Stifling Inflation and Productivity

From *The Reasons Behind the Obama Non-Recovery* by Robert Barro in The Wall Street Journal

> *The main U.S. policy used to counter the Great Recession was increased government transfer payments. Federal social benefits to persons as a ratio to GDP went from 8.7% in 2007 to 11.7% in 2010, then fell to 10.9% in 2015. The main increases applied to Medicaid, Medicare, Social Security (including disability) and food stamps, whereas unemployment insurance first rose then fell. Unfortunately, increased transfer payments do not promote productivity growth.*
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> *The 2007-08 financial crisis was also followed by vast monetary expansion involving increases in the balance sheets of the Federal Reserve and other central banks. The Fed's expansion featured a dramatic rise in excess reserves, used to fund increased holdings of Treasury bonds and mortgage-backed securities. Remarkably, the strong monetary growth came without inflation.*
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> *The absence of inflation is surprising but may have occurred because weak opportunities for private investment motivated banks and other institutions to hold the Fed's added obligations despite the negative real interest rates paid. In this scenario, the key factor is the flight to quality stimulated by the heightened perceived risk in private investment.*

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High monetary growth without inflation happened because:

1. High friction costs stifled investment. Included is the

accumulation and addition of regulations and the uncertainty; every increase in regulation and taxation is followed by calls for more.

2. The combination of low interest rates and higher friction costs meant that the prudent use of the cheap money was stock buy back rather than increases in productive investment. Misguided corporate incentives that pay for increased shareholder value rather than higher productivity or better return on assets (as opposed to equity) exacerbated this trend.
3. Low velocity of money. Related to the above, individuals reduced debt and curtailed both consumption and investment. The individuals still have some control.