pennlive.com

Fiscal restraint could prolong our recession

By Patriot-News Op-Ed
November 29, 2009, 5:50PM

Why is it the happiness of our children and grandchildren today matters so little?

In the last several months, the federal government has implemented far- reaching policies to address the country's economic woes.

And the list of woes is long.

Unemployment is at 10.2 percent, a rate not seen in a quarter-century.

Even this figure conceals disturbing details — most notably, the large number of discouraged workers (those who have stopped looking for jobs and are no longer considered to be part of the labor force). Similarly, the figure does not account for those who are forced to work in part-time jobs — officially they are considered employed.

Even worse, the unemployment rate is not likely to fall any time soon.

In fact, unemployment is expected to rise further as firms wrestle with lackluster demand, and state and local governments grapple with falling tax revenues and deepening budget shortfalls. (A recent story in The Patriot-News describes the poignant case of Heather Logan, a state employee who came to learn she was fired when she was out sick with the flu.)

The latest productivity numbers offer some comfort.

In the second quarter of 2009, labor productivity grew a remarkably robust 6.9 percent; in the third quarter, it grew an even more astonishing 9.5 percent.

Under normal circumstances, such news would occasion great delight (at least among the tribe of dismal economists), because increases in productivity are what really drive a country's living standards over the long run.

Through extended periods of time, workers' real wages (i.e, wages adjusted for inflation) track productivity gains closely. American workers earn far more today than in the 1930s because they are far more productive now.

But the eye-popping figures of the last two quarters seem to be a grim confirmation of weakness in the current labor market.

Faced with declining demand for their goods, firms are forcing their workers to work fewer hours and produce more. The productivity gain of 9.5 percent occurred as a result of rising output and a decrease in hours worked.

And what of gross domestic product? Here the news is more encouraging.

The country's output of goods and services rose 3.5 percent in the third quarter, a faster rate than analysts had expected. The rise in GDP occurred as a result of increased consumer spending, construction of new homes (finally), growth in exports and higher spending by the federal government.

A closer look at the data, however, tempers our ebullience, because temporary factors such as the cash-for-clunkers program and inventory adjustments accounted for a good part of the acceleration in economic activity. But still. ...

Notice the effect of higher spending by the government. The stimulus package is starting to make itself felt.

As the remaining funds in the program percolate through various segments of the economy, they will continue to serve as a critical underpinning for any nascent economic recovery.
In the absence of such federal spending, growth in gross domestic product is likely to be stunted. Unemployment and incomes will decline sharply and prospects for recovery will recede further into the future.

But what of the rising federal budget deficit? The $1 trillion budget shortfall every year for the next 10 years? The sharp growth in

national debt? Will they not exact a terrible toll?
Our elected representatives, sometimes clutching babies in the House (Senators seem less disposed to brandishing babies during debates), point out that our children and grandchildren are the ones who will bear the brunt of all the federal borrowing.

They (when they grow up) will face a mountain of debt and along with it, all kinds of stated and unstated calamities — rising interest payments, falling standards of living, lives of penury.
Such Cassandra-like prophecies are unlikely to materialize. The recession will end, and GDP will start growing again.

Labor productivity tends to rise through time, and there is no reason to doubt this will remain the case.

As incomes rise, tax revenues will increase, bolstering the government's ability to repay its debt.

If we were to pay heed to the siren call for fiscal restraint in the current environment, we will almost certainly prolong the recession.

As GDP growth sputters to a halt and unemployment rises inexorably, hundreds of thousands of workers will lose their livelihoods, leading to immediate misery for their children and grandchildren.

Those calling for reduced government spending out of concern for the well-being of our children and grandchildren in the future need to answer this question: Why is it that the happiness of our children and grandchildren today matters so little?

Sanjay Paul is associate professor of economics and chair of the business department at Elizabethtown College. He can be reached at pauls@etown.edu.