

Modeling Delusions

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It is disheartening these days to see some of the country's supposedly foremost media outlets publish economic writings that are completely fallacious without any mention of dissenting views. Rather, these writings are offered up as a settled science, that all experts agree, and the academic credentials of the said author defies the need for logical explanation. In fact, the authors are so brilliant, ye common man need not understand, as you won't, only trust in their wisdom with faith.

Despite the vast efforts and careers of many people to prove that government intervention, government spending, and government debt somehow provides for a better economy, these notions are easily refuted. These economists, mostly in academia, have devised numerous theories and mathematical models that illustrate how government spending increases the productivity of the economy by xtimes what the economy would have been without the spending. The mathematical models have become more and more complex, but the models are all based off of inaccurate and oversimplified assumptions. Models can produce any results desired, simply by changes in the assumptions and variables.

In structural engineering modeling is used very successfully. However, even in structural engineering, where the materials are known, tested, and uniform, many assumptions and simplifications are still required. Regardless of the best intentions, this distorts the model from reality. While someday perhaps the technology may be so advanced that all materials, loads, and all other variables will be exactly known and incorporated into a perfect structural model, we are not there today. That does not make the structural model useless, but it means the model is only a tool that needs to be checked and verified by other means and experience. As more assumptions are made in the model, more scrutiny needs to be applied.

Now consider any model in the field of economics. Even the most simplistic economic assumptions such as the demand curve are imperfect due to the complexity of the subject in study. The variables are as infinite as the field of study in concern. And while we may be able to closely assume and build simple equations and formulas that somewhat mimic reality, they still aren't perfect, and when grouped and ran over time, even those simple models can result in horrific miscalculation. Therefore, all economic models need to be tempered, and regarded again only as a tool, with all outcomes being subject to critical analysis through other means and experience. When too much blind faith is put into the complex economic models, and the proper evaluation of the outcomes of these models is lacking, it can make for drastically erroneous results. The results can become so absurd, that simple common sense by a non economist can easily refute the long labored after results of the professional economist.

Any economist that claims that they can accurately model the entire macro economy is claiming that they have all the information on all the factors that make up an economy. Any economist that claims that they can accurately model the outcome of economic policies is claiming that they can accurately predict the reaction to those

policies by all the factors that make up the economy. Bear in mind that the macro economy consists of millions of consumers, millions of investors, thousands of businesses, thousands of regulations, millions of products and commodities, and a global economy with another million or billion factors, therefore, any macro economic modeling must be regarded as it pertains to reality, speculative at best.

Recently Paul Krugman, a Nobel Prize Winning Economist and NY Times editorialist, who has been pushing for much higher government 'stimulus', despite the fact the government is set to spend \$3.72 trillion dollars in 2010. [1] Without any more stimulus spending we are already set to spend 40% more this year than our federal government spent just in 2006. When you try to start an engine, if you pump the primer 10 times and pull the cord 30 times, and your engine still isn't started; common sense tells us your engine doesn't need more priming, it's probably flooded, and you might just want to leave the engine alone for a little while and give it some time.

Krugman, however, wants to keep throwing money at our problems, with no considerations to other factors, such as where the government is coming up with all this money. Common sense tells us that the government like any other business or personal entity cannot spend more money than it has in revenues. Common sense tells us that borrowing money just to pay the interest on previously borrowed money is a road to bankruptcy, default, or in the federal government's case printing money and massive inflation. Krugman tells us, that these worries and concerns are illogical and contrived as he tells us, "on belief on what I've come to think of as the invisible bond vigilante and the confidence fairy."

Unfortunately Krugman is not the only nationally known economist to be publicly touting more spending. James Galbraith, a professor at the University of Texas, echoed similar tunes in an interview with Ezra Klein that was published in the Washington Post. When Galbraith was asked if he was concerned about long-term debt, he responded, "No, I think the danger is zero. It's not overstated. It's misstated."

Galbraith continues throughout the article with the numerous statements that there is no concern with running continued government deficits. Galbraith states, "What people worry about is that the federal government won't be able to sell bonds. But there can never be a problem with the federal government selling bonds. It goes the other way. The government spending creates the bank's demand for bonds, because they want a higher rate of return on the money than the government put into the economy. My father used to say it's so simple the mind recoils from it."

Galbraith ends with a statement on government borrowing. Galbraith states, "Because the government needs to run a deficit, it's the only way to inject financial resources into the economy. If you are not running a deficit, it's draining the pockets of the private sector."

Krugman assures us that short-term spending will not at all affect our ability to pay off our long-term debt. He supports this point by illustrating that investors are still putting their money into government bonds, "long-term interest rates have plunged again. Far from fleeing US government debt, investors evidently see it as their safest bet in a stumbling economy, "

Krugman completes his latest NY Times article, titled 'Myths of Austerity', with the following suggestion. "So the next time you hear serious-sounding people explaining the need for fiscal austerity, try to parse their argument. Almost surely, you'll discover

that what sounds like hardheaded realism actually rests on a foundation of fantasy, on the belief that invisible vigilantes will punish us if we're bad and the confidence fairy will reward us if we are good."

When an economist tells you to suspend common sense because he's won a Nobel Prize for his contributions to economic modeling, and your common sense is akin to believing in the 'tooth fairy', I'd make sure to question the reasoning and logic behind the economist before I'd go dropping common sense and experience.

While arguing for more stimulus and more spending, both of these economists unknowingly have stated the problem with the current state of our economy. Erroneously, these two esteemed economists believe that it is only through government spending that the economy is able to churn. However, every dollar the government spends is a dollar that is taken out of the private economy. Isn't the answer here obvious? If the government was not running a deficit, it wouldn't need to sell bonds. Where would that investment go? The investment would go into private business; it would be investment directly into our economy. More investment in the private sector leads to more employment in the private sector. It is so simple that your mind can easily comprehend it without recoiling.

When government spending isn't borrowed, it comes in the form of taxes. Taxes take money directly from a consumer, investor, or business and shuffle it through the government machine; which is an expensive machine, and then returns a smaller proportion back into the private sector. How the government can take a dollar from an individual, pay for the collection of that dollar (with that dollar), pay for the political process to decide how that dollar should be spent (with that dollar), and pay to spend that dollar (with that dollar) would provide that individual or business with more value than if he himself had used the dollar on what he deemed valuable is unfathomable. Even Galbraith admits that if we didn't run a deficit (and paid for all our spending with tax dollars), we would drain the pockets of the private sector. How is draining the pockets of employers going to help employment? It won't, and that is bearing out quite clearly.

The constant government stimulus theme is that we need to create demand in the economy. The logic is equivalent to a businessman giving away his profits to his customers so that they have more demand for his products. If you create a model that says this is a productive way to run a business, I don't care about your intelligence, your algorithms, or your differential equations; your model is wrong.

In the case you have no beliefs in either invisible vigilantes or the confidence fairies, and your mind is recoiling, you could perhaps use the following paragraph by Ludwig Von Mises from his book 'Human Action':

"The long-term public and semipublic credit is a foreign and disturbing element in the structure of a market society. Its establishment was a futile attempt to go beyond the limits of human action and to create an orbit of security and eternity removed from the transitoriness and instability of earthly affairs. What an arrogant presumption to borrow and to lend money for ever an ever, to make contracts for eternity, to stipulate for all times to come! In this respect it mattered little whether the loans were in a formal manner made irredeemable or not; intentionally and practically they were as a rule considered and dealt with as such. In the heyday of liberalism some Western nations really retired parts of their long-term debt by honest reimbursement. But for the most part new debts were only heaped upon old ones. The financial history of the last century

shows a steady increase in the amount of public indebtedness. Nobody believes that the states will eternally drag the burden of these interest payments. It is obvious that sooner or later all these debts will be liquidated in some way or other, but certainly not by payment of interest and principal according to the terms of the contract. A host of sophisticated writers are already busy elaborating the moral palliation for the day of final settlement.”

This country has to stop spending and borrowing. Already our hole is massive, and the government is continuing to make it worse. I don't believe in fairies and a Nobel Prize is not an indicator of ignorance (well, it might be). This country needs fiscal responsibility; plug that in your model.

[1] Government spending statistics from www.usgovernmentpending.com