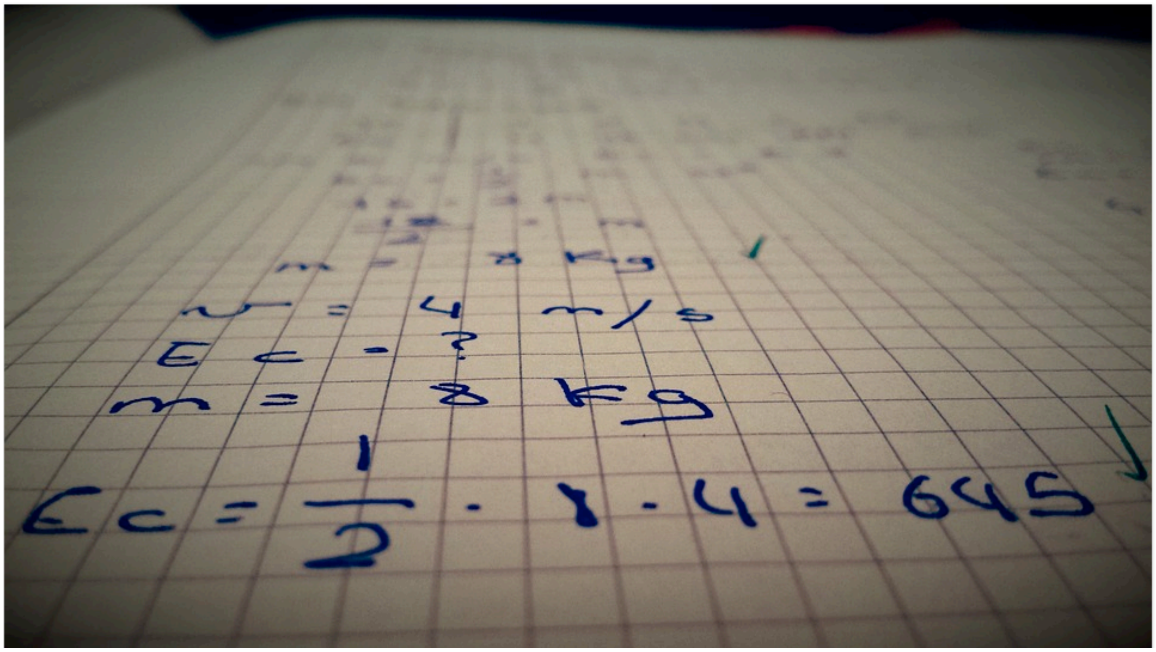

Keynesian Multiplier is a Subtraction from Reality

One of the biggest fallacies in all of economics, especially of the Keynesian variety, is that governments can spend and print the economy into prosperity. This flimsy logic is akin to that of the flat earth crowd or those who scour the woods looking for Sasquatch. Like the above examples but less sensational, the Keynesian philosophy is a figment of a perfect world. Economic think tanks around the world elude reality and choose to think of the economy in terms of equilibrium rather than the diverse, complex, and interconnected organism that it actually is. Never more evident is this than the notion of the Keynesian Multiplier. The Idea is that the government can induce growth via the spending, hiring, and producing of labor. This means that a government can hire people to do jobs like infrastructure or remedial projects and in return the income distributed from that labor (paid by the government) would be used and would perpetuate other economic activity. This idea does not specifically distinguish the cost or benefits between productive government investment and frivolous government spending. Keynesian in its purest form is uninterested in focusing on the

merits of the labor itself but rather the misallocated income/capital that is distributed to the population. To this point, a bridge to nowhere or repaving an already well functioning road is as effective as creating new more efficient public transit and other investments that could result in a more productive society. Nevertheless, promoters of these theories postulate that the laborer will then take that earned income and spend it at the market and that merchant will then take that new found income and spend elsewhere. This cycle repeats itself several times over creating a so called multiplier effect in which that original dollar given by government contract turns into multiple dollars of economic activity. Although this may indeed bring about higher money velocity, as a principle these ideas are plain fantasy. If Governments could buy or spend its way to prosperity than the economic ecosystem would never fall out of bed as it does quite often. More importantly, these ideologues fail to consider several major factors. First to mind is where does this capital come from? It can only come from three places: taxes, debt issuance, or Federal reserve servicing (or maybe all 3). Raising tax revenue would create a higher burden on producing members of society which would leave those affected with fewer savings to invest and further create jobs and economic output. Debt issuance would strain the treasury as well as spook bond and note buyers sending prices lower and yields higher. Someone buying a U.S treasury wants to know that the loan is used for sustainably economic means and will produce cash flow for which to pay back the lender. The Bond market is the deepest and "smartest" market in the world and would undoubtedly smell out the ponzi scheme if such government programs were enacted. The last possibility is certainly the craziest one. That is for the Federal Reserve to provide the means by either directly providing fiat dollars to the government or by way of Quantitative Easing (Ie. Financing the treasury by buying the bonds without the expectation of payment). Many pundits have called this proposed action "Helicopter Money". This is the idea that the fed would directly or indirectly inject freshly printed money into the hands of common citizens rather then member banks to potentially loan out a specified rate. Whatever the name for this process the

outcome would be detrimental to the U.S. Presumably; inflation would spike damaging savers, the elderly on fixed incomes and domestic and foreign holders of Treasuries. More than likely the economy would see a boost in GDP. Initially this would be welcomed but eventually it would be exposed as quasi "cooking of the books" as GDP growth would be manly in nominal terms only and when looked at in real terms (or adjusted for inflation) would look much less impressive. Another knock off effect would be the standing of the dollar as the world's reserve currency. Mistrust or abuse of the dollars value by way of Keynesian policies would put the reserve status in jeopardy and potentially act as a trigger to replace it with gold, the SDR, or some other commodity backed system. This would be disastrous for our markets as the dollars reserve status has given the U.S the leverage to continue its deficit spending, financing both the welfare and warfare state. Defaults along with Political upheaval could be the result leaving the current system in disarray.

Leaving those negative outcomes aside, the Keynesian multiplier still falls flat in its realistic utility. If such seemingly drastic policies were to be implemented it begs the question how bad would the economic environment be? In times of economic distress indiscriminately paying labor the market deems undesirable or printing prosperity does not solve the problem of how recipients would spend it. One plausible outcome is that people will just use that to pay down existing debt which otherwise would be unserviceable. This would do little to perpetuate the multiplier part of the equation as money would have little to no turnover or further output. If there was an effort to establish some system of expiration of the funds forcing spending and consumption, the effects could lead to an initial economic boost but would soon tail off. This consumption would be front loaded by pulling forward tomorrows spending to today. I have no doubt that this would leave the economy and the monetary officials in a never ending cycle of injections which would have serious implications for the free market system. Said differently, once you dose the patient you need to continue to dose the patient with ever diminishing returns. This brings

another important principle to mind. That is: Is it fundamentally right for the government to intervene at all during times of economic distress? Newly appointed physicians must agree to what is called the Hippocratic Oath. This oath has many principles but a few hold values for which the economic authorities ought to strive for. Specifically the quotes *"I will apply, for the benefit of the sick, all measures which are required, avoiding those twin traps of overtreatment…"* and *"I will not be ashamed to say "I know not," nor will I fail to call in my colleagues when the skills of another are needed for a patient's recovery"* are shining examples. If the powers that be are unsure, ill-equipped or are in danger of over treating the patient (the economy) then it is best that they let market forces take hold and allow for low prices to cure low prices. There is not better example of this than the economic downturn of 1920-21. Due to debt hangovers from WW1 the U.S found itself in a deep recession. Rather than try and spend and further indebt there way out of the situation the federal government cut is spending by 2/3rd while the Fed raised rates to 7% in the face of falling consumer prices. The result was the opposite of what Keynesians would have predicted as the economy quickly and naturally found its footing and went on to thrive during the roaring 20's. This is the ultimate lesson of "less is more". It also calls into question the whole theory of the Keynesian multiplier. How can it be a so valid yet not account for the quick recovery in 1921. The answer is easy. The best corrector off market distortions is the market itself. If the authorities were at all capable of creating prosperity there would have never been a Great depression and we would not be in a long period of stagnation that we are experiencing today.

I have no illusions that any one philosophy has all the answers. Instead it is the market and true unencumbered price discovery and capital allocation that answers all. If nothing else 1921 proved this point brilliantly. Still, I have little doubt that Keynesian policies like the multiplier effect will be employed in the future as the cure all. My only hope is that I will be able to bask in the irony that it will be the Mr. Market which finally deals

the death blow to draconian policies like the Keynesian multiplier.