Statement of Senator Chuck Grassley
Senate Finance Committee Hearing
"Strengthening America's Economy: Stimulus That Makes Sense"
Tuesday, January 22, 2008

There are two opposing views on the economy. Some people say consumption is the key to economic growth. When people go shopping, business is good; when people stay home, business is bad. According to this view, we need to spend more. Other people say investment is the key. When people invest, business is good; when people don't invest, business is bad. According to this view, we need to save more.

Some economists try to reconcile these opposing views by suggesting the correct view depends on the circumstances. When workers are fully employed and factories are fully utilized, they say we need to save more and increase supply. But, when workers are unemployed and factories are idled, they say we need to spend more and increase demand. While this explanation is appealing, it does not withstand careful scrutiny.

As a family farmer, I'd like you consider a barnyard example. I'm talking about the proverbial chicken and egg. In the first example, you have five chickens that each lay five eggs a week, but people want more eggs.

The solution is to save some eggs, let them hatch and then you will have more chickens to lay more eggs. In the second example, you have five chickens that each lay five eggs a week, but people want fewer eggs. The solution cannot possibly be to buy more eggs because that is the problem. There is a surplus of unwanted eggs.

When economists talk about stimulating consumer demand, they give the impression that we can grow our economy by getting people to go shopping, and it doesn't matter what they buy. But, such talk obscures the fact that at any given point in time our economy is comprised of a specific set of goods and services, each with its own unique factors of supply and demand.

When market conditions change – either because of fickle consumers, foreign competition, rising oil prices, a stock market bubble, or a housing bubble – the goods and services that existed before the change are no longer suitable to meet the market conditions that exist after the change.

For example, if consumers decide they want more milk and fewer eggs, no amount of consumer demand is going to magically turn eggs into milk. Farmers are going to have to raise fewer chickens and more cows, and that takes time.

When workers are unemployed and factories are idled because of changing market conditions, those workers and resources must often be re-employed or re-deployed in a new occupation or industry. Economist Joseph Schumpeter referred to this process as "creative destruction."

This process is ongoing. Millions of jobs are created and destroyed each year. Most of the time, we end up with more than we started with. But, whenever our economy falters and millions of Americans are out of work, it's only natural to want to help. As the President said during the last economic downturn which occurred early in his first term, "Everyone who wants a job ought to be able to get a job." Thankfully, we've had several years of robust economic growth since. The question is how do we get the desirable level of economic growth? How do we put in place policies to assure the economy provides enough jobs for workers? How do we respond to the near-term economic problems without doing long-term damage?

The last question is really the critical question for today's hearing. Chairman Bernanke has said there should be fiscal stimulus. Leading economic thinkers on the Democratic side, such as former Treasury Secretary Summers, have agreed. So has Dr. Martin Feldstein, a leading economic thinker on our side of the aisle. So, turning to another farming analogy, the fiscal stimulus horse has left the barn. I'd prefer the horse be a thoroughbred and not a sway-back. So, with the die cast that we need some kind of fiscal stimulus, again, how do we best respond to the immediate situation and not damage economic growth over the long-term?

We are told that in order to stimulate the economy, all the government has to do is put money into the hands of consumers and they will spend us back into prosperity. The problem with this approach is that the only way the government can put money in someone's hands is by taking it from someone else's pocket. That power is exercised either in the form of higher taxes or more borrowing.

Over the long-term, this can be a zero sum game in which one person's loss is another person's gain. Some economists try to obscure this fact by introducing a concept known as the marginal propensity to consume. That's a fancy way of saying some people spend more of their money than others.

According to this concept, low-income people are more likely to spend an extra dollar than high-income people. Thus, taking money from the rich and giving it to the poor will stimulate consumer demand and boost the overall economy. They will point to the multiplier effect.

This concept is flawed because it ignores the role of saving. Money that is saved does not disappear; it flows back into the economy in the form of investment. Investment is just another form of spending, specifically, spending on capital goods (factories and equipment). Thus, money spent on capital goods adds to the overall economy just like money spent on consumer goods.

Designing an effective policy requires a clear understanding of why the economy is slowing and unemployment is rising. The idle workers and resources that exist today are the result of changing market conditions – primarily rising oil prices and falling home prices. Government efforts to stimulate consumer demand can neither force people to buy things they no longer want, nor transform unwanted items into things they do want.

I don’t think we’ll find many folks who feel that currently, or over the long-term, Americans are saving too much.

Realigning our economy in a manner consistent with changing market conditions will take time. Efforts to stimulate more consumption would only come at the expense of the investment needed to bring about the necessary realignment.

Everyone agrees investment is the key to higher productivity and a rising standard of living. We should not let our desire for a quick fix to divert our attention from this fact. Mr. Chairman, let’s keep our eye on the ball. With that, I look forward to Director Orszag’s testimony.