April 4, 2003
Economy Lost 108,000 Jobs, Raising Worries of Recession
By DAVID LEONHARDT

The job market continued to deteriorate in March as the economy lost 108,000 jobs, raising worries that the United States is closer to slipping into a recession than it has been for more than a year. The unemployment rate remained at 5.8 percent last month, the government reported today, largely because of a rise in the number of people not looking for work, who are considered to be outside of the labor force.

Two years have now passed since the nation's payrolls peaked, and employment has fallen by almost 2.4 million jobs over that span, according to the Labor Department's recently revised numbers. The loss — 1.8 percent of employment — is much worse than it was during the so-called jobless recovery of the early 1990's, when employment never fell by more than 1.3 percent during a two-year period.

The nation employs fewer people than it has at any point since late 1999, its longest stretch without job growth in 20 years.
Testing Ricardian Equivalence

At first glance, should be easy- data is readily available:
  Deficits,
  interest rates,
  savings.

But – big problem:
Ricardian Equivalence involves a particular thought experiment: a deficit financed tax cut.
  government expenditures are held constant.

Current deficit may signal future govt. exp.
Sorting all this out in the data is very difficult.

- Conclusion – there is no conclusion.
- My opinion – the majority of economists find the assumptions of Ricardian Equivalence too strong:
  - active bequest motives
  - perfect capital markets
  - perfect foresight (or rational expectations)

Yet – econometric studies find support for Ricardian Equivalence
The Ricardian equivalence theorem has been widely debated since (at least) the seventies. The theorem states that households should not change their consumption path in response to changed timing of taxes, given the path of government consumption. In this essay, theoretical models giving rise to the equivalence result as well as models predicting deviations from debt neutrality are presented. In general, the Ricardian models are based on unrealistic assumptions, such as infinite horizons, perfect capital markets and lump-sum taxes. The issue of Ricardian equivalence is thus perhaps better viewed as a question concerning to what extent the equivalence hypothesis is a reasonable approximation of the real world. This could only be established by empirical studies. To formulate a test of Ricardian equivalence, it is however vital to extend the standard analysis in deterministic models to stochastic models. In a stochastic model we need to incorporate the fact that agents have to make predictions about future levels of government consumption, and that public debt might be a useful predictor for that purpose. It is therefore necessary that an empirical study distinguishes between debt as a potential source of net wealth, which is the concern of the equivalence proposition, and debt's role as a signal of future levels of government consumption, which is due to the stochastic nature of the world. It is argued that there are few empirical studies that make this distinction, and in case the distinction is made, the evidence is in favor of the Ricardian equivalence proposition, namely that public debt is not net wealth to households. Changing the timing of taxes will therefore not change private consumption. In other words, although the Ricardian equivalence hypothesis is burdened with unrealistic assumptions, it seems (historically) to provide a reasonable approximation of actual data.