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Dear Readers,
MuseLetter for February offers pretty slim pickings (see below). Why so little, so late? Well, I'm working on a new book. I'll have more to tell you about that next month!
Best wishes,
Richard

Deficit Reduction = Recession

The math is not difficult. The US has an annual GDP of $14 trillion, and the nation's current $1 trillion in annual deficit spending is seven percent of its GDP. Growth in GDP has recently been running at about two percent annually (though in the last quarter of 2012 the economy actually contracted slightly). The relationship between deficit spending and GDP growth may not be exactly 1:1 but it's probably quite close. The conclusion is therefore inescapable: doing away with a substantial portion of deficit spending would reduce GDP by a roughly corresponding amount, almost certainly causing the economy to tip over into recession.

Now, nobody in Washington is openly calling for a recession. So why are so many politicians adamantly demanding deficit reduction? It's because they see accumulating US government debt spiraling to unsustainable levels. Many politicians also believe that the main actual function of government is to *stand in the way of* private enterprise. Assuming that's true, it follows that by downsizing government these politicians will succeed in opening space for the private sector to flourish. Whittle! Cut! Slash!—it's all good.

Meanwhile, back in the real world, the private sector shows no signs of being ready to pick up the slack. Indeed, US economic growth has been stagnating for decades now. Economist Robert Gordon's research conclusively demonstrates that the lion's share of historic GDP growth occurred in the mid-20th century and was driven by cheap oil and electrification. Since 1970, globalization and an explosion in information technologies have produced comparatively minor economic expansion by comparison, at least in the OECD countries. We kept faux-growth alive largely through borrowing—by an unprecedented accumulation of household, corporate, and government debt. Spending borrowed money on bigger cars and new iPhones kept the consumer economy ostensibly healthy; meanwhile, making and managing the ensuing mountain of debt fattened the financial industry to the point that Wall Street now calls the shots on Main Street, Pennsylvania Avenue, and just about every other

thoroughfare in America. Since the US housing bubble burst in 2007-2008, households have stopped taking on increasing amounts of debt; that has left government deficit spending—and one more ephemeral Wall Street bubble, this one based on hyping stock shares in companies specializing in shale gas and tight oil fracking—as the final props holding up the growth facade.

The implication of Gordon's work is that *real* growth is pretty much over and done with no matter what we do at this point. I made the same observation in my 2011 book *The End of Growth:* expensive oil, too much debt, and rising environmental impacts (especially climate change) mean the growth party is over.

Yet no one in Washington is planning for a post-growth economy, even as Congress giddily kicks loose the last backstop against recession. This experiment has already been tried elsewhere, most recently in Greece, Spain, and Ireland; in each instance, dramatic cuts in deficit spending led to plummeting economic activity.

But what are the alternatives? There is a relatively small group of economists and politicians (think Paul Krugman, Robert Reich, and Bernie Sanders) who understand the obvious link between deficit cuts and recession and are calling for *more* government deficit spending as a way of jump-starting the economy. If Gordon is right, that tactic won't actually accomplish much. The eventual result will be inflation and an international backlash against the dollar. It would be, at most, a time-buying measure.

The best way forward would be, yes, to continue deficit spending, with the Federal Reserve buying up most new Treasury debt and rebating the interest to the government (as it has been doing with its QE programs) . . . *but*—crucially—*to shift that spending toward supporting a transition to a post-growth economy*. Downsize the financial industry with re-regulation and a tax on financial transactions. Organize a massive debt jubilee. Provide incentives for the development of local cooperative enterprises geared toward import substitution. Create make-work programs building low-energy public transit, constructing renewable energy infrastructure, and insulating homes. Train a generation of young ecologically savvy farmers and provide them with the land and tools they'll need to succeed.

That's a fantasy future based on a realistic assessment of the present. Its likelihood of realization is small. What we're likely to get instead is a hard-edged future following inexorably from the economic delusions of the left and right. The political situation in Washington is such that—whether it's the "sequester" or a compromise work-around—substantial near-term deficit reduction is more or less inevitable. As a result, America will be thrust back into an economic situation reminiscent of early 2009.

Recession 2013: it's a mathematical near-certainty.