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Will more state spending stimulate the economy? [1]

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Things look pretty grim in the economy right now, so naturally people want to do something about it. That 'something' seems to be more capital spending in order to stimulate demand and put 'idle' resources to work. That's a bad idea, as Prof Steve Horwitz (whose ASI lecture next month is now fully booked)explains in a blogpost for the LSE's EUROPP blog [3]:

> *What advocates of stimulus are arguing is that we need spending, just any old spending, to jump start struggling economies. But this argument must assume that it does not matter which capital and which labour are brought out of idleness and into what sorts of activities. They must of necessity ignore the specificity of resources and their limited complementarity. It does us no good to try to force pieces together that don?t fit, as that?s what got us in trouble in the first place. And the point of doing a jigsaw puzzle of this sort is to get the pieces to fit in a way that forms an orderly pattern, not to simply use them all up.*
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> *The assumption in most stimulus spending is that there are projects just waiting to be pursued if only we would spend the money. What is overlooked is whether the capital and labour that are idle are the resources best suited to those projects, not to mention whether consumers and citizens even want those outputs in the first place. Just buying, hiring, and producing for the sake of ?doing something? will create a structure of production that is quickly found to be unsustainable. A few projects may be ?shovel ready,? but most will require engineers and others to do the planning. If the unemployed are mostly construction workers and financial managers, these projects will not be able to find the engineers they need at wages they can afford, and unemployment will not be reduced.*

Many people talk about discarding the unrealistic assumptions of neoclassical economics when it comes to policymaking, yet they cling on to notions of aggregate supply and demand that have no bearing on reality. Like capital, labour is heterogeneous: some capital can help to make cars and some can harvest strawberries, but they can't be interchanged quickly or easily -- in the same way, some people are good at designing bridges and others are good at building them. If you treat them as one big lump, you'll make a mistake. Disaggregating the factors of production is key to understanding why Keynesian fiscal stimulus by and large hasn't worked so far [4].

In a non-homogeneous world, adjustment takes time. As Horwitz says, we can "free up competition, prices, profits, *and losses* so that entrepreneurs and others can finish the process of tearing down the mistakes of the boom and figure out how to reallocate those resources to their new best uses". I'm struggling to think of one major pro-competitive reform the Coalition government has made since 2010 that would speed up that tearing-down process, and they certainly haven't freed up prices, profits or forced bad banks to make the losses they need to. Maybe that points to why things seem to have gone so badly wrong.

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