



COMPUTER WORLD – MIS ASIA

***GOVERNMENT SPENDING
DOES NOT STIMULATE
ECONOMIC GROWTH
DURING CRISES***

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**MATRYZEL
CONSULTING**

LEVERAGING KNOWLEDGE, CREATING VALUE

AGENDA

- The Stimulus Myth
- Why Idle Savings Don't Stimulate Economies **and** One Sided Picture With Job Creation During Recessions
- Is Free Market Economics Dead
- Malaysia – Going Forward



THE STIMULUS MYTH



The Crisis of Crises!



- ✓ **US Sub-Prime Mortgages Crisis, & Resultant Credit Crunch Hits Financial Markets Very Hard**
- ✓ **Over \$3 Trillion Impacted**
- ✓ **Capital & Money Markets Reel Under Pressure; Countries Go Bankrupt**
 - ✓ Cut or Halted Trading
 - ✓ Market Capitalization Losses Significant
- ✓ **Questions Raised On Unfettered Capitalism** – Blaming China For Not Permitting Faster Appreciation of the Yuan

Solution – Government Intervention Via Stimulus Packages

- ✓ **Central Banks Make A Concerted Move**
 - ✓ Reduce Interest Rates on Lending
 - ✓ Support Liquidity Of Floundering Global Firms - ***Too Big to Fail syndrome***
 - ✓ Provide Government Guarantees On All Deposits For A Minimum of 3 Years
 - ✓ Create Fiscal Incentives To Spur Sustenance
 - ✓ Certain Markets Provide Blanket Guarantees On all Bank Deposits
 - ✓ Governments Invest In Key Financial Institutions To Support Liquidity Needs

Why – Free Market Economics?



- ✓ An economic shock has left demand persistently and significantly below potential supply.
- ✓ As people stop spending money, businesses pull back production, and the ensuing vicious circle of falling demand and production shrinks the economy.
- ✓ Government spending can make up this shortfall in private demand.
- ✓ In an underperforming economy - government spending adds money to the economy, taxes remove money from the economy
- ✓ Increase in the budget deficit represents net new dollars injected. Therefore, it scarcely matters how the dollars are spent
- ✓ Government program that pays people to dig and refill ditches would provide new income for those workers to spend and circulate through the economy, creating even more jobs and income
- ✓ The Keynesian argument also assumes that consumption spending adds to immediate economic growth while savings do not. By this reasoning, infrastructure spend, unemployment benefits, food stamps, and low-income tax rebates are among the most effective stimulus policies because of their likelihood to be consumed rather than saved

Economic Stimuli & History of Failures



- ✓ During the 1930s, New Deal lawmakers doubled US federal spending - yet unemployment remained above 20% until World War II.
- ✓ Japan responded to a 1990 recession by passing 10 stimulus spending bills over 8 years (building the largest national debt in the industrialized world)--yet its economy remained stagnant.
- ✓ In 2001, President Bush responded to a recession by "injecting" tax rebates into the economy. The economy did not respond until two years later, when tax rate reductions were implemented.
- ✓ In 2008, President Bush tried to head off the current recession with another round of tax rebates. The recession continued to worsen.
- ✓ Now, the most recent \$787 billion stimulus bill was intended to keep the unemployment rate from exceeding 8% percent. In January 2010. it topped 10.85%. 3.3M new jobs were to be created; 3.5M existing jobs were lost!

So Why Did Economic Stimuli Fail?



- ✓ Stimulus Spending – *Inject NEW Money, Increase Demand & Hence Production*
- ✓ Where Is The NEW Money Coming From - *Either From New Taxes or Borrowed OUT of the Economy*
- ✓ ***NO NEW SPENDING POWER IS CREATED, RATHER ITS MERELY REDISTRIBUTION OF EXISTING PURCHASING POWER***
- ✓ ***ALTERNATIVELY GOVTS. HAVE TO***
 - ✓ *Borrow from domestic investors: those investors will have that much less to invest or to spend in the private economy.*
 - ✓ *Borrow the money from foreigners: Then balance of payments will adjust by equally raising net imports, leaving total demand and output unchanged.*
- ✓ ***CONCLUSION - Every dollar Governments spend must first come from somewhere else!!***

And Its Impacts On Long Term Growth Are Adverse

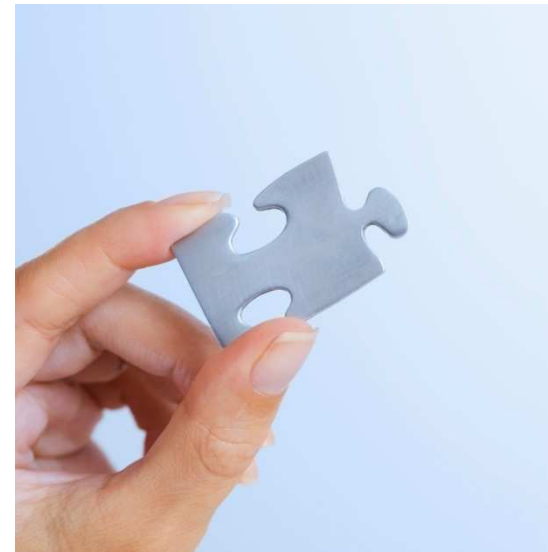


- 1 Less Money For Private Initiatives:** Every PRIVATE Dollar Borrowed By Govt. Is One Less Dollar Spent On Private Initiatives That Can Create Jobs
- 2 Job Offsets:** Every New Job Created Corresponds To One or More Private Jobs Lost
- 3 Long Term Growth Compromised:** Needs Labor Productivity, Labor Supply, New Technology – Not Done Short Term By Stimulus Packages
- 4 Productivity Losses –** Long Term Productivity Lost Owing to Shifting Resources From High Productive Pvt. Sector to Less Productive Govt.
- 5 Increased Budget Deficits –** Results In Tax Restructuring, Higher Interest Rates & Higher Debt Burdens on Future Generations

**IDLE SAVINGS DO NOT
STIMULATE ECONOMIES**

&

**NEW JOBS IS A ONE-SIDED
CONVERSATION**





Are Savings Idle? New Jobs Created?

Idle Savings

- ✓ SAVINGS In Banks, MFs, Trust Funds, Stocks, Personal Debt Reduction Avenues
- ✓ FINANCIAL SYSTEMS Immediately Lend Such Savings Out – Transferred to Someone Else to Spend
- ✓ **SO ALL MONEY IS QUICKLY SPENT – Whether Initially Saved or Consumed!!**
- ✓ Another Contention – *Banks Hoard Savings Beyond Legal Minimum Reserves [Overnight Inter-Bank Repos Proof Its Not Happening]*
- ✓ *Hence Unless If People Are Hoarding Savings In Safe Boxes or Under Their Mattresses, There Is No IDLE MONEY Available!!*

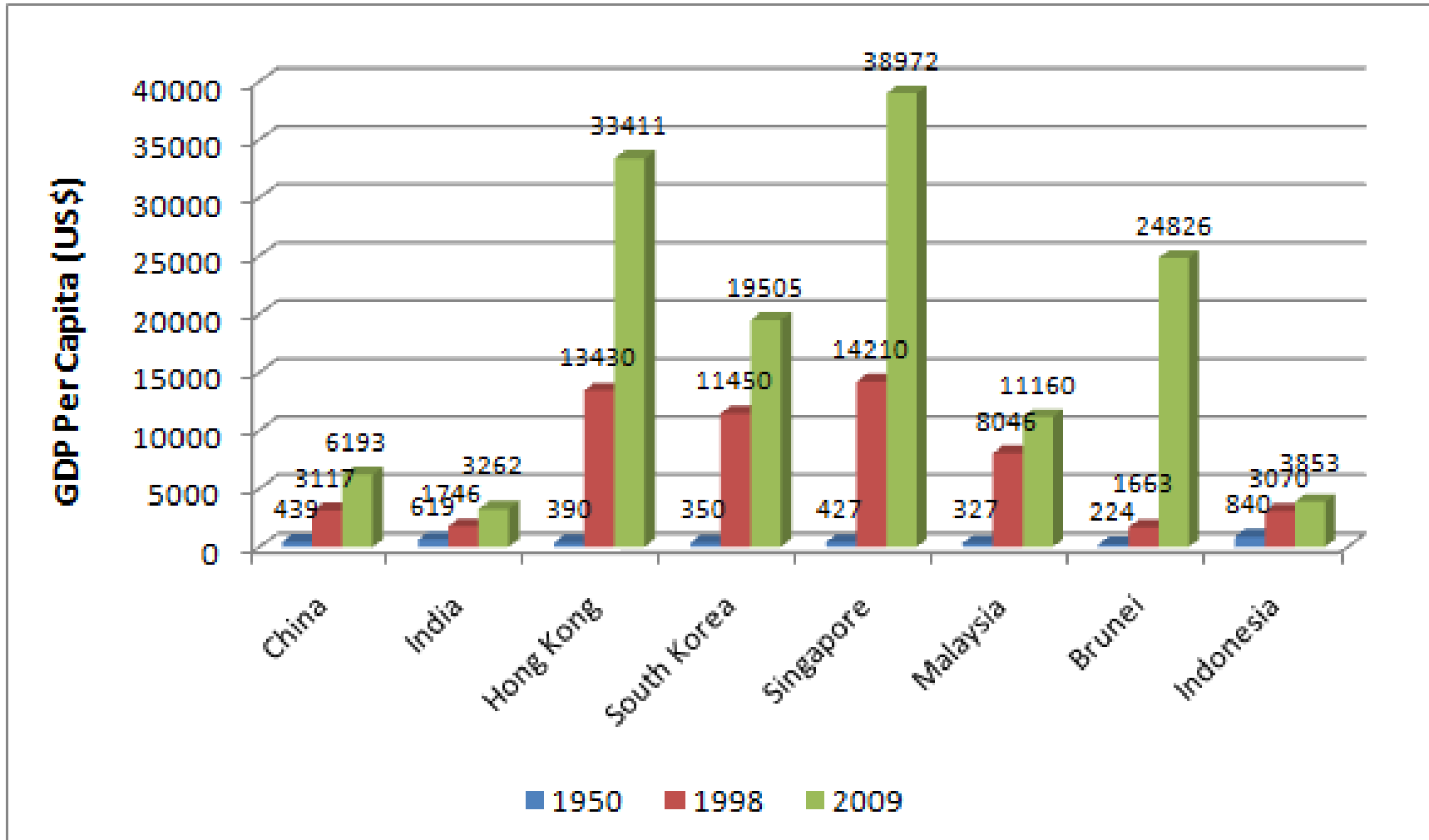
New Jobs

- ✓ Create New Projects – Infrastructure, New Factories, Deploy Under-Utilized Factories etc
- ✓ This Will Mean New Jobs, Or Redeploying Underutilized Resources
- ✓ **But At The Cost Of Other Utilized Resources That Will Have To Give Up Their Productivity**
- ✓ New Jobs Created In One Sector Are AT THE COST OF Existing Jobs In Another Sector That Supplied The Stimulus Funds
- ✓ *Hence Regardless of Unemployment Rate, It's a ZERO SUM GAME!!*

FREE MARKET ECONOMICS – CONSECRATED TO THE HISTORY BOOKS?



Is The Free Market Model Bad?



Seems The Free Market Model Did Work Very Well Indeed!!

Commission on Growth & Development



- ✓ Established by the WORLD BANK in 2006 Alongside Other Key Sponsors
- ✓ Studied High Growth Developing Economies From 2006 to 2008 That Showed Growth of 7% or More
- ✓ Chaired By: **Michael Spence**, *Nobel Laureate Economist*
- ✓ *Members*
 - ✓ **Trevor Manuel** - *ex-Finance Minister, South Africa*
 - ✓ **Zhou Zioachuan** - *Governor, People's Bank of China*
 - ✓ **Montek Ahluwalia** - *Dy. Chairman, Planning Commission, India & Key Economic Advisor to India's Prime Minister*
 - ✓ **Robert E. Rubin** – *Former Treasury Secretary, USA and Co-Chairman, Council of Foreign Relations, USA*

Successes & Findings



Positive Findings

- 1 ✓ **Sustained Movement toward Market-Based Economics**
- 2 ✓ **Governments That Effectively Provided Sound Fiscal and Monetary Policy**
- 3 ✓ **Substantial Public Investments**
- 4 ✓ **Increasing Integration with the Global Economy**
- 5 ✓ **High Savings & Interest Rates**
- 6 ✓ **Political Stability and Rule of Law**
- 7 ✓ **Considerable Focus on Widening Distribution of Income**
- 8 ✓ **No Economy Has Ever Been Successful with Large State-Directed Activities**

Systemic Issues

- 1 ✓ **Significant Income Distribution Problems Globally**
- 2 ✓ **Median Wages Lag Productivity Growth & Skewed Toward The Affluent**
- 3 ✓ **Significant Increase In Rich-Poor Gap In Developing Nations**
- 4 ✓ **Global Trade Imbalances Owing To Restrictive Barriers To Trade**
- 5 ✓ **Fundamental Issues With Policies Governing Market Intervention by Governments**
- 6 ✓ **Poverty & Impact of Climate Changes on Economies**
- 7 ✓ **Problems Posed By Complex Derivatives & Off Balance Sheet Financing Norms Incl. Mark-to Market Accounting For Illiquid Assets**
- 8 ✓ **“Too Big To Fail” Concerns Skew Policy & Increase Systemic Risk**

Lessons From The BRICs



Brazil

Low Inflation, High Domestic Investment Climate, Moderated Commodity Pricing, Focus on LATAM Markets For Growth, Support For Private Sector Development, Spread of Exports Reduced Need for Stimulus Spending

China

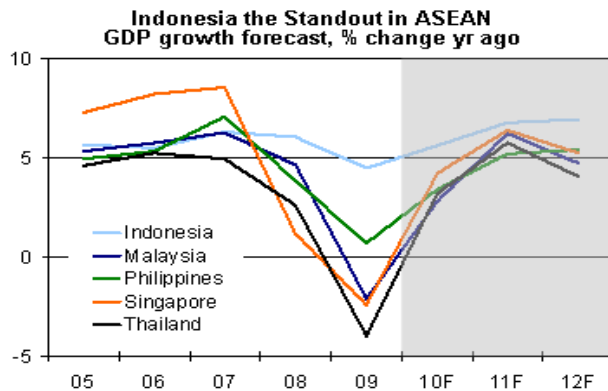
Quick Domestic Demand Stimulation, Controlling Inflation with a View to Spur Domestic Incomes and Consequent Consumption, Increasing Private Sector Participation; Realization of Systemic Issues with Current 75% GDP Dependence on Exports



India

Less Dependence on Global Trade & Capital, Large Domestic Consumption, Significant Domestic Production and Retention of Revenues, Conservative Financial Institutions, Refusal To Focus on Exotic Derivatives, Lower Interest Rates, Expanded Credit for the Poor and Reduction in Excise Duties

Lessons For Malaysia



Source: Moody's Economy.com

Stimulus Has Not Impacted the Country

Most Invested In Infrastructure Projects – New Jobs @ Cost of Old Jobs

Education Globally Saw Greatest Spend – Malaysia The Least [as % to Stimulus] – *No Focus on Long Term Future*

Closely Controlled Economy Protected Malaysia From Overheating

Recommendations

Expansionary Fiscal Policy To Be Contained To Avoid Inflation & Price Surge of Essential Commodities

Spur Domestic Demand & Consumption; Reduce Export-Oriented Inventory

Target New Markets For Growth

Containment of Prices of Financial Products/ Instruments & Real Estate

Reduce Subsidies & Let Markets Determine Pricing

Direct Public Spending Toward Private Enterprises to Support Productivity Growth



Bobby Varanasi, COP
Chairman & CEO
bobby@matryzel.com

KUALA LUMPUR

NEW YORK

DALLAS

MUMBAI



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