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Like Steve Jobs, Ben Bernanke Should Think Long-Term

WILLIAM POOLE | 08/30/2012

Today, Fed Chairman Ben Bernanke kicks off the annual Economic Symposium of the Federal Reserve Bank of Kansas City, which draws central bankers, academics, market participants and policymakers from around the world. I have taken the liberty of drafting his ideal speech:

Again this year, as for the past three years, we seek to understand the prospects for the U.S. and world economies following the most severe recession since the Great Depression.

We thought that by now economic growth would be picking up, but the expected sustained recovery has not occurred. In the U.S., employment is growing but far too slowly.

Why?

Bottom line: The absence of a long-run fiscal plan is weighing heavily on planning by the business sector.

I'll focus this morning on the role of nonresidential fixed investment and the effects of fiscal policy on this important component of GDP. In the second quarter of 2012, real business fixed investment was still 6% below its level at the business cycle peak in the fourth quarter of 2007.

As I reflect on these issues, I keep coming back to the marvelous biography of Steve Jobs by Walter Isaacson. Are there lessons in his life as an entrepreneur and head of Apple Computer — now just Apple — for public policy today?

Apple made huge investments in developing the Macintosh computer and subsequent i-this and i-that. The vision was remarkable and the length of time to develop new products not trivial.

Apple's Macintosh computer project began in 1979 and continued through turbulent years in the early 1980s of very high interest rates followed by deep recession; the machine did not come to market until early 1984.

Later products also took years to develop. Even the Apple store took almost two years from Jobs' conception to opening.

Business investment is especially vulnerable to uncertainties about the future because the lead times are often long. Projects expected to come to market in three to five years are much more dependent on the long-term environment than on the immediate business situation.

Washington's Fiscal Paralysis

Lagging business fixed investment cannot be attributed to monetary policy. Interest rates are at historic lows and have been for some time. Banks are flush with funds, as are large corporations. Monetary conditions are not restraining economic growth. We need to look elsewhere for the source of the problem.

Everyone is well aware of the standoff — indeed, paralysis — in Washington over fiscal policy. Monetary policy cannot fix or even offset the damage being done by fiscal inaction.

In round numbers, to stabilize its finances the federal government needs to cut its annual deficit by $500 billion, or about 3% of GDP.

Doing so will require cuts in outlays, revenue increases, or some combination of the two. Doing more would be wise, but 3% of GDP is the minimum. The problem for the economy is this: No one knows where the spending cuts or revenue increases will fall.

Consider expenditure cuts first, because their impact is easy to explain. In nominal dollars, in 2011 total government consumption expenditures and gross investment — "government purchases" for short — was 20% of GDP. This figure includes both federal and state and local purchases, which are partly financed by the federal government. Obviously, a resolution of the budget issue will not eliminate the entire 20%.

If you were a government contractor, however, from a defense supplier to a road-paving company, absent a budget deal, you couldn't know what your share of the cutbacks would be. Even if ultimately government purchases are reduced by 3% of GDP, 20% of the economy is negatively affected today because no one knows who will fall in the 3% group.

Thus, although on crude Keynesian terms current fiscal policy is stimulative, because of the deficit, in fact policy is very restrictive.

The same argument applies to revenue increases, whether by increases in tax rates or by reduction of tax preferences.

Until disputes about corporate taxation are resolved, corporations are left wondering what the effects will be on their particular businesses from some combination of tax rate and tax preference changes.

Tax Uncertainty

What about the individual income tax?

Reducing certain tax preferences will affect the businesses of those benefiting from those preferences. For example, scaling back the deductibility of home mortgage interest — a proposal discussed by many — leaves prospective homeowners and homebuilders in doubt.

Similarly, increasing upper income tax rates, which may or may not occur, will affect the return to entrepreneurial activity.

Steve Jobs was not himself much motivated by money, but his investors and employees were. The possibility of a tax increase and uncertainty over its size weighs negatively on today's entrepreneurs.

The Apple story makes clear the importance of accumulation of human capital. Steve Jobs attracted skilled and experienced software engineers and managers from other companies.

They gave up secure jobs to join a young firm with a charismatic leader and the promise of great riches if the company were successful.

They knew, however, that they would have to make a commitment of several years to see the Mac and, later, various i-products come to market.

In no case was the outcome clear at the outset.

Every serious observer agrees that there is a pressing need for tax reform, and that the shape of reform is to lower rates and broaden the tax base. It may or may not be desirable to raise more tax revenue in the process of reforming the system. That is a political judgment properly left to elected officials.

My counsel, however, is to get on with it.

In the late 1990s, Steve Jobs launched the "Think Different" ad campaign. For the federal government, the mantra needs to be "Think Long-Term."

We are fortunate that the U.S. economy is terribly resilient. Current fiscal uncertainties have depressed growth but seem unlikely to cause a recession in the near-term.

Vigorous growth is in our future once people understand what government spending is going to be cut and what taxes are going to be increased to control the deficit.

I emphasize again that monetary policy cannot fix the fiscal problem. If the Fed finds something more that might be done through monetary policy, we will do it.

But I must be clear: Monetary policy has gone about as far as it can in offsetting the negative effects of current fiscal policy paralysis.

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