

Does Good Politics Beget Good Economics?

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An appraisal of The American Rescue Plan Act of 2021

Close to fifty years ago, there was a lively discussion about helping the poor. George McGovern, the Democrat Presidential Nominee in 1972 came up with an idea he labeled as a “demogrant”. This program would give checks of \$1,000 a year to every adult. It was branded as Socialism by the right. Even Hubert Humphrey, a liberal Democrat, was against it and thought it would have to be financed by tax increases on the middle class and would undermine the will to work. To make matters worse, polls showed that the very people who would most benefit from demogrants (the poor) were against these “handouts”. When McGovern heard about the poll results, he complained in disgust: “Do they think they will win the lottery?”

McGovern soon gave up on the idea. The idea that he was a Socialist stuck and he won only one of the fifty states against President Nixon.

Friedman’s Negative Income Tax

What was less noticed at the time was that Milton Friedman, the conservative Nobel Laureate Economist, also had a plan to help the poor. He called it the “Negative Income Tax”. Here is the basic idea. People who earn beyond a certain income threshold would pay income taxes. And those earning below that threshold would get money back from the government according to a specific formula. The program would be designed so that people who work would always make more money than people who do not. Friedman thought that this system would act as an incentive to work while alleviating poverty.

This program, as discussed over the years, has had bipartisan support. But for political reasons, it has never been acted upon. Too many people were against what they perceived to be “handouts” to the poor.

The Reagan Revolution

The 1970s were difficult times economically. A new phenomenon appeared which went against the idea that the government could help ensure economic prosperity. This new phenomenon was called Stagflation. Both inflation and a recessionary economy appeared at the same time. This paved the way for Reaganism and the famous pronouncement from Ronald Reagan that “government is the problem”. For the last forty years, the country has been under the sway of free market economics. Bill Clinton in a sense blessed the Reagan Revolution when he stated that the era of big government is over.

Over the years, the Reagan Revolution has seen a massive rise in asset values, particularly stocks and real estate. There has also been a very large increase in inequality favoring the top 1%.

But the first real jolt to free market economics appeared in 2008 when the economy spiraled downward and was only saved by strong government programs initiated by the Bush Administration (Republican) and continued by the Obama Administration (Democrat).

The second jolt to free market economics appeared in 2019 with the arrival of Covid-19. The Republican Administration of Donald Trump, working with Democrats, crafted unprecedented government programs which succeeded in stopping the economy from heading into a massive Depression.

Big Government is Back

We know that there is basic agreement among a majority of Americans that government action is required and that the poor and the disadvantaged should be helped. Part of the reason for this is that now with the onset of Covid-19, many more are now "poor and disadvantaged." With the destruction of certain small businesses and some industries, people who thought themselves comfortably in the middle class have now become nervous about the future. In addition to being "good" for the recipients, money for the poor is good for the economy for one reason: the poor will spend the money, they will not hoard it. In the language of economists, the poor have a high marginal propensity to consume. This spending will spread throughout the economy and cause a substantial increase in economic activity.

With this in mind, one would think that in difficult times, such as today, both Democrats and Republicans would get together and put together a package with bi-partisan support. But unfortunately, political considerations have entered into the picture. The Republicans have accused the Democrats of coming up with a liberal wish list and that some aspects of the program are not necessary to address the current Covid-19 related problems. There is also the fear that the latest bill just signed by President Biden is too stimulative and may lead to inflation. There is the further fear that the bond markets and the Fed would react to inflation by increasing interest rates which would cut short any recovery and, in fact, lead to a downturn.

The Democrats, on the other hand, remember the lessons of the last downturn in 2008 (GFC, the Great Financial Crisis). Then, the stimulation supplied was not enough and the recovery was slow and less than expected. At that time, the Democrats wished to have bi partisan support but this failed. Many Democrats do not want to make that same mistake again.

The Biden Administration and the Fed, headed by Republican Jerome Powell, think that it is better to have too much stimulation than to have too little. They argue that this package is not at all stimulation, it is a recovery bill. They think that the fears of inflation are exaggerated.

What Joe Biden has achieved with the American Rescue Plan Act of 2021 is an extraordinary political achievement

Here is what Helaine Olen wrote in the March 14, 2021 Washington Post (See "Opinion: Joe Biden's covid-19 relief bill is an extraordinary achievement"):

The just-signed \$1.9 trillion American Rescue Plan Act is incredibly popular. Polling shows that 7 out of 10 Americans support it. A majority of men and women say they are in favor of it. People of all ages, races and income brackets give it a thumbs up in large numbers. This is extraordinary. In a nation where people who need to rely on welfare to get by are routinely derided as 'takers,' Joe Biden and congressional Democrats sold the nation on the largest expansion of the social safety net since the Great Society initiatives of the 1960s and they did it in less than two months.

The article continues: "Here's the secret: By ignoring decades of so-called Washington wisdom about the need for narrowly, targeted aid and small steps forward, this legislation allows us to sidestep our societal tripwires around race, poverty and who we think is deserving of government assistance."

And here is why the plan is such a large political success: "The American Rescue Plan assumes that almost everyone can use a helping hand." This sentence is worth repeating and capitalizing – "THE AMERICAN RESCUE PLAN ASSUMES THAT ALMOST EVERYONE CAN USE A HELPING HAND." About 85% of adults and children, for example, will receive a stimulus check. In other words, this Act makes benefits "near universal".

Helaine Olen ends her article by stating: "Yes, many of the benefits for individuals and families are temporary, but it's almost certain that the expansion will create a large constituency for making them permanent. This bill is a remarkable and amazing achievement."

Key Elements of the American Rescue Plan Act of 2021

Over half (54%) of the money goes to households. This includes the \$1,400 checks which go to most Americans, unemployment insurance through Labor Day, expanded tax credits and various other programs for rent, food and health insurance. This program is expected to reduce poverty by one third and child poverty by one half. In addition, about 8% of the Act provides funds for schools and universities.

Here are the Key Elements of the American Rescue Plan Act of 2021:

- Individual stimulus checks of \$1,400 per person and dependents will amount to about \$420 million.
- Unemployment benefits of \$300 per week through Labor Day.
- Earned Income Tax Credit is a refundable tax credit for low and medium level earners which include workers without children. The amounts were increased and the law extends eligibility to young adults who are not full time students and to people over 65.

- The Child Tax Credit is expanded from \$2,000 per child to a maximum of \$3,600.
- Nutrition Assistance - this enlarges the so-called food stamps program through the end of September.
- State and local governments will receive \$20 billion for assistance to low-income households for rent and utility aid. An added \$10 billion is available to help homeowners with mortgages and property taxes.
- Employers who voluntarily provide paid sick and family leave through the end of September will continue to receive tax credits.
- An additional \$130 billion will be provided through September 2023 to assist elementary and secondary school students return to classrooms.
- Funding of \$70 billion is provided for Covid-19 vaccine distribution, and testing-related expenses.
- There will be temporary increased subsidies for people purchasing health insurance through the Affordable Care Act.
- Small business relief including for restaurants and bars are provided through a Restaurant Revitalization Fund of \$28.6 billion. Also, \$15 billion is allocated for targeted Economic Injury Disaster Loan Payments which provide help for businesses suffering from a temporary loss of revenues. This relief includes \$23 billion earmarked for the airline industry.

Repercussion of this Act and Other Government Spending Programs during the Covid-19 Era

There is no doubt that the American Rescue Plan Act of 2021 is politically popular. But is it good economics? How will it all turn out? Who is right? Is this a good package from an economic point of view? Reasonable people can disagree. At this juncture, it is too early to tell.

What are the economic effects of this bill and other stimulus programs as a result of Covid-19? (The following statistics were gotten from the presentation on 3/16/21 by Steven Rattner on the TV Program "Morning Joe" on MSNBC. Mr. Rattner is a New York investment asset manager and was the lead adviser to President Obama in rescuing the auto industry in 2009. As an investment banker, he worked for Lehman Brothers, Lazard Freres and Morgan Stanley. He is presently a journalist and opinion writer for the New York Times and is the Head of an Investment Group which manages the personal and philanthropic assets of Michael Bloomberg).

- In the last two years, the federal government deficit amounts to about \$6.5 trillion which is 50% more than the total federal government deficit from 1965 to 2005.
- This deficit is substantially larger than the deficits resulting from the Great Financial Crisis in 2008 and 2009 for which the Obama Administration received a good deal of criticism (by Republicans), and which led to negative political repercussions for Democrats who lost control of the Senate and the House during the Obama years.
- During World War II, the ratio of total government debt to GDP (Gross Domestic Product) exceeded 100%. By the late 1970's, the ratio had dropped below 30%. As a result of the Covid-19 stimulus programs, the ratio is now more than 100% during peace time. In other words, total

Federal Government Debt is now greater than the economy for the first time during peace. (Of course, another way to look at the situation is that we are now at war in another sense).

- These deficits have increased the debt per person in the US to about \$72,000 which is a startling figure considering that the median income in the US is about half this amount.
- Projections in the future show that deficits, even after recovery from Covid-19, will be more than \$1 trillion/year.

The counter argument is made that rates are so low that the increased debt will not be a burden. But this argument assumes that rates will continue to be low in the future.

Mr. Rattner expressed the opinion that at some point, deficits of this magnitude may lead to inflation and higher interest rates. Should this happen, the deficits would increase just to finance the interest payments on additional government debt. This would crowd out other important social spending programs.

This is the danger posed by these spending programs according to Mr. Rattner who is skeptical of the economic merits of the program. Mr. Rattner is a Democrat.

Is the American Rescue Plan Act of 2021 economically irresponsible?

Opinions on this are mixed. Predictably, most Republican politicians are critical and this explains why no Republican in the House or in the Senate supported this bill despite its enormous popularity across party lines.

More importantly there are some doubts among Democrats such as Mr. Rattner (as noted above) and Larry Summers who was President Clinton's Treasury Secretary. They are afraid of the possibility of inflation. They are also critical of the fact that the program was not sufficiently targeted to help the needy (for example, does a family of four making \$140,000 a year need stimulus checks of \$1,400 each in some cases). In addition, they are critical of the fact that there was nothing in the bill for badly needed infrastructure. They fear that it may be politically impossible to continue large spending programs without significant tax increases.

On the other hand, Treasury Secretary Janet Yellen, Fed Chairman Jerome Powell and Nobel Prize Economist Paul Krugman argue that the mistake the Obama Administration made was not enough stimulation and that this should not be repeated again. They think that the fears of inflation are exaggerated.

To sum up, we have a bill that is overwhelmingly popular and is putting money into the hands of people which should pump up the economy to solid growth rates. The latest projections show that GDP should increase by over 6% this year. Whether the magnitude of spending will lead to inflation and high interest rates is not at this moment clear

Conclusions

The American Rescue Plan Act of 2021 is widely popular and a political success despite the fact that no Republican in Congress voted for the bill. In the past, huge spending bills to help the poor were not popular. This bill has something in it for the overwhelming majority of the population. If the bill is an economic success it will change the political landscape of the country.

The Biden Administration is taking a big gamble. It knows that the bill is good (perhaps even crucial) politically because there is something in the bill for the overwhelming majority of Americans.

The success of the bill is dependent of course on the economic outcomes. The Head of the Federal Reserve (a Republican) and the Treasury Secretary (a Democrat) are supporters of the bill. Both are serious, respected figures known to be very careful and analytical.

The unvarnished truth is that nobody knows what the economic consequences of this bill will be. As my Father used to say: "We will see what we will see." If the bill turns out to be an economic success, we can be sure that the era of big government is back.

If the bill is not an economic success there will be not only economic consequences but political consequences as well.