Liberals wanted fiscal stimulus. Conservatives delivered it

Left-leaning economists hate the timing and the composition. But the expansionary fiscal policy they sought is on the way

By Neil Irwin
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For years, many liberal economists have argued that a little more federal spending and a higher budget deficit would create a stronger economy.

Now, they're getting their wish, or at least a fun-house mirror version of it. All it took was total Republican control of the government.

The fiscal austerity that drove the budget deficit from around 9 percent of G.D.P. in 2010 to 3 percent in 2016 has, for practical purposes, been abandoned. First, Republicans passed a $1.5 trillion tax bill in December that sharply cut rates on businesses. Then last week they made a deal to undo budget caps demanded by the Republican House in 2011. President Trump signed that bill on Friday.

This sudden reversal has the economists who have long argued we should run the economy a little hot — that is, stimulate it using the government's power to tax and spend — in something of a quandary.

"It's a very weird and conflicted feeling," said Jared Bernstein of the Center on Budget and Policy Priorities, who worked in the Obama White House. "On some level I should be happy, and I am sort of happy right now, but with some nontrivial caveats."

He and others in this boat don't at all like the composition of this particular easing of fiscal policy. It is focused on tax cuts for businesses, rather than on investment in roads and bridges or worker training. The latter would be the kinds of steps more likely to have long-term payoffs and to benefit working-class Americans, they believe. (A big chunk of the additional spending will go toward the military.)

Liberal skeptics of this new age of anti-austerity also don't like the timing. Mr. Bernstein, no one's idea of a deficit hawk, notes that never in its modern history has the United States run deficits as large as those now on the horizon while the unemployment rate was as low as it is now. That creates the risk that the government will have less capacity to respond to future recessions.

But those misgivings aside, this mix of budget-busting policies will provide the best test in years of some ideas that have percolated among economists, especially but not exclusively on the left. The former Federal Reserve chairman Ben Bernanke, originally a George W. Bush nominee, spent years imploring Congress to spend more money in the near term to try to boost growth, to little avail.

The case for a more expansionary fiscal policy varies depending on the individual, but arguments have included:

- It might spur more jobs at higher wages.
- Coax people who had dropped out of the labor force to look for work.
- Fuel higher productivity growth.
- Mitigate a global shortage of safe government bonds.
- Help break the United States out of a prolonged cycle of sluggish growth and financial booms and busts.

For example, Larry Summers, the Harvard economist and former adviser to Presidents Obama and Clinton, has been a leading advocate of the idea that "secular stagnation" has taken hold. The idea is that the economy is in a self-reinforcing pattern of low growth, low inflation and low interest rates, and that overreliance on the Federal Reserve's interest rate policies to try to spur growth has fueled financial bubbles.

To escape that trap, Mr. Summers urged government to make large-scale investment in infrastructure. That investment, he said, would create jobs for men, a demographic that has disproportionately dropped out of the labor force. And it would improve the long-term economic potential of the United States, taking the pressure off the Fed's interest rate policies to achieve growth.

He argues now that the policies that the Trump administration and Congress have reached, while directionally the same as those he advocates, won't get the job done and carry risks.

"Yes, I have favored more expansionary fiscal policy, and this is more expansionary fiscal policy," Mr. Summers said. "But it's the wrong kind of expansionary fiscal policy, and it's at the wrong time, at the rare moment when fiscal policy is likely to be almost entirely crowded out."

Expect to hear that term, "crowded out," frequently in the economic debates of the years ahead.

In mainstream models of how the economy works, it's the idea that if the government runs budget deficits when the economy is at full employment, its borrowing won't spur new economic activity as desired. Instead, the borrowing will simply raise interest rates and squeeze out private-sector investment, resulting in no net improvement in the economy.

The decline in stock markets since Jan. 26, and the rise in Treasury bond yields, suggests investors are becoming wary of that happening in the coming years.

Advocates of fiscal stimulus during the 2008 recession and the slow recovery argued that crowding out wasn't a valid fear during that time. Vast economic resources, including workers and machines, were sitting on the sidelines, so the government had room to stimulate without causing a rise in interest rates.

A common refrain — and the baseline for negotiations between the Obama administration and Republicans in the House — was that any short-term boost to spending had to be accompanied by longer-term deficit reduction. It was on those terms, for example, that stiff budget cuts known as "sequestration" were partly reversed — with offsets to avoid raising the deficit over the ensuing decade.

"Republicans were very tough about that," said Jason Furman, who was chairman of the Council of Economic Advisers until President Trump took office and is now at Harvard's Kennedy School. Now, a Republican Congress is agreeing to raise spending beyond those sequestration limits without other cuts to offset the increases. "This is very frustrating because it feels like one group of people are living by the rules, while another group is not living by the rules of economics or arithmetic."

The frustration of facing resistance to more expansionary fiscal policy during a period of high unemployment wasn't confined to liberals. As Fed chairman, Mr. Bernanke urged Congress to pair a higher short-term fiscal boost with long-term deficit reduction.

As recently as last year, he wrote that "there is still a case for fiscal policy action today," but that it should focus on improving the economy's productive capacity, "for example, through improved public infrastructure that makes our economy more efficient or tax reforms that promote private capital investment."

Still, even if it isn't designed as the stimulus that advocates would prefer, and even if its timing is the direct opposite of what Keynesian economics might recommend, this may be the best test of some of the theories on expansionary fiscal policy that will come along.

“This is a test of whether we’re at full employment or not,” Mr. Bernstein said. “I think by knocking the unemployment rate down even further, we’re going to get more real economic activity, not just more inflation. But now we’re going to find out if I’m right.”