, Feb. 10).

Lynne Murchie, director of the co-op program at the Sauder School of Business, reiterated the message of increased opportunities for students. When asked about her predictions in today's economy, she replied optimistically and added that the number of postings this year for the Commerce co-op program is in line with numbers from previous years.

Employers may be inclined to hire co-ops for a number of reasons beyond efficiency. For instance, the BC provincial government requires that a certain number of co-op students be used to fill staffing needs. Within the federal government, co-ops will likely be a strategy to cushion the current hiring freeze, which prevents only the hiring of permanent staff.

Taking advantage of a co-op program puts students in a great position to weather the economic downturn and gain valuable work experience for the future. As permanent hiring decreases, as is expected, companies will look toward the lower commitment and high reliability that co-op opportunities provide.

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Alicia Woodside is a third-year Marketing and International Relations student at the Sauder School of Business. She is currently completing her first Co-op term with the provincial government at the 2010 Olympic and Paralympic Winter Games Secretariat. In her free time, she writes for The Ubyssey News, and competes for the University of British Columbia track and field team in the marathon.

HOT TOPICS!

Canada falls behind on trade with China

Canadian trade with China represents just a miniscule portion of Canada's overall international trade, and the country has a long way to go to fully take advantage of the opportunities presented by one of the world's fastest growing markets, concludes a new study by the Fraser Institute: *Canada's Economic Relations with China*.

Just 2% of Canadian exports were sent to China in 2007, while 80% of Canadian goods were exported to the United States. In terms of imports, Canada imported 9% of its goods from China, while more than 50% of its imports originated in the United States.

"While Canada enjoys a robust trade relationship with the United States, and this shouldnot be neglected, the economic recession experienced by our neighbour and largest trading partner shows the necessity for Canada to find expanded markets for its goods and services," says Mark Mullins, Executive Director of the Fraser Institute. ■

The complete study is available at www.fraserinstitute.org.

Annual mining survey reveals gloomy outlook

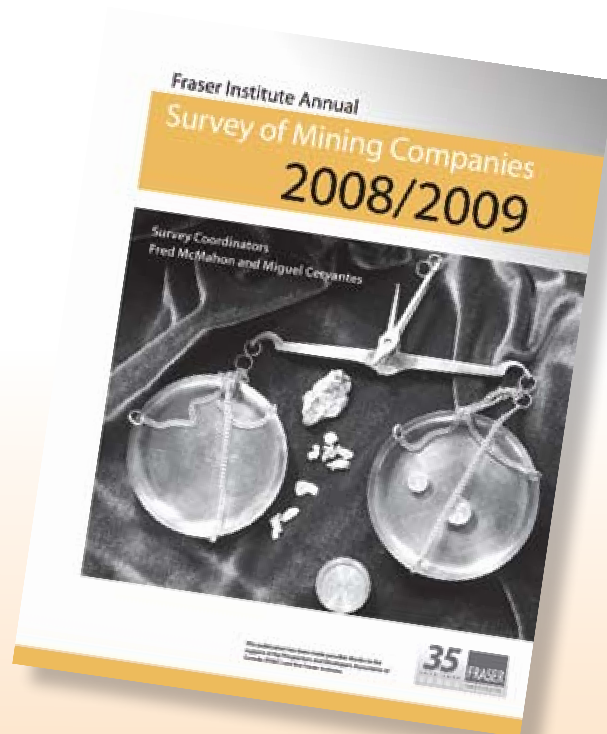
The global economic slowdown has cast a pall over the mining industry with the vast majority of mining executives saying they expect a severe pull back in exploration activity and at least 30 per cent of exploration companies going out of business, according to the Fraser Institute's *Survey of Mining Companies 2008/2009*.

"Survey responses indicate that the mining sector expects dramatically decreased investment plans, along with a large number of companies either reducing activity or going out of business all together," said Fred McMahon, coordinator of the survey and the Institute's Director of Trade and Globalization Studies.

Despite the overall gloom, industry executives give many of Canada's provinces top marks for policies that encourage mineral exploration and development.

For the second year in a row, Quebec was ranked number one overall in the annual survey. Wyoming earned the number two spot, while perennial favourite Nevada dropped one spot to number three. Alberta was the second highest ranked Canadian province at number four overall. ■

The complete study is available at www.fraserinstitute.org.



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Ask the Professor

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Here's an excerpt from a recent Ask the Professor discussion on Inflation with Steven Horwitz, Charles A. Dana Professor of Economics at St. Lawrence University in Canton, New York:

Dr. Horwitz says:
The cause(s) of the onset of the Great Depression is among the most debated topics in all of economic history. Economists associated with the "Austrian School" argue that even though price levels were largely stable during the 1920s, they concealed a significant increase in the money supply caused by the Fed (productivity gains offset the upward pressure on prices coming from the money supply). Those inflationary pressures created an unsustainable boom in the economy that finally broke with the recession that began in the summer of 1929, which itself was then reflected in the rapid downward valuation of stocks in the fall. Some point to the international effects of the managed gold standard then in place as the cause of the depression, while others point to speculation in the stock market. Although my own sympathies lie with the Austrian story, the one thing virtually all economists agree on is that the typical explanation given in a high school history class is wrong.

The US economy of the 1920s was hardly an example of "laissez-faire." Governments at both the state and federal level were highly involved in the economy in a variety of ways, several of which were very relevant to the Great Depression. Also, the US Federal Reserve was a major player in the economy, and although it is technically privately owned, it operates with government-granted monopoly privileges that would not exist under a laissez-faire system.

Shari asks:
Would you say that the government is more laissez-faire today than it was at the time of the Great Depression. A lot of people blame the current economic downturn on greed running wild. What do you think?

Dr. Horwitz answers:
Great question! I've actually written an op-ed on the greed issue, which you can find here: http://www.csmonitor.com/2008/1022/p09s01-coop.html. More generally, I think government is much more intrusive in the market today than it was back in the 1920s. It was still very much involved in some key ways back then, and in ways that mattered in terms of how we got into the Great Depression. But today, the government is so much bigger in scale and scope and has its hands in so many places. The current crisis is a good example, as the Fed once again is a culprit (this time via inflation rather than deflation), but so are all of the various regulations and policies that artificially encouraged the growth in the housing market, which is at the root of its collapse.

People today, including the new president, who are blaming this crisis on "deregulation" need to tell me just what deregulation they're talking about when the size of the government has skyrocketed in the last eight years in the United States under Bush; there's been no deregulation of financial markets since the Clinton years.

So this isn't a stimulus plan. It's the Patriot Act for the economy. And that's not good.

Freddie Mac asks:
Can you provide a critique of Obama's stimulus plan? Are there any features you think would be helpful to actually "stimulating" the economy, or might it all just be for the sake of "doing something"?

Dr. Horwitz answers:
My own best effort at a critique is here: http://austrianeconomists.typepad.com/weblog/2009/01/stimulus-or-carpe-diem-the-new-deal-wasnt-a-stimulus-package-either.html.

The quick summary is that little if any of it will stimulate much of anything. When governments spend, the resources have to come from somewhere and the decline in that line

of spending will offset whatever governments do. It might be the case that current GDP rises a bit, but only at the expense of the future if the funds are borrowed. In any case, it's not going to do much—neither did the New Deal in the 1930s.

What the stimulus plan shares with the New Deal is that it's not a stimulus plan. It's a bunch of programs that politicians, Democrats especially but not only, have wanted to pass for years and now have a chance. In that way, it's an economic Patriot Act: presented with a crisis, the government responds the only way it knows how—by pulling all kinds of programs off the shelf, claiming that there will be a disaster if we don't pass them, and then ramming them through the voting process so quickly that they can't be read, digested, and debated.

So this isn't a stimulus plan. It's the Patriot Act for the economy. And that's not good.

Query asks:
Is there any government action that is actually helpful to the economy during downturns like the current one?

Dr. Horwitz answers:
The most important thing the government can do (other than to stop doing bad stuff!) is to act in ways that are clear, transparent, and predictable. In many ways, governments that flail around and experiment are the worst problems of all because their actions generate enormous uncertainty for the private sector, which then hesitates in investing and hiring. So governments should reduce their burden on the economy (through reduced taxes, regulation, spending, etc.) and make sure that they supply enough, but not too much, money. And if they decide to do more, they should do it clearly and transparently and should announce a plan and stick to it. But that "doing more" is likely to be harmful in and of itself. It's worse if they flail around, though.

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