

## ECONOMIC NEWS UPDATE

Irwin Stelzer

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### **Defining Fiscal Deviancy Down**

Any lingering opposition to Barack Obama's stimulus plan melted in the face of today's report that 2.6 million workers lost their jobs last year, 1.9 million in the last four months alone. The official unemployment rate jumped from 6.7% to 7.2%, the highest since January 1983. If we count those involuntarily working part-time or on reduced hours, 13.5% of American workers are in distress. So it makes sense to assume that the two-year, \$775 billion stimulus package for which Obama rallied congressional and public support in yesterday's speech at George Mason University, will become a \$1 trillion package by the time it is finalized. Indeed, congressional Democrats are calling for a \$1.3

billion stimulus. Trillion is the new billion as we define fiscal deviancy down, to borrow from the late scholar and senator, Daniel Patrick Moynihan.

It is also a lot of money, allowing the President and the congress to promise something for everyone. Republicans want tax cuts? Fine, here is \$150 billion for middle income and poor families, and more than \$100 billion in tax breaks to encourage businesses to hire and invest. Want to help "the struggling states" cover their budget deficits without cutting their bloated spending? Here are a couple of billions for governors to dispose of. Want to rebuild "crumbling roads", bridges, airports and build a new smart

grid? Here is \$300 billion for infrastructure.

Obama is disappointed that the necessary legislation won't be ready for his signature on inauguration day, January 20. Every day lost is another job lost, another dream shattered, argued the president-elect on in his Thursday speech at George Mason University. But congressional leaders say they want to get it right the first time, and will need until mid-February to put a bill on Obama's desk for his signature.

Transparency is to be the order of the day. Rahm Emanuel, Obama's chief-of-staff-designate, has promised "a Google-like search function to show every program funded by the stimulus package, whether it comes under- or over-budget, whether it is meeting its intended purpose, and how many jobs it is creating," according to ABC news. And if you doubt that a new President who has never managed even a corner candy store, and who could not organize a single meeting of the Senate subcommittee he chaired, can efficiently spend billions, there is the new CPO to look after things -- chief performance officer Nancy Killefer, a Treasury official in the Clinton administration. It will be her job to make sure that efficiency trumps politics and bureaucratic lethargy.

Of course, if you are one of those old-fashioned deficit hawks, you now are grounded for years to come. The deficit Bush is willing to Obama already tops \$1.2 trillion, at 8.3% of GDP far above the postwar record of 6%, and "we've got trillion dollar deficits for years to come, even with ... economic recovery", says Obama. Remember, that in addition to his stimulus package there are bailouts for banks, auto companies, students, mortgagees and others from the \$350 billion remaining in the \$750 billion Troubled Asset Relief Program (TARP) fund. And if you are not worried that all of this will trigger inflation and a run on the dollar, don't forget that the Federal Reserve Board has announced that it will lend and lend and lend, including its latest plan to buy \$500 billion of mortgage bonds, printing money to do so.

The big worry is that inflation will take off, and foreigners will be unwilling to buy all those government IOUs unless interest rates go up, offsetting the stimulating effect of Obama's spending. But for now at least, the world seems to regard Treasury IOUs as islands of safety in a sea of economic woe, and to be willing to buy all of these promises-to-pay that the government offers for sale. And for now at least the Fed has not decided to emulate Rudolf

Havenstein, president of the Reichsbank (equivalent to our Fed). When hyperinflation that made it cheaper to burn money than logs to keep warm in Germany in the early 1920s, Havenstein boasted that he had solved the problem by ordering faster and faster presses to use for printing the billions of marks flooding into the economy.

Obama knows that the stimulus can't make up for the slack in the private sector in the long run. If it succeeds in persuading consumers that an end to the recession is in sight, prospective homeowners that falling mortgage rates have put a bottom under home prices, banks that it is safe to lend again, and businesses that it pays to invest in plants to turn out stuff consumers will buy, it will have succeeded in priming the pump, as the old saying went. If not, America will end up burdened with debt and at the beginning of a long hard road to a sustainable recovery, which in the end will depend on the private sector.

Meanwhile, the Obama teams are getting acquainted with their new jobs. On the surface, it is centrists replacing centrists, to the chagrin of Obama fans who believed he was the change they were waiting for. But just one notch below the surface, change is indeed in the offing. Obama's

appointees to the environmental and energy regulatory agencies will work to prevent new coal plants from being built, and to arrange financial and regulatory subsidies of wind and solar power. Pressure on the automobile industry will be unrelenting and irresistible. In hock to the government, GM et al. must respect the wishes of congressmen who have never sold a car, and produce green cars in which consumers have shown little interest. Change there will be, but whether it will contribute to economic recovery and long-term growth, or impede it, is an open question.

There is reason for optimism. By including tax cuts, some for businesses, Obama has shown that he is willing to make Democrats unhappy in order to gain bipartisan support for his program and, it must be said, to do the right thing. Otherwise, so well regarded a conservative economist as Harvard's Marty Feldstein would not have signed on to the Obama plan. Most important, Obama recognizes that he has to tackle long-term drivers of budget deficits even as he spends money to reverse the current economic decline. Give the man credit: he has a clear view of what he wants to accomplish, of the tools he has available, of his inability to turn the economy

around immediately, and has a team that understands how a modern economy works. Just how much of a slip there will be between cup and lip will depend on whether his star-studded team is as competent in action as it seems to be on paper. Let's hope so: competence has been in short supply in Washington in recent years.

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