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## ECONOMIC NEWS UPDATE

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05 August 2005

The members of congress have fled hot, humid Washington to rush home to tell their constituents what they have done for them lately. They have quite a story of fiscal carnage to report.

Congress passed a 1,700-page energy bill that will not reduce America's dependence on foreign oil, but will cost taxpayers somewhere between \$12 billion and \$66 billion over the next ten years -- no one is quite sure just how much, since the bill is long on promises and mandates, and short on specific costings. Ed Markey, a Democratic congressman not noted for enthusiasm for free markets, said "Right now, Adam Smith is spinning in his grave so fast that he would qualify for a subsidy in this bill as an energy source." Beneficiaries include Iowa corn farmers and processor Archer-Daniels-Midland, more of whose corn-based ethanol henceforth must be included in petrol, raising its cost by about 10-cents per gallon; oil companies rolling in profits from \$60 oil; nuclear power advocates, who will get subsidized insurance; producers of wind and solar power; and the coal industry, among others.

Congress also passed a massive transportation bill that will give Alaskans hundreds of millions of dollars with

which to build bridges from tiny towns (po.800) to tiny airports; South Carolinians \$25 million to add to the \$34 million already spent on their famous "Bridge to Nowhere"; and other states goodies ranging from bike paths to transport systems in their zoos. Estimated cost: \$286 billion over six years. Combine that with the energy bill, allow for the inevitable cost over-runs, and you have annual outlays approximating the GDPs of Peru, Algeria, or the Czech Republic.

Fortunately, the American economy is so strong that even such profligacy doesn't seem able to deflect from its growth path. The economy grew at an annual rate of 3.4% in the last quarter, the ninth straight quarter in which the growth rate has topped 3%.

The business sector is all smiles. Wal-Mart and other such retailers are reporting higher-than-expected sales growth, and some 60% of all the firms reporting first-half profits are coming in above expectations. It took some severe price cutting to do it, but the auto manufacturers have pared inventories to levels that clear the way for stocking the 2006 models that are due to start rolling off the assembly lines. The service sector is booming, and even the

formerly woebegone manufacturing sector is growing.

The housing market moves from record to record, both in homes built and in prices (up 15% since last year), as immigrants buy into the American dream at the low end, and baby boomers snap up second homes in which to spend part of their golden years. These are the same boomers whom the president seems to think are so worried about their living standard in retirement that he must “reform” the entire social security (pension) system, a project on which he has squandered untold political capital.

Workers, too, are starting to reap some of the benefits of what my business friends are starting to call a boom. Some 2.24 million jobs have been created in the past year, 207,000 in July alone. With the unemployment rate at a low 5.0%, and workers’ incomes rising, the Fed is certain to continue raising rates. But if productivity continues to rise, those interest rate increases will remain modest.

Little wonder that forecasters are scrambling to revise earlier predictions upward. But every economic horizon has its clouds. So let’s look at some of the principal worries.

- Rising interest rates might stifle demand for houses -- but so far even Federal Reserve Board chairman Alan Greenspan’s measured increases in short-term rates have not produced a sufficient rise in long-term and mortgage rates to do harm to a market that is more solid than the “bubble” blowers imagine, according to a study by Harvard University’s Joint Center for Housing Studies.
- The persistent trade deficit might cause a run on the dollar -- but so

far its downward drift shows no sign of accelerating as Asian and other investors continue to find America a good place to put their excess savings.

- The high price of oil might slow economic activity -- but so far consumers and businesses seem to be adjusting to \$60 oil, not without pain and grumbling, but without triggering a recession.
- The fiscal deficit might trigger inflation -- but so far the deficit is headed down and is at an unthreatening ratio to GDP.
- The over-indebted consumer might retreat from the malls, triggering a recession -- but the \$2.9 trillion in debt that households have taken on since the end of the mild recession is more than offset by the \$10.6 trillion increase in assets owned, and the cost of carrying the debt as a percent of after-tax income is no higher than it was two years ago.
- A wave of protectionism might stifle the growth of world trade and produce a recession -- but the President did manage to twist enough arms in congress to get the Central American Free Trade Agreement (CAFTA) through, and the Chinese finally seem to be trying to cool protectionist sentiment by revaluing the renminbi a tiny bit, and withdrawing CNOOC’s bid for Chevron.

President Bush is off to his Crawford ranch for what passes as a presidential vacation, in which daily briefings from the intelligence services, speeches in some six states, and regular visits from

cabinet members are interspersed with clearing brush in the sweltering Texas heat. More important than what he has done for the economy is what he hasn't done to it: he hasn't interfered with the flexibility of an economy that sees one million job separations (fires plus quits) and even more hires every week, or sapped entrepreneurial energy by proposing excessive regulations.

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## **THE SUNDAY TIMES**

A version of this Update appeared in  
The Sunday Times (London)