

# Prepare to Be Stimulated

From the president on down, Washington agrees the economy needs a jolt. **BY IRWIN M. STELZER**

**I**t seems that political panic puts paid to partisanship. In a telephone lovefest, George W. Bush and the Democratic congressional leadership reached agreement on the need for and the contours of a fiscal stimulus package, or what the president prefers to call an "economic growth package." They agreed that the economy is slowing, or worse, and that it needs care and feeding not only from the Fed, but from the feds. Soon, your check will be in the mail.

Federal Reserve Board chairman Ben Bernanke took a page from the great musical *Chicago* when he appeared before Congress. Like murderess Velma Kelly (played in the film by Catherine Zeta-Jones), he sang, "I simply cannot do it alone." And got the same response from the assembled politicians as the dancer received from her ogling fans, "Those two-bit Johnnys . . . cheer[ed] the best attraction in town."

Politicians of almost all stripes are trampling over each other in their

rush to come to the aid of Bernanke, and add a fiscal stimulus to the monetary policy weapons he has deployed to shore up the economy. What started as a possible \$70 billion stimulus has been bid up to \$150 billion, a bit more than 1 percent of GDP. Even that larger sum seems "reasonable" to Bernanke, who believes that anything in the \$100 billion range would have a "significant" positive impact. If history is any guide, by the time the legislative Christmas tree is fully decorated, the final package will cost close to \$200 billion.

One of the interesting aspects of this dash for cash is that many of the Ladies and Gentlemen Bountifuls were until very recently arguing that the subprime mortgage collapse and other problems related to the housing sector would not infect the larger economy. Bernanke's initial optimism faded in the face of reports of rising unemployment, falling house prices and sales, a slowing manufacturing sector, and a new cautious mood by previously profligate consumers. So he is now of a mind to cut interest rates, a lot and soon, even if that risks increasing an already uncomfortably high inflation rate.

Then Treasury Secretary Hank Paulson turned gloomy. The former Goldman Sachs boss at first doubted that the problems in the subprime mortgage market would slop over into the general economy. But he is now saying privately that we are facing a recession, and one that will not be the short, sweet corrective characteristic of recent such downturns. Whether he is excessively influenced by his old buddies in the financial sector, some of whom are salving their battered egos by cashing multimillion dollar goodbye checks, and others of whom are busy peddling chunks of their firms to Asian and Arab sovereign wealth funds at prices that would have been considered bargains only a few months ago, we can't tell. No matter: Paulson's early opposition to vigorous government intervention is no more, and the president has put him in charge of negotiating final details with Congress.

Then influential economists on both sides of the aisle made it officially bipartisan: We need a fiscal stimulus. Larry Summers, Bill Clinton's Treasury secretary before moving on to further fame as Harvard's president, and Marty Feldstein, long an important voice among Republican policymakers, both decided that some sort of fiscal stimulus is necessary. About \$75 billion, right away, would satisfy Summers, now considered a piker by most politicians; Feldstein would wait until there is proof of further weakening in the labor market, at which point he would jolt the economy awake with a variety of stimulants. The politicians are disinclined to be that patient—"What do we want? We want to mail checks to constituents. When do we want it? Now!"

Finally, the president signed on to the stimulus stampede. Of course, George W. Bush has rarely met a tax cut that he doesn't like, so he was always inclined to ignore those of his Republican colleagues who prefer to let the markets work through the current problems rather than inject a short-term cure that might cause even greater problems down the road. These dissidents argue that Alan Greenspan

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brought on the problems we now face by keeping interest rates too low, for too long, in order to overcome the several crises that he faced during his long tenure at the Fed. Washington is not noted for long-held, fond memories of the achievements of departed icons.

Almost all of the multiple contenders for their parties' presidential nominations have put forward their own stimulus schemes, the notable and some would add, honorable exceptions being John McCain and Fred Thompson, both deficit hawks. Mitt Romney unsurprisingly chose the Michigan primary to share with us his impossible dream: the U.S. auto industry will regain its former glory if only all interested parties attend the conference he plans to call within one hundred days of moving into 1600 Pennsylvania Avenue; no plans to resurrect his father's Nash Rambler have yet been released. Others include in their programs handouts to help the poor pay their heating bills (Clinton), or measures to sock it to the rich by

repealing the Bush tax cuts for those earning over \$250,000 and raising capital gains taxes (Obama), or build infrastructure (Edwards), or cut the corporate tax rate (Giuliani).

None of these more or less nonsensical ideas, with the possible exception of some help with heating bills for low-income families, will be included in the stimulus plan that Bush and congressional leaders agree to. Fortunately, Bush is hearing more than the voices of pandering candidates and tax-and-spend Democrats. The president knows, and should he forget will be reminded by Paulson and the chairman of his Council of Economic Advisers, Ed Lazear, that all economic forecasts, including the current consensus that a recession is either already underway or about to hit us, should be viewed with a touch of skepticism. Not only are projections suspect; past data are subject to such major revisions that minuses become pluses, as was the case with a recent employment report. Economists not only have to peer through a fogged-over windshield; they are afflicted with clouded rearview mirrors.

The president is also being urged to retain a sense of proportion, something it is unreasonable to expect of the primary-contest combatants and congressmen who must face the voters in a few months. The much-reported losses of Wall Street financial institutions now total about \$100 billion, or 0.7 percent of GDP. The *Wall Street Journal* notes that losses "from savings and loans and related commercial bank loans from 1986 to 1995 were about \$189 billion, or 3.2 percent of average GDP in that period." The S&L losses alone came to over 2.5 percent of GDP. So concern should not be allowed to morph into panic, lest measures taken bring excessive long-term pain as the price of too little short-term relief. After all, even the newly nervous Bernanke expects the economy to grow in 2008.

Which is why Bush agrees that any stimulus must be timely, temporary, and targeted. Bernanke wants the stimulus to be put in place quickly,

to have its impact very soon, and pass into history within a year. Paulson concurs. By the latter part of next year the economy should be back on track, and any stimulus that hits consumer and business pockets at that time would be too late to do much good, and worse, might trigger overheating. That means that politicians on both sides of the aisle will have to resist the temptation to roll into a temporary stimulus package parts of their long-term wish lists, lest they trigger a drawn-out round of acrimonious debate.

Yes, the tax system needs long-term reform. And yes, the president would like to make his tax cuts permanent, rather than allow them to expire at the end of 2010, and can argue that such a step would encourage businesses to invest now in anticipation of sales and profits a few years down the road. But he has reluctantly agreed to separate his fight to make his tax cuts permanent from the stimulus package. And yes, the Treasury would like to reduce corporate tax rates, now among the highest in the developed world. And surely it would be a good idea to see the alternative minimum tax consigned to the dustbin of history, which Charlie Rangel, the House Democrat in charge of tax policy, has set as one of his many goals. Whatever the merit of these measures, they shouldn't be confused with a short-term, focused fiscal stimulus.

In addition to avoiding irrelevant controversies, the president and Congress will manage to keep nervous, deficit-hawk Republicans in line, and avoid losing crucial support from Paulson and Bernanke, by scratching from their shopping list any measures that will permanently expand the scope of government. Big spending programs are famously easier to start than to stop. Senator Clinton's targeted relief for heating bills, once with us, would become a permanent feature of the ever-expanding welfare state, in which the government not only redistributes income but tells the lucky beneficiaries just how to spend the money they get. That, in contradiction to the teachings of the

great economist-advocate of demand-side stimulus programs, John Maynard Keynes, who proposed that any demand stimulus allow "consumers . . . themselves [to] decide how to spend their incomes." And in contradiction to the president, who wants the recipients of the stimulus checks to "use the money as they see fit." We are all Keynesians now.

In short, given the notorious unreliability of economic forecasts, and the Fed's commitment to continue the vigorous use of monetary policy to stimulate the economy, a fiscal stimulus that threatens to add significantly to the structural budget deficit is simply not called for. But neither would it be appropriate to ignore the warning signs that Larry Lindsey, the architect of Bush's first anti-recession plan, reads as creating "significant" odds that we face a recession that "might be longer and deeper than recent recessions."

Fortunately, there seems to be bipartisan agreement that it is not necessary to add permanently to the deficit. That can be avoided while getting money to the people most likely to spend it, and soon. Bernanke proposes "putting the money into the hands of households and firms that would spend it in the near term. . . . Getting money to low- and moderate-income people is good, in the sense of getting bang for the buck." Talk is of tax refunds of something like \$1,600 per family, or \$800 for single taxpayers. In addition, families and singles who earn so little that they pay no income taxes will either get checks or have the payroll taxes taken from their weekly paychecks reduced, if Democrats have their way, which is likely. The short-term dent in the Social Security trust fund—if indeed such a "lock box" exists in reality rather than in politicians' fantasies—might well be more than made up by increased employment in the longer run. No matter how delivered, the added money in consumers' hands will soon pass to shopkeepers, and give the economy a significant boost, according to Bernanke.

The final plan will end up containing other provisions. The most frequently mentioned include Democrats' proposal for an increase in unemployment insurance payments, and the president's proposal—agreed to in principle by Nancy Pelosi—for tax incentives to encourage businesses to make major investments this year.

When all is said and done, it is not clear that a stimulus, even one totaling about \$150 billion, will provide much of a lift to the sagging economy. Data on the effectiveness of Bush's attempts to boost the economy in the early days of his presidency are ambiguous. Some say that the recipients of the \$600-per-family checks spent only a small portion of their windfall (if it is fair to characterize returning money to the people who earned it as a windfall), and that it was the cut in the marginal tax rate on high earners, and in taxes on dividends and capital gains that gave a fillip to an already-recovering economy.

No matter. The proposed stimu-

lus is not large enough to cause any real harm, and just might help the economy to right itself. Besides, no politician dares to be seen as passive in the face of an economic downturn, lest he meet the fate of the president's father, whom Bill Clinton successfully portrayed as somewhere between detached from working-class people and hard-hearted.

With politics trumping economics by more than the usual margin in this election year, the president is demonstrating his compassion by joining the pro-stimulus, bipartisan crowd. The plan that is taking final shape will not add to the structural budget; it will target the right people, and get the cash to them quickly; and it will be temporary. Not what big-government spenders would prefer, nor the first choice of those who believe that the effectiveness of an economic readjustment is proportionate to the pain it is allowed to inflict. But not a bad merger of sound economics with the politically possible. ♦