



Written by [Walter McLaughlin](#) on February 29, 2016

Are Economic Stimulus Programs Worth the Price of Admission?

A good film is when the price of the dinner, the theater admission and the babysitter were worth it.

— Alfred Hitchcock

Last Wednesday, an International Monetary Fund Report called upon the Group of 20 (G-20) members to act in a coordinated fashion in order to stave off a looming global recession. According to the report, the impact of China's economic struggles "points to higher risks of a derailed economy."



There is plenty to dissect here, but let's first take a look at how the Group of 20 works.

The Group of 20

Formed in 1999 in order to discuss and debate issues related to the global economy, the G-20 consists of the following members: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States, and the European Union.

Added together, the G-20 represents two-thirds of the world's population, over 75 percent of global trade, and nearly 85 percent of collective gross domestic product. Decisions made as a result of G-20 recommendations have far-reaching impacts throughout the world, not the least of which were the aggressive monetary policies undertaken following the 2008 financial crisis.

Saturday's IMF Press Release

The IMF issued a press release over the weekend summarizing some of the key discussion points following the G-20's recent Finance Ministers and Central Bank Governors Meeting in Shanghai, China. Its recommendations were as follows:

- First, a broad-based response at the *national* level. In advanced economies, this requires a mix of mutually reinforcing demand and supply policies, including continued accommodative monetary policy and supportive fiscal policies — making the best possible use of fiscal space (for example, through infrastructure spending). In emerging economies, it requires reducing vulnerabilities and rebuilding resilience — strengthening fiscal buffers and diversifying growth models in commodity-exporting countries, for example.
- Second, bold *multilateral* actions. This requires following through on past G20 commitments and, in particular, renewed momentum this year to deliver on the goal of achieving 2 percent additional growth by 2018. Reinvigorated structural reforms are a critical element of the necessary policy package, and I welcome the G20's commitment to enhance this agenda by formulating a set of



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principles to guide prioritization. The IMF is pleased to support this effort.

The press release also called for an “adequate and effective global safety net” and concluded with a call for immediate action to combat the “weak and uneven” economic recovery.

Global Economic Growth Has Been Slowing

Even prior to the stunning revelations regarding China’s shaky economy, global GDP growth has been trending downward in recent years.

After growing between 4-6 percent from 2003 through 2007, global GDP growth plunged over the next two years as the steep recession gripped the world’s economy. It rebounded to a solid 4.9 percent increase in 2009, but has steadily eroded since then, falling to just 2.4 percent in 2015. With the impact of the China factor still unfolding, there is little doubt that G-20 nations are concerned the combination of the downward trend with a weakening Chinese economy could pull the world into another global recession.

Types of Economic Stimulus

Before we discuss whether fiscal or monetary stimulus policies have long-term positive impacts upon economic growth, let’s take a look at the differences between the two. Per Investopedia.com:

Fiscal policy: Government spending policies that influence macroeconomic conditions. Through fiscal policy, regulators attempt to improve unemployment rates, control inflation, stabilize business cycles, and influence interest rates in an effort to control the economy. Fiscal policy is largely based on the ideas of British economist John Maynard Keynes (1883–1946), who believed governments could change economic performance by adjusting tax rates and government spending.

Keynes believed that during recessionary periods, increased government spending was necessary to offset lower private sector demand for goods and services.

Monetary policy: Monetary policy consists of the actions of a central bank, currency board or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates. Monetary policy is maintained through actions such as modifying the interest rate, buying or selling government bonds, and changing the amount of money banks are required to keep in the vault (bank reserves).

The Federal Reserve Bank is charged with establishing monetary policy in the United States.

Do Economic Stimulus Programs Work?

Whether or not to employ economic stimulus is the trillion-dollar question facing every country during economic downturns. It’s clear from the IMF press release that it believes in the necessity of stimulus. Economists, on the other hand, differ in their opinions on its long-term efficacy.

With respect to fiscal policy, not only are the long-term impacts questioned, but even its effect on immediate economic growth can be debated. A *Washington Post* article from 2011 profiled nine studies on the subject of fiscal stimulus. Six concluded that Keynesian-style stimulus worked, two determined that it did not, and one gave fiscal stimulus a mixed review. Another key fact worth noting: spending the additional dollars can strain a country’s shrinking financial resources, leading to larger budget deficits.

Monetary policy is unarguably more effective but no less controversial. Although a central bank has a number of tools available in its toolbox, lowering interest rates (“accommodative monetary policy”) has been proven to be highly effective. Low interest rates stimulate consumers and businesses borrowing,



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improving overall economic activity.

Short-term interest rates are typically lowered by the central bank's purchasing of government bonds, which drives prices up and yields down. The cash used to buy the bonds ends up circulating throughout the economy, and eventually being put to use in the form of loans, investments, and increased overall spending.

But there's a dark side to monetary policy. Aggressive central bank actions and the interference with natural ebbs and flows of supply and demand represent three major risks to the economy:

Asset bubbles. Excess liquidity pumped into the economy by the Federal Reserve helped lead to the Dot Com bubble bursting in 2000 as well as the recent housing market crash.

Dependency on low interest rates. Japan experienced their "lost decade" during the 1990s, with an economy trapped by slow growth and low interest rates — the exact problems we face today.

Inflation on the horizon. Although there have been virtually no signs of runaway price increases striking the United States anytime soon, economists agree that \$3 trillion of excess cash in the money supply threatens to spark rampant inflation down the line.

Is Stimulus Worth the Price?

E.B. White once wrote, "There is nothing more likely to start disagreement among people or countries than an agreement." To that end, the IMF's call for action may be difficult to obtain, given the disparate issues and factors facing each of the G-20 countries. With that said, perhaps that's a good thing. Based upon the massive \$19-trillion national debt the United States already faces, an existing dependency on accommodative monetary policy and slow growth throughout the globe, it seems we are already stuck in our own "lost decade." One Japanese-style recovery at a time.



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