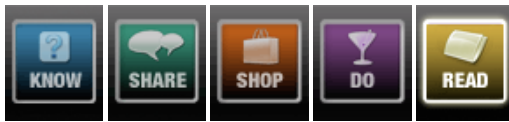


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Story



Free Enterprise: Fed, White House trying to stoke the economy fire without getting burned

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MICHAEL REKSULAK | Saturday, January 19, 2008 at 12:30 am

So, it's the economy after all, or to use a more familiar locution fitting the political season, "It's the economy, stupid!" This week saw a [Michigan](#) primary with its emphasis on lost jobs, a meeting of the Joint Economic Committee in the Capitol on ways to avoid a recession, and competing news conferences by Democrats and Republicans in Congress, as well as a speech by the president; all on the need for an economic stimulus plan.

[Sen. Charles E. Schumer, D-N.Y.](#), started the first congressional hearing of the year recalling a conversation with [Federal Reserve Chairman Ben Bernanke](#). According to him, [Bernanke](#) concurred that "fiscal stimulus is certainly needed." Speaking after Schumer, [Rep. Jim Saxton](#), R.-N.J., agreed. He did, however, point out that he differed with Schumer on some tax cuts set to expire in 2010.

Despite these inevitable political squabbles, everybody it appears has taken the avalanche of bad news in the first weeks of 2008 seriously. The Grinch, as it turns out, actually did steal Christmas, or at least the propensity of consumers to spend freely in December.

Overall, 2007 proved to be the worst year in retail since the recession of 2001. Other statistics showed a disquieting increase in the unemployment rate from

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4.7 percent to 5 percent and the highest rate of annual inflation (including food and energy prices) in 17 years. [Bernanke](#) himself acknowledged a bleaker outlook, and the [Fed's](#) "Beige Book" on Wednesday noted a countrywide slowdown.

At the aforementioned hearing, the former Treasury Secretary and [Harvard](#) economics professor [Larry Summers](#) reiterated his edict that any stimulus should be "targeted, timely and temporary." In his judgment, policymakers should enact a \$75 billion stimulus package "right now."

And in the timing lies the crux of the matter: Generally, there are two major avenues for the federal government and the [Fed](#) to provide relief to the economy. Congress and the president have the tools of budgeting and taxation at their disposal. Such a fiscal stimulus usually includes higher spending (extending unemployment benefit eligibility, additional retraining programs) and tax relief (rebate checks, time-limited incentives for businesses).

[The Fed](#), on the other hand, can use monetary policy measures to kindle economic activity. It has been cutting interest rates and all but guaranteed another dramatic cut is imminent. However, monetary policy adjustments take time to "work their way" through the economy. Stimulating the economy via fiscal policies is much more likely to have an immediate effect on the biggest driver of economic activity, namely consumer spending.

Employing both fiscal and monetary tools simultaneously, however, also has its dangers. They rely on economic actors to react predictably. Recession fears can change behavioral patterns: People may just put that tax rebate into their savings accounts rather than spend it.

Not only could that render the policies ineffective, but it would also multiply the threat of overheating the economy once confidence rebounds. Thus, only an immediate and truly temporary package that puts additional funds into the hands of exactly those who are most likely to spend it right away makes sense.

Even so, nobody should encourage false hopes about the efficacy of economic stimuli. It is easy to overstate their usefulness and hard to implement them optimally. One thing we cannot afford in this time of creeping inflation and a stalling growth, political high season or not, is to be "stupid about the economy."

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