Please – No More Stimulus

Christina Romer, the Chairwoman of president Obama’s Council of Economic Advisers has announced her resignation. While some people say her departure is a sign of deep divisions in the Obama team, we take her comments, about getting along with Larry Summers and enjoying every minute of her tenure, at face value. You, of course, can decide for yourself.

Romer’s infamous forecast that the $800 billion Obama stimulus bill would keep the unemployment rate at or below 8% will go down in history as one of the worst by any political economist. A 131,000 drop in jobs during July and an unemployment rate holding at 9.5% are not the headlines a president needs going into mid-term elections.

If Romer is taking the fall for all this, she has herself to blame. Her forecast of the economic benefits of government stimulus was not only wrong, but flawed. Politicians love Keynesian economists – they tell them what they want to hear – “bigger government is good.” Romer apparently fell into this trap. Now others are doing the same thing. We have one thing to say. Please, no more stimulus.

Don’t take this the wrong way. Up to a point, some government spending is good. Defending the nation and the rule of law, and helping create some national efficiencies are positive additions to growth. But the US is past that point. No matter how many studies pretend that there is a positive multiplier (every dollar of government spending creates more than a dollar of GDP) they are all just political cover for expanding the size and scope of the political class.

A good test case is Canada. It has been cutting spending and tax rates for the past decade or so. While Canada bowed to pressure from the G-20 last year and is currently running a budget deficit of about 4.5% of GDP, this is well below the US and its $1.4 trillion, 10% deficits. This Canadian stimulus is smaller than in past recessions (see budget here). Canada ran deficits of 5.6% of GDP in 1992-93 and 7.6% in 1982-83 – both larger than in the US.

If Keynesians are right, the US economy should be outperforming the Canadian economy now and Canada should have done better back in the 1980s and 1990s, right? Wrong. It’s the opposite. The unemployment rate in Canada is currently 8% (Romer’s target rate) and has been below the US level since October 2008, when government spending started to go crazy. And from 1982 to 2008, the Canadian unemployment rate was always higher than the US rate – by an average of 2.8 percentage points.

This is the fruit of trusting the market and reducing the size of government. In Canada, total government spending fell from 53.3% of GDP in 1992 to 39.2% in 2007. Since then, stimulus spending boosted it to 43.8%, but the trend is down, not up. At the same time, tax rates have continued to fall. Corporate tax rates were cut from 21% in 2006 to 19.5% in 2008, 19% in 2009 and then 18% this year. The GST (a national sales tax) was cut from 6% to 5% in 2008.

The lesson is clear. Less spending, less taxing and more freedom work. Let’s not stimulate anymore. The US economy just can’t take it.

Date/Time (CST)  U.S. Economic Data  Consensus  First Trust  Actual  Previous

8-10 / 7:30 am  Q2 Non-Farm Productivity  +0.1%  +0.1%  +2.8%
7:30 am  Q2 Unit Labor Costs  +1.3%  -0.8%  -1.3%
8-11 / 7:30 am  Int’l Trade Balance - Jun  -$42.1 Bil  -$42.9 Bil  -$42.3 Bil
1:00 pm  Treasury Budget - Jul  -$169.0 Bil  -$169.0 Bil  -$68.4 Bil
8-12 / 7:30 am  Import Prices - Jul  +0.3%  +0.3%  -1.3%
7:30 am  Export Prices - Jul  +0.0%  +0.2%  -0.2%
7:30 am  Initial Claims - Aug 7  465K  461K  479K
8-13 / 7:30 am  CPI - Jul  +0.2%  +0.2%  -0.1%
7:30 am  "Core" CPI - Jul  +0.1%  +0.1%  +0.2%
7:30 am  Retail Sales - Jul  +0.5%  +0.8%  -0.5%
7:30 am  Retail Sales Ex-Autos - Jul  +0.3%  +0.3%  -0.1%
7:30 am  Business Inventories - Jun  +0.2%  +0.1%  +0.1%
8:55 am  U. Mich. Consumer Sentiment  69.3  68.5  67.8

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L.P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.