

Economic Stimulus in the United States

Stimulus is something external that influences an activity. Economic stimulus is a means by which a government can encourage or seek to boost its economy by, encouraging consumers to purchase goods or encouraging the expansion and growth of business and job creation through vigorous investments in infrastructure and research. The first targets the short run, while the second targets the long run. This paper will attempt to analyze the economic arguments and implications of the Economic stimuli, highlighting on areas that the plan touches on.

President Obama, on taking over his term in office in Jan 2009, was faced by the most serious economic crisis since the great depression. Faced with this, he and his team came up with a plan that was meant to help prevent the country and the world from slipping into another economic crisis that could be equated to the great depression.

Economic stimuli are many and just like their monetary stimulus contrasts which are instituted by the Federal Reserve board, work in different ways. Individuals for example can be encouraged to spend in the short term by individual tax cuts by the government. Companies getting tax cuts will entice them to both spend and invest. If the government considers investment in public works, this will create short term employment hence meet some of the short term aims of an economic stimulus plan.

While some plans or approaches are direct, some work indirectly for instance a plan meant to reduce the consumption expenditure for all. This can be demonstrated by investing in an energy grid which would make energy costs low for individuals as well as companies. Some are based

on the premises that their benefits will be realized in the future period like investment in research and development.

There are many forms of economic stimuli that a government can adopt to create jobs and promote investment and consumer spending during the recession. These are tax cuts for individuals, tax cuts for companies, investment in healthcare, education, financial aid to low income workers and unemployed including retirees job, training and extended social services benefits, infrastructure investment which include core investments, investments in government facilities and supplemental investments.

There were many a myriad who were vehemently opposed to the economic stimulus popularly known as the Recovery Act and had very genuine reasons for their concerns. This is because despite the huge effort that was put in by the supporters of the bill there were issues that if not keenly addressed could easily determine the success or failure of the venture. There is more than just sufficient proof that the measures taken were justified and they were successful. This will be discussed below.

There were risks of large stimulus packages will not work or will not have the desired effect. This would result in the crisis continuing as if nothing had been done. There were also concerns that some of the measures like tax cuts might be taken too far. Tax cuts were also opposed since it was viewed that they would create less than an immediate economic boost than others like government investments.

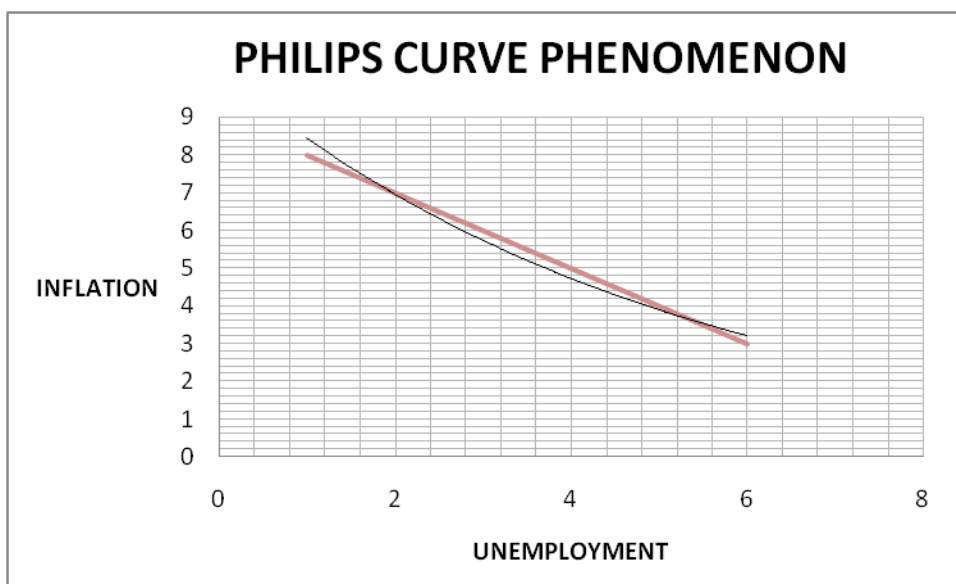
Government investments however have a limit, which would be determined by budgetary constraints and policies budget deficit, hence the measures had to be temporary so that there would not be any unnecessary long run budgetary strains.

There were concerns of the size of the budget and current balance of payment, where the country was having a deficit. According to Tobins portfolio distribution view of the demand for money, persons with a given amount of liquid assets split their holdings between money and bonds as a fraction of the level of interest rates. Hence, as US wealth grows, citizens put more of their additional wealth in foreign assets the higher the foreign interest rates are. Hence there was a view that since interest rates were low, the incremental wealth would be converted into foreign assets.

$$F=F(r); F'<0$$

There was also the risk that the stimulus package might work too fast. If the result of a quick and rapid recovery will result in a sudden shift from debts, this would result in inflationary pressure.

Unemployment was one of the major factors that the economic stimulus plan was meant to counter. Cyclical unemployment is caused by the cyclic variations in an economy. According to Philips curve that shows the short run tradeoff between unemployment and inflation. There is an inverse relationship between inflation and unemployment. Hence, at recession, there would be very high levels of unemployment as shown below:



Energy in the US market where more than 30 billion spent on projects that utilize renewable energy as well as improvement of the national grid that represents investments whose benefits will be felt in the future periods.

According to Says law, supply creates its own demand. Although this was meant to apply in a barter economy, it was further developed to apply on a monetary economy. Households engage in production in order to exchange goods with other households. Hence, production of goods in the market would stimulate recovery since demand is created and more money would eventually be available in the economy. In production various factors of production are involved. These are labor, land, capital and entrepreneurship. The rewards to these factors of production i.e. rent, interest, profits etc represent income to one sector in the economy.

Aggregate demand concerns the determiners of the demand for goods and services. While post Keynesians favor discretionary policies especially fiscal policies to ensure full employment and inflation less demand. Monetarists choose demand management policies such as money as supply rules a balanced budget and non intervention in income. In their view, the policies ensured sufficient aggregate demand. However, there was no chance that the Obama administration would sit and wait for nature to take up control of the economy. The risk was too great.

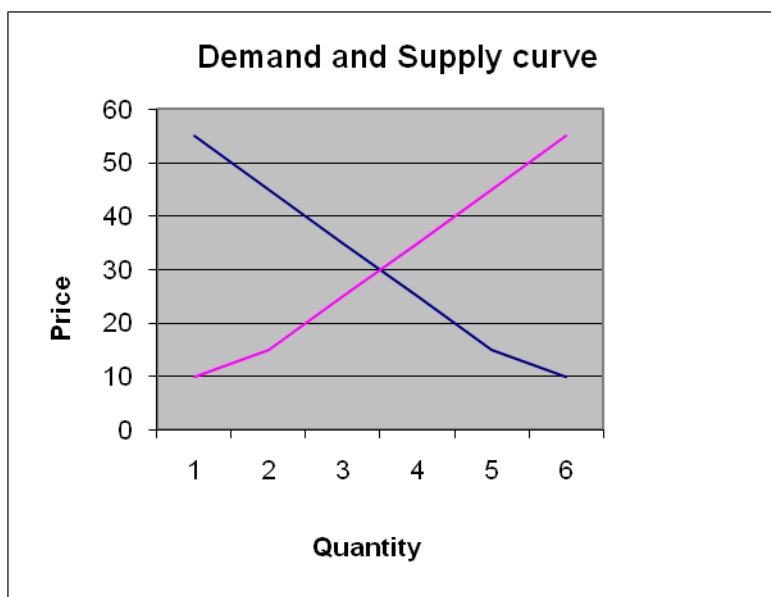
Aggregate supply analysis describes the overall effect of the level of goods available. On the supply side productivity and capital is emphasized. The 1970 inflation maybe analyzed in terms of supply side economics e.g. in the USA labor productivity, grown slowly over that period in fact slower than the raise in wage rate. This results in inflation as more dollars chase very few goods and services. The economic surplus plan is meant to counter this effect by ensuring that there enough goods that are being produced at any given time. Supply siders were of the opinion that tax cuts could also be used as their tool kits. The policies could increase savings and capital formation by reducing welfare subsidies and stimulating private labor training programs.

GDP price deflator is a measure of inflation that uses current prices to account for inflation b y converting output into constant dollar GDP. It shows how much a change in price level is relied by base year price levels. The real interest rates are adjusted for inflation measures whereas nominal interest rates do not account for inflation.

Real interest rate = Nominal Interest rate - Inflation.

If inflation is positive, then the real rate would automatically be lower than the nominal interest rate. Nominal GDP is the value of all the goods and services produced in a country, while when we talk of net national product is a measure of value at current prices.

Net exports represent the difference between imports and exports. An economic stimulus plan had the aim of encouraging the consumption of local American commodities. This was dubbed the “buy American” campaign. In this respect, raw materials used for construction especially steel would all be locally produced. This would help reduce the balance of payment deficit and ensure positive net exports. Though income taxes would be reduced, there would improvement in the economic state.



This debate of the various macroeconomic policies available would be so incomplete without the analysis of the factors of production and their corresponding reward in the circular flow of income. In the US economy it is very relevant that the various factors of s are able to interact in a certain way while holding other factors constant.

To advance this debate we can assume a two sector economy which is composed of individuals and firms as illustrated in this debate. This holds constant the fact that there are external factors that influence these two sectors.

The operation of this is in such a way that the firms provide goods and services to the households while the household pay for these good and services in return. Households on the other hand render their services in terms of labor to the firms and in return they earn income.

There are various macroeconomic problems that have however been advanced in the speech by Barrack Obama. For example there is the evidence of the depression period. A remedy formulated for this would be to increase aggregate demand by combination of tax cuts and government spending programs that would increase national employment and output. This was greatly seen in the commissioning of many infrastructural projects that acted as a source of the employees in the US economy.

Another problem is inflation. During the period of inflation the fiscal remedy introduced is to increase taxes with a reduction in government spending thus reducing aggregate demand. The fiscal policies adopted to solve these macroeconomic problems can be complemented with monetary policies such as open market operations, cash ratio and rediscounting windows.

A close analysis of these policies adopted by the United States government shows that they adequately meet the requirements needed to solve macroeconomic problems as the country has been able to solve the depression and the inflation issues at hand.

Work Cited.

Faiola, Anthony; Montgomery, Lori (May 15, 2009). "Trade Wars Brewing In Economic Malaise". *The Washington Post*. http://www.washingtonpost.com/wp-dyn/content/article/2009/05/14/AR2009051404241_pf.html. Retrieved April 23, 2010.

Leonhardt, David. "Economic Scene: Judging Stimulus by Job Data Reveals Success." *New York Times*. February 16, 2010.

<http://www.nytimes.com/2010/02/17/business/economy/17leonhardt.htm>

MacGillis, Alec (May 21, 2009). "Tracking Stimulus Spending May Not Be as Easy as Promised". *The Washington Post*. <http://www.washingtonpost.com/wp-dyn/content/article/2009/05/20/AR2009052003535.html>. Retrieved April 23, 2010.

Sullivan, Andy (February 23, 2010). "UPDATE 2-US stimulus added up to 2.1 mln jobs in Q4 2009-CBO". Reuters. <http://www.reuters.com/article/idUSN2311303720100223>. Retrieved 2010-02-28.