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Free Enterprise: New year's new deal may be same old

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Everybody is waiting for, if not anticipating, the new year's new deal. A cacophony of voices across the political spectrum sings the praise of a new stimulus proposal that mirrors the legendary Depression-ara recovery plan.

Even this column has suggested several times that infrastructure investments of a significant magnitude would be a constructive approach to soften the effects of the current economic slowdown. However, what is sometimes lost in the hype is that there should be serious warning signs attached to the reportedly $1 trillion stimulus program.

A cursory search of the most prominent academic journals in the world results in 1,159 "hits" representing academic papers that have "New Deal" in the title. If one extends that search to the full text, then it increases that number to a whopping 24,690. Consequently, many a page has been filled discussing the efficacy of "New Deal" spending under Franklin Delano Roosevelt.

The majority of those studies support common wisdom in that they assign credit to the New Deal spending in alleviating some of the worst economic suffering. However, insights that are not reflected by common wisdom and popular lore include the dangers and pitfalls of such humongous government spending programs.

In order to see those hazards, one does not necessarily have to agree with a prominent 2004 study that suggested New Deal spending may have prolonged the Great Depression. Although the analysis was published in the highly respected Journal of Political Economy, its results are not uncontroversial.

UCLA economists Harold L. Cole and Lee E. Ohanian concluded in their paper (an earlier version is available at http://tinyurl.com/5ucwso [1]) that "New Deal labor and industrial policies did not lift the economy out of the Depression as Roosevelt had hoped. Instead, the joint policies of increasing labor's bargaining power and linking collusion with paying high wages prevented a normal recovery."

It suffices to be aware of the insidious effects of New Deal spending as detailed in a book published 10 years ago. Economists William F. Shughart II and Jim F. Couch demonstrated in their "The Political Economy of the New Deal" how stimulus expenditures were frequently the result of political motivations rather than economic needs.

In a large number of case studies, the two authors trace spending and loan projects across the United States and present evidence that, habitually, mitigating the pain from the effects of the Great Depression took a backseat to re-election goals by politicians in the decisions about where to spend the available funds.

To be clear, many economists - including this year's Nobel Laureate and Princeton University professor Paul Krugman - suggest that FDR's New Deal policies did not go far enough. In their analysis, more spending should have been undertaken at the time - and faster - in order to effect a speedier recovery. Consequently, as the suggestion goes, being too cautious in approaching the 2009 economic stimulus would be foolhardy.

However, the compelling arguments compiled by Shughart and Couch should be a humbling reminder that enormous sums of money can easily be redirected to support nepotism and cronyism rather than be targeted at projects that are most beneficial economically.

In that sense, an additional New Year's resolution on top of weight loss and smoking cessation may be in order: spending the money we borrow for a new New Deal wisely.

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