REVIVING THE U.S. ECONOMY

Sidney Weintraub

My impression of the post-September 11 economic maneuvering of the administration and its allies in the House of Representatives is that they saw and seized a double opportunity to promote their ideology. The first objective was to reward business with tax favors, over and above those enacted in the tax legislation earlier this year—whether or not these favors provide short-term economic stimulus. The second goal was to continue to starve the federal government of resources in order to keep key activities, such as airport security, in private hands—despite the manifest shortcomings of this security prior to September 11.

Lobbyists pushing for favors, from tax breaks to import protection for their business clients, have swamped the halls of Congress. This was evident in the fight to prevent making airport security personnel federal employees. The airline industry was given funds immediately. The insurance industry comes next. Steel protection is likely to be augmented. The Senate Finance Committee, controlled by the Democrats, included special tax breaks in its version of an economic stimulus bill for citrus growers, crop dusters, and other agricultural interests. I am a big enough boy and therefore expect self-interest to manifest itself even in a time of crisis, but I had hoped that the federal government—and the Congress—would have loftier goals. In a moment of candor, Paul O'Neill, the secretary of the Treasury, labeled the party-line vote on the House Ways and Means Committee economic stimulus package as "show business"—of the members showing their benefactors which side they are on.

The media have focused much attention on the provision in the House "stimulus" bill to repeal the corporate alternative minimum tax retroactively to 1986, which would provide a windfall of about $25 billion to some of the United States’ largest corporations. This provision may not survive the House-Senate reconciliation that is sure to come, but that this handout was included at all in the name of stimulus is distressing. At the same time, the bill provided stingy resources for augmented unemployment compensation or help in maintaining health insurance at a time when hundreds of thousands of workers are losing jobs.

I do not wish to berate the Republicans alone. It is mostly the Democrats in the Congress who are fighting to prevent negotiations to lower trade barriers, even though we have long known that open trade raises global welfare. A recent World Bank analysis concluded that developing countries stand to gain about $1.5 trillion of additional income in the 10 years after trade liberalization is begun and developed countries would see their income rise by $1.3 trillion. Import protectionism at a time of a declining economy was the tragic formula at the onset of the great depression of the 1930s. Today’s protectionism is not of the same order, but it is there—and especially against goods exported by poor countries, mainly textile and agricultural products.

The U.S. economy does need stimulation. The Fed is doing what it can by lowering interest rates, but we do not know how effective this has been or will be. What is at issue is the nature of the fiscal program to augment the monetary stimulus. This can be done in a number of ways, such as increasing government spending or lowering tax receipts. John Maynard Keynes, who supply-siders vilified for many years, is suddenly much in fashion. However, those who seek to reduce taxes for a decade or more into the future are misinforming the public about Keynesianism. Keynes did not advocate perpetual fiscal deficits, but rather to vary fiscal policy in a countercyclical way—to have deficits in bad times to increase demand and thereby stimulate economic activity, and surpluses in good times to moderate inflation.
Keynesian thinking fell out of favor largely because the U.S. legislative process is so lengthy that by the time a fiscal stimulus could be put into effect, the economy recovered on its own and the stimulus would thus have a perverse effect. This time, however, it seemed possible to take the necessary stimulative measures in real time before the economy reached bottom. To take this thinking one step further, this implies that the resources should be injected quickly to augment demand and then removed when no longer needed.

Fast-disbursing government expenditures can accomplish this, as President George W. Bush recognized when he sent envelopes with $300 or $600 in cash earlier this year to those who paid income taxes. The idea was that this windfall would be spent and we now know that this was not necessarily the case for middle and higher income taxpayers. Checks could be sent this time to those who earn too little to pay any or much income tax and thereby have more assurance that the funds will be spent. Payroll taxes could be forgiven for a reasonable time, thereby putting more money into the hands of probable spenders. The rationale of each of these techniques is to bolster consumption, which was a central element stimulating economic growth during the past several years, at least until this year. Each of these techniques has the virtue of directing funds to those who most need this support and of being self-limiting in time.

There have been arguments in favor of increased government spending to improve U.S. infrastructure, such as the inadequate rail system, or urban transportation facilities in order to reduce automobile use and thereby conserve energy, or school buildings to replace those that are clearly inadequate. The problem here is that these are not short-term expenditures, nor are public construction projects quick disbursing. These are permanent needs and, if they make sense, should be included in ongoing budgets.

The stimulus legislation that passed in the House put most of its stress on tax incentives to encourage private investment. As with building needed infrastructure, encouraging investment over the long term is a proper function of growth policy. President John F. Kennedy's investment tax credit demonstrated this clearly in the 1960s. However, the current situation calls for a quick injection of funds to augment domestic demand. The longer-term, continuing needs should not be neglected, but they can be debated in their own right and not under the camouflage of emergency measures. In order for investment incentives to work in the short term, we must assume that companies are looking for incentives to invest. The evidence is just the reverse, namely, that there is considerable excess productive capacity.

The issues I raise here relate to the role and actions of a great power. The U.S. response to the September 11 terrorist attacks has many elements. The first task was to build a coalition to fight the source of that attack, and also to seek allies to punish terrorists generally. The United States is showing the kind of leadership one would expect in the military field. Similarly, leadership is being shown in the worldwide effort to cut off financing for terrorist activity. The events of September 11 also made abundantly clear that the United States was utterly unprepared to deal with the aftermath of the destruction in the homeland, or to safeguard against future terrorism that could be even more devastating than destroying buildings. The government and population of the United States, with some fits and starts and considerable uncertainty, are responding to all these imperatives.

However, the United States thus far is not showing the same leadership in the economic field. If the U.S. economy is slow to recover, as is likely if the stimulus is long-term rather than immediate, so too will economic recovery be delayed in much of the rest of the world. In each of the key areas—military, money laundering, and economic stimulus—the United States has a leadership obligation both to its national well-being and to the well-being of our friends and allies. A slow recovery will lead to more domestic unemployment and this will weaken public resolve to stay the course for the other elements of the antiterrorist effort. The longer it takes for solid growth to resume in the United States, the greater will be the hardship elsewhere in the world, particularly in the poor countries that look to the U.S. market for their export revenue. The economic dimension of the war on terrorism is not a sideshow, but a central element if the entire effort is to be successful.