Funding the Future

Will Biden blow it?

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Ambrose Evans Pritchard is the International Business Editor of The Daily Telegraph. In an article on 9 March he claimed that Joe Biden's $1.9trn stimulus package was bound to fail. Worse, he claimed that would have knock on effects for the rest of the world as the cost of US debt rose as US inflation did likewise.

No one can doubt that $1.9trn is serious spending. But it is a lot less than the debt funded money Trump pumped into the US economy via massive corporate tax cuts, tax cuts for the wealthy and his own stimulus package. Those are, it would seem, successes in Evans Pritchard's' eyes. The trouble with the Biden stimulus is that it's just too much of a good thing, apparently. That, of course, is so often the case when state support goes to those in lower incomes, in the opinion of the right wing.

The reason given by Evans Pritchard is straightforward. As he puts it:

America is undertaking an extraordinary experiment. Real GDP will recoup pre-pandemic levels by the end of the second quarter. The "output gap" will be closed soon after that. The economy will run out of slack and hit capacity constraints by the late summer. Capital Economics says stimulus will by then be subject to "rapidly diminishing returns".

In other words, what he is arguing is that within an MMT framework (which does, of course, apply) full employment will have been hit long before the spending ends and so inflation results. The claim is that growth per dollar spent might be as low as 20 cents as a consequence, in Pritchard Evans' view..

This is, I suggest, a small world view. That there is a small inflation risk for the short term in any economy reopening after lockdowns as immediate pent up demand is released and supply capacity remains constrained is obvious. It's equally obvious that if the reopening is justified (meaning the risk of further lockdown is genuinely constrained so that supply can really return to normal) then that risk is small after initial reopening.

Firstly, that's because people do not rush to spend after economic shocks. They rush to save. Much of what Biden is injecting will, necessarily, have that consequence. After all,

all government deficits require that someone else save, although the US has tended to export that issue. This means demand is very unlikely to grow as Pritchard Evans predicts.

Second, the presumption that capacity might be reached quite so quickly within the US economy is extraordinary. Is it really presumed that in the US all that might gainfully be done will already be undertaken by mid 2021?

Like the UK, the US has a major problem with a heavily casualised workforce that have born the brunt of this pandemic in their case by very large numbers of people being made unemployed. The assumption implicit in Pritchard Evans' claim is that once these people return to work in their marginal employments the work of recovery is over. From there point on government spending will simply result in inflation.

This is exceptionally unlikely to be true. Spending of the level Biden is planning does not just return people to marginal employments at minimum wage, although it will undoubtedly have that impact. What it does do is force up demand for more skilled labour, leading in turn to investment to increase productivity, leading in turn to greater supply, leading in turn to demand being met but with greater overall return to labour resulting.

That in turn leads to a redistribution of the reward ratio in the US towards labour, something that is long overdue. This has also long been possible, but it has not happened because austerity economics has taken no risk at all with inflation, leading labour markets to stagnate.

I disagree in that case with the basic premise that there is only a small output gap in the US that will rapidly be filled with inflation following on shortly thereafter. I do as a result also disagree with the idea that bond market yields will have to increase as a consequence, exporting US inflation to the world as a consequence, and delivering austerity economics in much of Europe as a result.

What all this comes down to is a world view. Many economists spend their life obsessing with what they call equilibrium - that place where economic resources are supposedly optimally allocated. This is a particular fixation for the right wing because implicit in this idea is the notion that the status quo is optimal. This happens to suit those who benefit most from current wealth inequalities and the mechanisms that maintain them. So of course they roll out economic modelling that suggests that anything that might threaten that status quo - which is what Biden is doing - is a great threat. Economics is at this point political economy within itself, because conventional economics then becomes an instrument to maintain existing power relationships within the economy.

The important point is to appreciate this. The economics Evans Pritchard is promoting is not objective. It is driven by a desire to preserve a status quo where labour is the buffer stock that absorbs risk within the economy, which buffer stock of unemployed people then controls inflation to maintain the wealth claims of the richest in society. Evans Pritchard is terrified that will change. He is frightened that labour reward might rise in a world where it has fallen for decades.

Of course he will oppose a stimulus package that might upset his equilibrium as a result. But that does not mean Biden will blow this stimulus. It just means that it might work in ways Evans Pritchard may not like. And that may be good for everyone else.