

Economic Policy Stimulus: the tragedy of responsibility  
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## Economic Policy Stimulus: the tragedy of responsibility

Economic policy stimulus talk in the federal government and the recent hearing by Ben Bernanke (Jan 17, 2008) suggest that there is much to be done and not soon enough. Options that have been put on the table include:

- Continuing the tax cuts that expire in 2011
- More tax cuts
- Rebate type checks
- Lowering interest rates and discount windows
- Helping distressed borrowers.

### **What is a recession?**

First, review what a recession is or an economic slowdown and then we can better understand some of these suggestions. In generic macro-economic terms, the economy moves money from consumer to business, to supplier to producer to market in a circular pattern. A recession is where the circular pattern has stalled and a depression is where the cycle has completely stopped. A slow down infers that the cycle is, of course, slowing down, and thus, money does not move as quickly. Most economists generally believe that recessions and slowdowns are a natural part of the business cycle and that markets tend to work themselves out of these situations (Schurr, 2000).

The Economist (August 2007) suggests that there is a “peril” if central banks attempt to thwart recessions. They suggest that avoiding recessions does not ground investors and business in realities and possibilities of risks. They agree that there are negative consequences to recessions where unemployment, low wages, and bankruptcy rein, but point out that inefficient firms and processes are “weeded out” or have to become efficient to survive. This resembles an element of karma where in order to truly understand ‘good’ you have to experience ‘bad’. This will help one to appreciate what lessons are to be learned.

The Federal Reserve, acting as principle economist and central bank, has to balance rising unemployment with rising interest rates because too many people without a job will ultimately stall the economy since these are people without money to circulate. The Federal Reserve has a few specific tools other than overall interest rates, but the Fed is basically the gatekeeper of cash flow in the economy. Too much money in the economy, we can have cartfuls of cash to buy a loaf of bread, and too little money in the economy, then investment is too expensive. When unemployment rises, the government system has the burden of unemployment insurance. When that unemployment expires, unemployed people have no money to pay for houses, general consumer spending, groceries, or energy.

A downward spiral could ensue, nevertheless, if recessions are not managed as people toil over the looming problems and if panic sets. What can we do to offset the problems while the recession is here?

### **Tax cuts and rebates**

There is little that continuing tax cuts in three years will do on today's current fiscal crisis except to assure people that taxes will not be raised in the near future and to increase the need for better federal fiscal management. Long term outlooks may desire to retain the 2001 tax cuts, but the stimulus is supposed to be a short-term stimulation to get the economy working much like a cold car battery needs an outside jolt. The problem then is realized that a cold battery gets a jolt from outside whereas the economic tools available to Congress and the Fed are from inside the system. Roberts (January 2008) characterizes short-term stimulus to taking a bucket of water from a deep part of the pool to the shallow part of the pool.

One could argue that the tax cuts are not helping the current economy since we are in the current situation with the taxes unchanged since 2001. One might also argue that the unchanged rates have kept us from completely sliding into recession (assuming one thinks we are not yet in one). If the government cuts taxes again, do we not risk future similar troubles and have to revisit tax policy later. There is an element missing in the equation and we have to figure what the element is rather than keep wrapping a bandage around the sore. Additionally, a lack of tax revenue due to a tax cut will cause other short comings in the government including federal financing of state governments.

Many tax-cut enthusiasts will point to getting money through "discretionary" spending reductions (defined as not health care insurance and defense). This "discretionary" reduction would be for less than 25% of the current budget. In reality, the insurance trusts are the only thing the government has to pay and everything else is discretionary. As well, any additional tax cuts passed now may not be realized until next tax filing year in 2009 when the stimulus may be arguably well past due. Besides who would benefit most from income tax cuts corporations or personal?

Temporary rebate checks are a way to "inject" money into the economy, and this technique is mildly supported by Bernanke. Where does the money originate for the rebate? How much more tax, debt and spending cuts do we need to pay for the short-term wants? Further, what do people do with the extra couple hundred in their hands? They may pay bills or put the money in savings, but this does not help keep the circulation of money moving. Moreover, a small, one-time payment does little to reduce the circular credit problems that many are enduring currently. When the consumer acts as a spender instead of a saver the economy moves. When the consumer holds the money, which is likely in a recession, the economy may continue to stall, and thus, the injection does little to stimulate activity. The extra cash in hand, however, allows consumers to use money they would not normally have or had earmarked for a specific purpose.

In a recession, the consumer starts to truly understand the value of cash and what interest rates can do to the value of cash. Lower interest rates allow for more money to flow in the market, and thus rising prices, and likewise, higher interest rates restrict the flow since money is not as cheap. As well, companies have to find real revenue sources

rather than depend upon liabilities, bonds and notes to cover expansions (i.e. new employment). Inflation becomes prominent as the cost of everyday items like energy rise and squeezes the tightening budgets of consumers (especially those with no more lines of credit available).

People and businesses have to realize that late penalties and high interest rates would do more to hurt their overall financial picture as well. One has to become diligent in erasing debt obligations especially high interest ones and avoid gaining more of them. A disciplined and frugal nature has to take over and has to determine what is more important rather than constantly feeding every want with new credit and debt. Essentially, the current economic crisis is based upon poor credit decisions by consumers and banks. The only way to resolve this is to make better choices about credit.

### **Handling Foreclosures**

With rising credit use, Americans have become completely saturated and used to credit for everything from groceries to houses. The most dangerous of these is using credit cards to buy staple items. This indicates a spiral of spending where the consumer is consistent using relying upon credit card debt to make fundamental necessary purchases rather than discretionary wants. Banks and mortgage companies for years would advertise home equity lines to help rein in previous debt and luxurious items like vacations, a new car or other things. A home equity line became a way to use one's house to gain additional credit and sometimes to help pay for a first mortgage. Once those equity lines were used up, credit cards are maxed and now rising inflation is diminishing real cash value. Instead of fixing the problem, banks kept offering more "consolidation" loans and many Americans simply continued to use debt spending, ignored the consequences, and now have no where else to turn.

Specifically, the current bubble burst is due to debt spending, interest rate adjustments and sub prime mortgages where some have estimated over 12 million Americans face foreclosure within the next couple years. The question of whether to help these people is personal because these are neighbors, relatives, friends and other acquaintances that bought into the image of an "American dream" only to find that dream squashed by rising interest rates.

Even more so, when interest rates were at "teaser" rates, people were speculating that the markets will continue to rise regardless of inevitable cycles in business. People were essentially buying houses they could not afford based upon the teaser rates or to "flip" the property for a speculated profit. As well, many people boasted the Dow would go to 15,000 when an inflated 14,000 was barely obtained only to see the market go south to 12000 within months. Average American retirements "secured" in pensions, 401Ks and IRAs suffer with the market. Loosing money and failure is a distinct part of capitalism, but speculators gambled only to lose. Yet, when the gambling affects more than just the speculator, there is cause for concern.

Almost unanimously, politicians and market analysts have no love for speculators who got caught in the mortgage meltdown. Yet, many millions of Americans made decisions to buy expensive houses at teaser rates or borrowed against the value of depreciating homes and now face foreclosure (i.e. adjustable rate mortgages, home equity borrowing and expensive sub-prime credit).

In my housing development, there are 22 units built and 3 have foreclosed already. Many Americans, like me, did not accept teaser rates to buy homes, locked in fixed rates, or simply did not accept unaffordable housing prices. Further, we are not getting any assistance for our depreciating home values due to the overall devaluation. We made “practical” decisions in order to know what we were paying each month for the house instead of getting surprised every month and as well, avoided home-equity lines.

Mortgage companies and brokers may not have heeded warnings and may have kept promoting such “impractical” decisions. Yet, the brokers were motivated, if not outright directed, to get as many accounts as possible. Are they at fault for trying to get profits and accounts and taking advantage of looser monetary policy? The companies are now being penalized by the markets with substantial write-downs in the billions per quarter, layoffs, subsequent loss of share value, and in some cases going out of business. For examples, Merrill Lynch writes off almost \$10 billion and Bank of America drops almost 400 people from their workforce. Their misjudgments are being handled in the market. Do they deserve more penalties at this point? A person without a job already understands the consequences of careless actions. A long term consideration might be to implement oversight towards housing sales to avoid a future collapse (if that is possible).

### **Monetary policy**

Alan Greenspan handed the problem to Ben Bernanke and the good thing is that Bernanke will not sell a poor tax policy like Greenspan did. When Greenspan testified in 2001 that tax cuts might help the economy, the President and Congress took that as a green flag to cut taxes and give rebates without regard to fiscal responsibility or future debt. Greenspan helped by holding rates low to keep liquid money moving, and thus they avoided a severe recession in 2001 only to push the inevitable stall to another day and made the stall worse. This encouraged searches for the next market craze, reckless finances and speculation as people were getting used to positive trends regardless of bad news. This time, the bubble bursting is affecting people where they live instead of irresponsible investments in empty technology companies.

With the return of stagflation, the economy is mired in its attempt to balance inflation pressures, poor credit decisions, productivity and unemployment. Politicians do not want to take responsibility for actions nor do the public that made poor decisions. This almost resembles the careless attitude towards consequences of foreign intervention (like that in the Mideast region). We may not have asked for specific attacks, but we have to take responsibility for what we have done and what we will do.

Likewise, would poor decisions be rewarded by rescuing these Americans from foreclosure by devaluing responsibility? Would such actions signal that they will always be bailed out of these situations, and thus what happens when the government can not help? Is this indicative of a careless approach towards credit and debt? The question is begged; “Why did so many people make such poor decisions about using credit (specifically with regard to the place they called ‘home’)?”

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