The Romers, and I suppose other neoclassical macro economists, believe that the economy tends towards full employment equilibrium and will move there on its own without need for government intervention or stimulus. They would acknowledge that following a negative shock, government stimulus spending may accelerate the recovery somewhat, as Bernstein and Romer in 2009 anticipated the Obama stimulus would speed recovery by about 6 months. They deny, however, that stimulus spending could change the permanent level of output because the economy will on its own return to full employment at a capacity output set without regard to the level of employment by factor endowments, by preferences, and by the level of exogenous technology. From this perspective, because a period of prolonged measured slow growth cannot be caused by involuntary unemployment, it must, by a priori assumption, be due to a decline in the exogenously determined growth rate in capacity. Like mosquitos on an otherwise delightful summer afternoon, slow growth is unfortunate but there is little that can safely be done about it.

Or maybe we can find safe pesticides. Here I agree with John Maynard Keynes that the economy can have a low-employment equilibrium because of a lack of effective demand, and I agree with Nicholas Kaldor and Petrus Verdoorn that productivity and the growth rate of capacity can be increased by policies that push the economy to a higher level of employment. And to the contrary, periods of prolonged unemployment and underutilization of capacity can lower capacity by discouraging workers and reducing the incentive to invest, to innovate, and to raise productivity. Unfortunately, this is what has been happening in the US for the last few years; and, fortunately, there is reason to believe following Keynes/Kaldor/Verdoorn that policy can reverse this decline by pushing the economy to a higher level of output and thus a higher level of productivity. Rather than dismiss the rising output gap as orthodox macro economists have done by assuming that the United States suffered a great loss of efficiency since 2007, I see an economy at low-employment equilibrium where discouraged workers have abandoned the labor market and firms have had little incentive to innovate or to raise productivity. In this situation, additional stimulus can not only temporarily raise output but by priming the pump and encouraging additional private spending and investment, it can push the economy upwards towards capacity. And, beyond because at higher levels of employment, more people will look for work, more businesses will invest, and employment will grow faster and productivity will rise pushing up the growth rate in capacity. That is why I see lasting effects from a government stimulus when, as now, the economy is in a low-employment equilibrium.

This theoretical point turns on empirical questions: are we 11% below capacity, as I would estimate, or are we 2-4% below, as the Romers suggest? And is capacity set or is it endogenous with respect to output levels; does it rise when the economy approaches capacity? If the Romers were right that the economy is at full employment at capacity utilization, and capacity utilization grows independently of the level of output, then there cannot be a lasting stimulus effect at a fully employed economy. In the Romer case, a stimulus can raise output only temporarily because output depends on capacity and the economy is always at or moving towards capacity. But, if the economy can be stuck at an unemployment equilibrium, if it does not move to a full employment equilibrium, or if a higher employment and output level can trigger a higher growth rate, then a Keynesian-style government stimulus can have lasting effects. Even a one year stimulus can push employment and output to a permanently higher level, and at that higher level it can generate faster growth by pulling more into the labor force and stimulating higher productivity growth. We might call this, the Keynesian-Kaldor case with equilibrium.
unemployment and growth dependent on the level of the output gap. In the Keynesian-Kaldor case, a one year stimulus can lead to permanently higher output both by reducing unemployment and by raising the growth rate of capacity.

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