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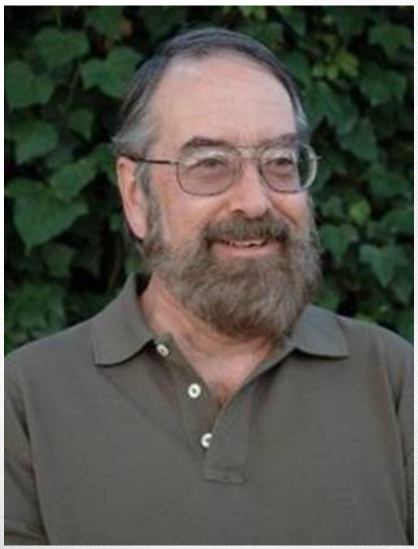
Expert Commentary

In light of deteriorating economic situation in the US, Dukascopy Bank SA interviewed Professor Lima and discussed various issues such as the Great Depression, the US debt, and measures to stimulate the economic recovery.

The [US] economy will begin to recover in January, 2013 if Mr. Romney wins the election in November.



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Why do you believe that the Great Recession is not over?

The Great Recession began in December, 2007. According to the NBER Business Cycles Committee, it ended in June, 2009. The passage quoted below is from the Business Cycles Committee's statement released September 20, 2010 [1].

"CAMBRIDGE September 20, 2010 - The Business Cycle Dating Committee of the National Bureau of Economic Research met yesterday by conference call. At its meeting, the committee determined that a trough in business activity occurred in the U.S. economy in June 2009. The trough marks the end of the recession that began in December 2007 and the beginning of an expansion. The recession lasted 18 months, which makes it the longest of any recession since World War II. Previously the longest postwar recessions were those of 1973-75 and 1981-82, both of which lasted 16 months."

Along with a few other economists cited in my blog post [1], I refuse to believe that an economy with over 8% unemployment rate and a labor force participation rate at about 60% (the lowest level in three decades) is healthy in any meaningful sense. The Business Cycles Committee seems to focus on growth in real GDP and national income. I think they made a mistake.

How would you evaluate the current economic situation in the US? When do you see a recovery?

Frankly, the main drag on the economy is the hundreds, if not thousands, of new business regulations either put in place or proposed by the Obama administration. I first pointed this out in March, 2010 [2]. There is incredible uncertainty about the future role of government.

ObamaCare, all 2700 pages, remains an impenetrable thicket of regulations that are not even written. Large businesses can afford to hire the experts needed to wade through all this. But it's not so easy for small businesses, those that create the jobs.

The economy will begin to recover in January, 2013 if Mr. Romney wins the election in November. If the incumbent wins, I don't think robust economic growth will return to the U.S. for at least ten years.

> *In the first quarter of 2012 the U.S. Debt to GDP ratio was 100.74%.*

The current US debt level is unprecedented. Do you think this might be a powerful driver, which may drag the US economy into "economic hell"? It's getting close. According to the best numbers I could find, in the first quarter of 2012 the U.S. Debt to GDP ratio was 100.74%. That scares me. France, for example, only has a debt to GDP ratio of about 90%. Germany is at 85%. Italy is around 110% and our old pal Greece is at 150%. Even an economy as strong as the U.S. cannot pile on higher and higher loads of debt without any danger.

As a small example, the government debt right now is $15,582,079 million. That's $15.6 trillion in debt. Right now the government can borrow at historically low interest rates. Let's say the interest rate on this debt is 1.5% per year. That implies annual interest payments of $233,731 million per year. That's $233.7 billion per year. If the interest rate on that debt rises to 3%, well within the historical range, those interest payments will also double to $467.4 billion. To put those numbers in perspective, the total government budget deficit for the U.S. in the most recent fiscal year was $1,299,595.0. That's the net increase in the national debt for the past year. Interest payments on that debt are currently about 18 percent of the budget deficit. An increase in interest rates to 3% would raise interest payments to 36%. This could lead to a debt spiral where interest payments on the debt grow, creating even larger deficits and debt growth.

President Barack Obama is proposing to encourage companies to move their overseas operations back to America, thus stimulating manufacturing sector in the US. Do you think this initiative might help to revitalize the US economy?

This is, frankly, a stupid idea. Mr. Obama has done more to cause companies to offshore jobs than any president ever. Companies are not hiring in the U.S. but output and profits are increasing. My guess, and it's only a guess, is that many jobs are being created in other countries. Why hire an employee here when you have no idea what that employee will cost you in the future? Better to hire a foreign employee not subject to ObamaCare and other absurd regulations. Consider one small example. For years the U.S. has restricted sugar imports. The U.S. price of sugar has been about twice the world price. In recent years, U.S. candy manufacturers have started giving up and moving to Canada and Mexico. They can buy sugar at the world price, make their candy, and export it to the U.S. under NAFTA. The problem is not outsourcing the jobs. It's a government policy that makes a U.S. industry unable to compete in global markets. But we really can't blame that on the president. Those sugar import quotas have been around for many years.

Prediction: when the 2.3% tax on medical device sales goes into effect on January 1, 2013, we will see hospitals moving some of their operations to Mexico to avoid this tax. More jobs moving to another country.

And consider the 35% U.S. tariff on tires imported from China. My colleague Professor Tom Prusa (Rutgers University, New Jersey) has calculated that this tariff "saved" about one job for every 25 it cost in the U.S. The cost per job saved was about $600,000. Even the U.S. economy cannot do well when burdens like this are placed on it. Finally, look at the complete lack of U.S. leadership on lowering barriers to international trade. The list is long and getting longer.

Do you regard measures taken by the Fed to foster economic recovery effective and efficient? What other measures might be considered by officials?

Monetary policy is like pushing on a string. All the Fed can do is change the "monetary base." It's up to the economy (specifically the banking system) to turn the monetary base into real money. That has not happened. During the Great Depression, Keynes hypothesized the existence of a "liquidity trap." As was so often the case, Keynes had the right answer but the wrong question. Then as now, the economy is in an excess reserves trap. Banks are content to hold vast quantities of excess reserves. That breaks the link between Fed actions and the money supply. The Fed has done all they can and has been very creative in formulating new policies.

The unfortunate Obama "stimulus" was a complete failure because the government simply did not spend fast enough. The ARRA was passed in February, 2009. By April, 2010, there was still 25% of the funds that had not been spent [3]. Fiscal stimulus must have shock power to work. Gradually dribbling out the spending over two years is guaranteed to fail.

References:

1. What Is A Recession?[link]
2. Business Cycles Committee's statement released September 20, 2010 [link]
3. The Health Care Bill: Disaster for the Economy, 2010 [link]
4. Stimulus Speed Chart [link]
5. Follow Professor Lima on Twitter: @GonzoEcon
6. Professor Lima's Blog [link]

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