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Will without War?

Mark Klinedinst

University of Southern Mississippi

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Short Bio: Mark Klinedinst is a professor of economics at the University of Southern Mississippi. He has worked on international projects with funding from groups such as the National Science Foundation, World Bank, United Nations and the International Labor Organization and acts as a reviewer for a number of economics journals. He has published in the European Economic Review, Journal of Comparative Economics, Journal of Economic Issues and a number of other outlets.

While congress debates the merits of a stimulus package of around 900 hundred billion dollars, a historical approach to the current situation suggests that the stimulus packages currently being discussed are actually far less generous than may be needed. The Congressional Budget Office projects that we are in “a recession that will probably be the longest and the deepest since World War II.” It is often suggested that the massive spending necessitated by the nation’s involvement in World War II helped end the Great Depression. Without a comparably ambitious unifying cause, however, I am afraid that the spending required to pull us out of a decline will be considered politically unpalatable, leading to an inadequate response to the crisis. An examination of spending patterns during the nineteen-thirties and nineteen-forties and their application to the current scenario suggest the true extent of the stimulus that may be needed.

Table 1 shows the average levels of unemployment, real GDP and real government spending for the 1930s and the 1940s. These dates roughly correspond

to the years of the Great Depression (usually defined as 1929 to 1941) and to the boom from World War II. The large increase in government spending (293 percent) in the early forties corresponds with a dramatic increase in real GDP (92 percent) and a drop in unemployment (71 percent). It is clear that the economy responded massively to this stimulus, ending the depression.

Table 2 takes data from 2007 (the latest data available for some of these figures) and uses the same changes found in Table 1 between the 1930s and the 1940s. The corresponding level of government spending is almost 8 trillion dollars (7.90997)! This almost 6 trillion increase over recent levels greatly exceeds the 900 billion that congress is debating now. This figure is illustrative of the magnitude of the potential problem that we currently face, and indicates that significantly greater spending may need to be considered on the basis of these ballpark estimates. Clearly we are not yet in as bad a position as we were during the Great Depression, but the calculations applied to the present are actually conservative estimates of the nominal figures that might need to be considered, since the base year used is 2007 and the figures are 2000 dollars.

A deep decline coming?

Estimates of the depth of the current decline vary widely and are difficult to assess given the global nature of the downturn. Carmen Reinhart and Kenneth Rogoff, however, give us figures for the average change to various economic indicators in their analysis of the aftermath of previous financial crises. Using these figures we can predict an escalation of unemployment of seven percent, output drops of nine percent and an eighty-three percent increase in public debt. In order

to combat a seven percent increase in unemployment, using a conservative estimate of Okun's Law at two percent by Andrew Abel and Ben Bernanke, any effective stimulus would have to be strong enough to lift GDP about \$2 trillion. Clearly the liquidity constraints of this crisis have caught the attention of a number of people who historically were averse to fiscal stimulus.

The eighty-three percent increase in public debt that Reinhart and Rogoff describe is actually fairly close to the figure that could be expected from a government budget that is similar to the WWII stimulus, especially if the stimulus were to be injected over a number of years. These large figures will hopefully not be needed, but underestimating the stimulus needed is likely to be more costly over the long run.

A way out

There are a number of projects that could absorb a large stimulus such as infrastructure development, extended unemployment benefits, aid to states, greening our energy consumption, and so on. Also, as was the case after World War II, we could scale back some of this spending once the immediate crisis was over (some of it could remain on the books for the purposes of having larger automatic stabilizers). As E. Cary Brown pointed out in his analysis of fiscal policy during the Great Depression; "it took the massive expenditures forced on the nation by the second world war to realize the full potentialities of fiscal policy." Right now congress is acting like a person looking in a dark attic for a valuable keepsake, but who is afraid to turn on the light because of the electricity it will burn: why not turn on the light and go right to it? Granted there is much we need to learn about

stabilizing our economy, but we could turn on the light with what we know already and bring back economic health much quicker.

Table 1

	Unemployment (all figures here are averages over the period)	Real GDP (billions of 2000 dollars)	Real Government Spending (excluding transfer payments, billions of 2000 dollars)
1930-40	18.09	811.19	159.05
1940-50	5.1	1560.3	625.25
Percentage Change between decade averages	-71.81%	92.35%	293.12%

Table 2

	Unemployment	Real GDP (billions of 2000 dollars)	Real Government Spending (excluding transfer payments, billions of 2000 dollars)
December 2007	4.9 (Dec. 08 is 7.2)	11523.9	2012.1
Amounts if used average changes from Table 1	1.38 (2.03)	22166.22	7909.97

REFERENCES AND FURTHER READING

Abel, Andrew B. and Ben S. Bernanke (2003), *Macroeconomics*, 5th edition. (Using Okun's Law, two percent of our over \$14 trillion current nominal economy is about \$280 billion).

Auerbach, Alan J. (2009) "Implementing the New Fiscal Policy Activism". Available at <http://www.econ.berkeley.edu/~auerbach/implementing-new-fiscal-policy-activism.ii.pdf>. (Discusses a number of reasons why fiscal activism has lately gained ground).

Brown, E. Cary (1956) "Fiscal Policy in the Thirties: A Reappraisal," American Economic Review 46: 857-879.

Bureau of Labor Statistics, <http://data.bls.gov> and U.S Census Bureau, <http://www2.census.gov/prod2/statcomp/documents/CT1970p1-05.pdf>. (This is the source of data used in the tables).

Congressional Budget Office (2009), <http://www.cbo.gov/ftpdocs/99xx/doc9957/01-07-Outlook.pdf>. (Concerns that this recession will be deep).

Reinhart, Carmen M. and Kenneth S. Rogoff (2008) "The Aftermath of Financial Crises". Available at <http://www.economics.harvard.edu/faculty/rogoff/files/Aftermath.pdf>. (Describes the depth and duration of other financial crises).