

USD-JPY \$98.405 ▲ 0.37%

S&amp;P TSX 7,591.47 ▼ 0.49%

S&amp;P 500 683.38 ▲ 0.12%

OIL \$45.52 ▲ 4.38%

GOLD \$942.00 ▼ 0.07%

## Mr. Market: Pink-Slipped by Federal Stimulus?

BY JASON AMARO

As we can infer from the abysmal corporate earnings reports being dropped like bombs lately, consumers have severely curtailed their spending as confidence has waned. Labour, investment and inventory are all on the corporate chopping block. Consumers, once relieved that commodity prices were taking a dive, are now facing the sobering reality that these downward pressures were actually a function of a slowing economy preparing to deliver higher unemployment. As the demand for goods and services suddenly drops and spurs layoffs, diminishing employee confidence produces spending cuts and yet another round of decreasing consumption, precipitating a downward spiral of trade.

This is where Mr. Obama and Mr. Harper step in. The stimulus packages are designed to fill consumers' demand shortfall by forcing current consumption. Plainly spoken, if Jimmy or don't want to spend their money but instead prefer (indirectly) to produce unemployment on the other side of the economy, then the government will gladly spend money for them and bill them later in the form of higher taxes. This, of course, is done to try and limit the amount of unemployment (read: political unrest) in society. What do Jimmy and Janie get? They get some brand new roads, bridges, aqueducts or anything else the government sees fit to spend on.

One might ask; if we really needed roads or aqueducts, then why didn't we build them before? Why now? Herein lies the problem associated with the stimulus packages.

Meet Mr. Market. His coworkers are supply and demand, who together determine prices and allow Mr. Market to do his job of efficiently allocating resources. As the government pursues projects that consumers might not really want (aqueducts), prices and incentives get distorted. Mr. Market doesn't get to do his job. However,



People might say, "I don't give a damn about Mr. Market... I just want to be employed." Fair enough, but when the government employees go home after building their aqueduct, they need essentials such as food. The government can't pay them in food since it doesn't produce any. Therefore, the government must tax food away from the participants in Mr. Market's private economy to satisfy the needs of participants in the inefficient government economy. Aqueducts could potentially help food production, but if they did so to a meaningful extent, then why weren't they built by Mr. Market?

To consider the notion of government efficiency in a different light, think about what would happen if the government told several people to dig holes in certain spots where buried stacks of money would constitute the pay for their service. So the employees are put to work digging up the money and, when the work is done, they spend their money by buying things in the private side of the economy. Did anyone working for the government produce anything meaningful? No. Were they paid? Yes. Widespread government spending without Mr. Market as a guide leads to similar yet less flagrant forms of waste. So in essence, everyone pays for the stuff that many may not necessarily care for; this is the result of the tradeoff between higher

unemployment and allowing Mr. Market to work as efficiently as he should.

One important consideration is the government's role in providing public goods. Although the U.S. political system's infamous pork-barreling precludes all government infrastructure spending to be on true public goods, there is no doubt that some bridges, roads, dams and other public goods will help increase economic activity.

Apart from the troublesome efficiency aspects, the stimulus package isn't nearly large enough to replace the current decline in consumption. The proposed C\$40B over 5 years amounts to a piffling \$240 per year per capita. Some people argue that a larger stimulus package should then be passed. But remember, the more the government spends outside of the guidance of Mr. Market, the more waste there is in the economy because of poor resource allocation. Tax policy would need to focus on redistributing more goods away from the private sector to be used in the public sector. Take this to the extreme and we won't have a capitalist society anymore.

So why is the package important at all? Well, it could help conditions in the economy but for different reasons than many expect. A bubble of confidence led the economy on the way up, and now its tattered remnants are accompanying the remains of the credit balloon on the way down. Consumption, led by consumer

confidence, holds the key for long-term recovery. With the government trying to cushion unemployment, consumption can be somewhat supported artificially until the economy stabilizes and confidence returns. However, stimulus plans are not a solution; they are a temporary patch. At any rate, the present willingness to rely on government-sponsored stimulus suggests that there are tough times ahead for Mr. Market and his cohorts.

## Obama's Stimulus: A Marriage of Politics and Economics

BY JACK HANSEN

The US stimulus package is a necessary step to helping the US economy recover quickly from the current recession. The final bill is a \$787B mixture of tax cuts and government spending that will help fill some of GDP gap caused by reduced economic activity. The final bill contains \$282B in tax cuts and \$507B in government spending and President Obama's target is for it to create 4 million jobs over the next two years. After much debate about whether it was necessary and the ratio of tax cuts to spending, the final package is too small, but the best that could be achieved politically. While there are limits to the effectiveness of fiscal policy, it is necessary since further monetary expansion is not an option to U.S. policymakers anymore. In prior efforts to stimulate the economy, the Federal Reserve has pushed the Federal Funds Rate to 0% (the lowest bound since banks will never pay for the right to lend). In such a liquidity trap, fiscal stimulus is the only potential option to fill the GDP gap, but not everyone agrees it is necessary or good idea.

President Obama's initial goal was to have a stimulus package on his desk by his inauguration in late January, but the final bill wasn't signed into law until February 17. This delay was caused by the sheer size of the legislation (1,073 pages) and partisan disagreements in both the House and Senate. Even after some attempts at negotiation in both chambers, no House and only three Senate Republicans voted for the package. These dis-



agreements stem from both ideological and political roots.

Since any economic recovery created by the bill is difficult to quantify, Republicans had a political incentive to vote against the bill. No matter the outcome, they can argue that the bill was wasteful and failed to stimulate the economy while raising future taxes, a position that could help them rebound from their disappointing showing in the 2008 elections. Even if they did believe in the bill, they knew it would pass and could safely please constituents by voting against it.

The ideological debate over the stimulus centers on how much government spending and tax cuts will help the economy, if at all. Generally, Republicans focused on adding tax cuts to give the market the decision-making power while Democrats focused on finding projects where government spending will have both short and long term benefits.

The primary Republican issue with the bill is the belief that the stimulus will saddle future generations with debt to finance pork-barrel projects that won't help the economy. This argument does not give enough weight to potential negative consequences a deflationary spiral would have on future generations. The reason monetary policy has failed is indicative of this possibility: banks have hoarded liquidity, much like taxpayers receiving tax cuts would hoard their money (see: Japan's Lost Decade). They argue the government must consume for the people. When compared to a prolonged Japanese-style "growth recession", the added cost of servicing and reducing the national deficit seems small. Given the crumbling state of

American infrastructure, it appears that many of the areas of spending would have to occur anyways, so it only makes sense to do it in a recession when the government isn't crowding out as much private investment. Since the spending projects will provide long-run advantages, the fact that they are being paid for by future generations makes sense. Obama is espousing fiscal discipline going forward anyway; he wants to cut the operating deficit in half by the end of his term (projected to be a manageable 3% of GDP vs. the current 10% deficit the "fiscal conservatives" in the Bush administration ran up).

Although imperfect, the final stimulus package is a measure that will increase US GDP and limit unemployment in the short-run, while also providing long-run infrastructure additions and economic benefits that outweigh the costs of an increased national deficit. Given the political pressures involved, this is as much as could be asked for.

## Harper's Budget: A Sign of The Times

BY SAM RYDER

Throughout the fall, Stephen Harper made it clear that he would not push the country into deficit to merely keep up with rampant American intervention. At the time this seemed the responsible decision; our financial system remained small but strong, the job sector had yet to contract, and the resource based real economy stood poised for a quick rebound. Unfortunately for Mr. Harper, there is a sub-

stantial difference between what is economically responsible and what is politically effective. The proposed coalition was based on providing immediate action to shore up employment and get credit flowing. The outcry for “big government” ironically became the trendy consensus in the private sector, which stands to benefit from government spending. Meanwhile, Michael Ignatieff heard the clamor of Bay Street and recognized an opportunity to win over Canada’s business leaders by pressing forward with calls for economic stimulus. Harper was forced to veer from his free market gospel and add socialist provisions to avoid an election. However, these policies are simply too small and too wide in scope to provide any real benefits to the Canadian economy.

There are certainly some innovative initiatives in the budget. Notably, the allocation of \$1B and \$4B for a green infrastructure fund and general infrastructure improvements, respectively, serve as worthwhile investments for the future. Compare this to the estimated \$120B Canadian infrastructure deficit projection of CIBC’s Benjamin Tal, though and it becomes apparent that the budget’s provisions are just drops in the bucket. The Conservatives were forced to spread funding across social programs (i.e., E.I. measures) instead of focusing large portions on, say, three or four major projects. This leaves the country at a disadvantage compared to the American infrastructure industry that has seemingly found a gold mine in Barack Obama. Further, protectionist policies such as the “Buy American” conditions scatter the fine print of the American economic stimulus projected to hit \$1.2 Trillion this spring. Massive government intervention stands to prop up American businesses while their Canadian counterparts receive little help. The only hope for Canadian firms is that the effects of the American stimulus will not stop at the border. A misalignment of Canada’s economic and political interests forced the Conservatives’ hands.

As such, it is difficult to single out a culprit responsible for a budget that is largely smoke and mirrors. Specifically though, it is the mingling of capitalism, socialism, and democracy that opens the door to problems. Countless

times throughout Western history private shareholders have been protected at the expense of citizens. A little known provision of the Canadian budget, the Extraordinary Financing Framework (EFF), stands to continue this tradition. Under EFF the Canadian government is granted the right to purchase up to \$200B of bad loans for mortgages, automobiles, and small businesses off of the books of private corporations (primarily banks). The central bank would finance these purchases by creating the money on the government’s balance sheet. So while the budget projects a deficit of \$54B over the next four years, this number could easily balloon to \$250B and beyond. This clause amounts to what Joe Stiglitz deems “cash for trash” as governments (the people) pay for the mistakes of financial institutions (private enterprise). Bankers are not paying the consequences for careless lending. The socialization of risk and privatization of profits plaguing Canada is symptomatic of the global financial crisis. Governments cannot preach the merits of the free market only to burden future generations by bailing out irresponsible lenders.

The frozen credit markets have brought the global economy to its knees. We have built a system that relies on paying tomorrow for what we consume today. Inevitably, the cycle of borrowing, spending, and borrowing again must come to an end. Either inflation will run rampant and erode the value of money, or the creation of money by central banks will cease, ending the obsession with economic growth. As it turns out, most of the growth of the last decade is artificial and paper based, with no real gain. Canadians are at the same place now that they were in 1990. Instead of realizing this and working to correct the problem, the masses are crying for government intervention to stifle the unemployment and deflation created by the credit bust.

Stephen Harper would not have veered from his free market course were he not genuinely threatened by a Liberal led coalition. He obviously felt Ignatieff could seize and maintain power. Connect the dots and it is clear that the disconnect between politics and practical economics stems from the population at large. Many of the same people who live in houses they

can’t afford and take on car loans they can’t repay stood to support a Liberal takeover. Thus, the Canadian budget provides proof that democracy is serving its purpose. Decisions are rendered by politicians based on public sentiment. Ultimately power rests with the people. This, perhaps, is the biggest challenge the global economy faces in picking up the pieces and moving forward.

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## THE ECONOMIC OUTLOOK

THE ECONOMIC OUTLOOK was created in 2008 to heighten the Western community’s level of economic awareness and understanding through the provision of a high-quality newspaper that blends firsthand analysis with secondary reporting.

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