Mitchell's Musings 8-25-14: A Heritage of Snake Oil

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It's rare when you find an article in which you agree with the title but almost nothing else. However, I found one in an op ed entitled "*Don't believe that a sluggish economy must be the new normal*" by Stephen Moore, president of the Heritage Foundation and available at http://www.losangelesregister.com/articles/economy-603678-growth-percent.html.

I have expressed the view in previous musings that the "new normal" thing is being way overdone. Whenever there is an adverse blow to the economy, it seems as if someone begins promoting the idea that what has happened was some kind of structural shift and things will be bad from now on. During the Great Depression, for example, when the cause was clearly a negative macro shock, there were voices saying that new technology meant that unemployment would be high forever. The idea persisted until the unemployment rate fell to record low levels during World War II.

During the sluggishness after the end of the Korean War, the "automation scare" developed. Again the idea was that unemployment was due to new technology – a structural shift - and therefore there was no sense in stimulating the economy. The result of such stimulus would only be inflation, not more jobs, according to this view. And, of course, now we hear similar prognostications. The new normalists tell us to forget that the unemployment rate was low before the financial crisis of 2007-2008. They say it's still high now because of some kind of technological shift which amazingly took place just when the crisis hit. Want proof? Just look at all the fancy new cell phones!

Why are there always new normalists when adversity strikes? Some of them are pundits who want to be first to put forth a "new" concept. Being a pessimist who purports to see hidden, deep, underlying causes is easily confused with being wise. Other new normalists are the powers-that-be who would like to cast off blame for adverse current events by saying that those developments were inevitable, a force of nature, and beyond their control.

Anyway, that's why I agree with the title of the op ed. The problem is the rest of the article. The op ed, after the provocative title, then focuses on the 1960s:

John F. Kennedy campaigned for president in 1960 by belittling the slow growth rate in the late 1950s of 2 percent to 3 percent and declaring, in his Massachusetts accent: "We can do bettah." And he was right. In the 1960s, after the Kennedy tax cuts, prosperity returned, the economy grew by almost 4 percent annually, and unemployment sank to record lows.

So far, so good. But then:

... (T)he problems with the U.S. Economy aren't structural, they are political. The current funk is the inevitable byproduct of a cascade of policy mistakes over the past seven years dating back to George W. Bush's last years in office. It would be hard to conceive of a worse set of policy prescriptions than the ones Mr. Summers and others conjured up. We've had bailouts, stimulus plans, tax increases on "the rich," Obamacare, hyperexpansive Federal Reserve monetary policy with near-zero interest rates, the Dodd-Frank bill, Obama's anti-carbon policies, the vast expansion of the welfare state during the recession, and on and on. These have flatlined the economy.

It's as simple as that. No there hasn't been some external shock to the economy or some uncontrollable divine intervention with God ordaining: thou shalt only grow at 2 percent. ***It was the result of the White House and the Fed following a discredited Keyensian [sic] model that government spending, debt and cheap money are the way to restore growth. Ideas have consequences, and bad ideas have bad consequences...***

If you know anything about U.S. economic history, you know that the Kennedy administration cut taxes entirely because of Keynesian ideas about how the economy ticked. If growth was sluggish, according to Keynesian views of the era (and now), stimulate through either more spending or tax cuts with their multiplier effects. You have only to look at the names of some of the members of the Kennedy-Johnson Council of Economic Advisors to get a sense of the degree to which Keynesian thinking and policy ruled:

Walter Heller, James Tobin, Kermit Gordon, Gardner Ackley, Otto Eckstein, Arthur Okun, etc.

Even apart from the formal White House advisors, there was a steady stream of outside experts brought into the Kennedy-Johnson White House for consultation. I was at MIT as a PhD student in economics during the 1960s and I can tell you that folks such as Paul Samuelson and Robert Solow – Keynesians! – were very much part of the policy conversation.

Now I suppose you could say – or maybe Moore would say - that while the Kennedy-Johnson economic advisors in the 1960s were Keynesians, they somehow inadvertently stumbled into laisser-faire/supply side policies. But that claim is hard to reconcile with such other policy initiatives as the wage-price guideposts program, i.e., direct intervention by the federal government into private wage and price setting. It's hard to imagine anyone in the White House today even thinking of such a level of activism. There were also voluntary – and then mandatory – controls on international capital movements designed to defend the prevailing fixed exchange rate Bretton Woods system. (That system which they were defending, by the way, was designed in 1944 through negotiations between Harry Dexter White for the U.S. and – you guessed it! – John Maynard Keynes for Britain. It required continuous official intervention in private currency and gold markets.)

In the aftermath of the 2007-2009 Great Recession, one of the things the Federal Reserve attempted was to change the differential between short-term and long-term interest rates (lowering the latter). But if you go back to the 1960s, you will find "Operation Twist," also an attempt to change that differential. If you don't like monetary activism now, surely you can't like it then. In short, the idea that the Kennedy-Johnson period was not Keynesian/activist at the macro level simply defies basic history.

What about social policy? According to the op ed:

We have paid people not to work, bailed out bad actors, disincentivized employers from hiring more workers, raised taxes on investment, passed new regulations to strangle our energy industry and refused to fix a corporate tax system that sends jobs abroad.

If those are the problems today, what does the author have to say about enactment of Medicare and Medicaid during the Johnson era? What about the various Great Society programs? What about the increases in the federal minimum wage in 1961, 1963, 1967, and 1968?

I suspect that although the op ed praises the real growth of the 1960s, the author would not praise the gradual build up of inflation during that decade, especially in the second half as the Vietnam War (and its spending) heated up. President Johnson was advised by his Keynesian economists that with the economy overheating, a tax increase would be in order, advice which he famously ignored for political reasons.

In short, if you like what happened in the 1960s in terms of real economic growth, you must also like Keynesian economics and government intervention – because that was what the 1960s were all about. If you like the real growth of the 1960s, but you don't like the uptick in inflation during that period, you have to blame Johnson for not following the Keynesian advice of his Keynesian consultants.

The op ed closes with:

Keynesianism should now be recognized as snake oil, and the challenge for Republicans is to convince the American people they have a plan that will "do bettah."

There is indeed some snake oil on offer here, but it's not being peddled by Keynes or his successors.