

## The Keynesian Addiction

January 2013

A New Year means a new round of economic fortune telling. Reading this year's onslaught of economic forecasts reveals a common tone. Although the investment markets ended 2012 on a fairly positive note, and although the global economy avoided collapse despite the looming threat of the EU splitting apart or China imploding, many economic prognosticators remain highly insecure. The world is muddling through and, better yet, 2012 exceeded the expectations of disaster – so why aren't we more confident in economy?

Over the last four years we have moved from one economic crisis to another, always able to “resolve” whichever one dominated the headlines. Most recently, we peered over the so-called fiscal cliff, a “debate” about raising taxes on the wealthy and cutting government spending. Like so many crises before, our TMI media ensured we went to bed and woke up overwhelmed with the “facts.” And just as we “resolve” one crisis, another almost immediately rears its head. How have we gotten ourselves into this mess, this government-dominated world that is in constant crisis management mode?

Could it be that the concept of a free market is nothing but an illusion? Is a free market merely an aspiration during economic expansion, because it certainly seems of no interest during economic contraction?

If it ain't broke don't fix it, but if it's broke fix it IMMEDIATELY. It is obviously in our nature to let the good times roll and to avoid pain, so when the economy gets even a mere bruise, there is no political will to live through a natural healing process. Forget that which doesn't kill us makes us stronger. Make us well immediately!

Politicians certainly can't win elections in democratic societies by telling voters they must take the medicine and like it. The democratic political system can only inflict pain on a small minority of voters who won't put at risk any politician's reelection efforts.

Economic theorist John Maynard Keynes (1883-1946) came up with the magic prescription to help relieve our economic pain. If our fiscal health stumbled, Keynes suggested that government needed to increase spending to revive the ailing patient. Politicians and government happily agreed. And why wouldn't they? Keynesian Stimulus gave government more power and control.

GDP is calculated as Government Spending + Capital Investment + Consumption + Net Exports. If the private sector economy comes down with a cold, then increasing Government Spending ensures the overall economy can remain in reasonable health. All that's needed is a little stimulus elixir to ease the patient of its symptoms.

Yet there may be a hidden consequence to Keynesian Stimulus. Without really knowing it, we have become afflicted with another disease.

Keynesian Stimulus interrupts the natural flow of a market-based economy. It prevents a market from clearing. In layman's terms, we have allowed weak economic actors who should have kicked

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the bucket during recessions to survive. Weak companies, weak workers, weak entrepreneurs, weakly skilled investors and weak government policy have all been allowed to survive.

Each time we prescribed stimulus in our thirteen recessions since the Great Depression, we have prevented the market from clearing. We prevented the patient from healing. So a little at a time, we built up an immunity to stimulus. With each dose of “medicine”, our economic infrastructure became more and more dysfunctional, populated by the weak actors and policy implemented to support the system, all to avoid the pain democracies can’t handle.

This has brought us to a point where not only do we have too big to fail, (General Motors, AIG), we also have too small to fail (home values). Any failure threatens the whole system because the system has become so dysfunctional. Our economic immune system has been shot; we have lost any natural ability to heal. It seems our only hope for survival, the only way our economy can be held together is by more and more stimulus. We have become Keynesian addicts.

Now we have a frail, decayed economic system. It can't be fixed by starving it, by massively cutting back government spending. There is not enough private sector organic growth to replace government spending and nurse us back to health. The economy can remain on life support only by tapping the Keynesian pump. But just like any drug, each subsequent dose elicits a lower return, a lower “high.”

Stack together decades of Keynesian policy and you get a dysfunctional market system. There is no longer a market. What's left is just Keynesian Policy, an economy completely dependent on government. When government pumps our economy full of endless stimulus, government’s growth and control eventually supplants any potential organic economy.

There is no cold turkey – that would be economic disaster. And the likelihood that we can slowly wean ourselves from stimulus addiction is highly remote for several reasons. To begin with, it is in government’s very nature to beget more government. No government is looking to contract its influence. This is because government has no competitive market to ensure it is acting as productively and efficiently as possible. And since democratic voters loathe accepting any pain, the likelihood of electing leaders selling sacrifice and suffering is smaller than remote.

So what does this prognosticator anticipate for the New Year? Economic results may very well exceed expectations, as more people become comfortable living with the drug of Keynesian Policy.

The Europeans have recently loosened bank liquidity standards for four more years. Calmer markets and improved economic activity should follow. The new Japanese Prime Minister has vowed to print money, bashing the yen to increase exports and GDP growth. And China has new leadership that surely is going to seek a return to faster economic growth. Add these together and we could see faster global economic growth, lifting the American ship with it.

But let’s not forget the developed market economies have become addicted to Keynesian Policy, where all roads come from and lead to government. At some point, uncertain as to when, an addicted patient must suffer through withdrawal. All will be fine until that day comes...thus the reason for so much anxiety.

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A handwritten signature in black ink, appearing to read 'Doug', with a large, sweeping initial 'D'.

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