

## What's A Mother To Do?

January, 2002  
by John Tuccillo, PhD  
Principal, JTA, Inc.

OK, it's official; we're in a recession. The National Bureau of Economic Research, the official scorekeeper for such things has proclaimed that it began in March. The holiday buying season belies this, of course, as do the lines at theaters featuring Harry Potter. But business investment has sagged badly, and the disruption following the September attacks hurt enough to generate the slowdown. When it will end is anyone's guess, although the betting choice is the second quarter of 2002. For what it's worth, I like that time, although growth will probably be weak until the second half of the year.

As is traditional, the administration and the Congress feel that they have the duty to pull us out of this disaster. Now, this ignores the fact that the economy goes up and it goes down, that things right themselves, and in the words of Peter Clemenza (trusted associate of Vito Corleone, These things gotta happen every five years or so. It helps get rid of the bad blood. It also ignores the fact that the government has a very handy way of regulating economic activity called monetary policy.

Mr. Greenspan and his cohort have done much to help ease the slump, lowering interest rates ten times over the past year, with perhaps more to come. In fact, there is a heap of anti-recession medicine already flowing through the economy's bloodstream, with the tax cut passed last spring augmenting the expansionary monetary policy. Some might argue (as I have) that all this is sufficient to cure what looks to be a relatively mild slump. This feeling is reinforced by the \$60-80 billion the government is spending in disaster relief and in pursuing terrorists.

But the sages of Washington press on. In addition to all the above, Congress is considering yet another dose of stimulus, this time of the order of \$100 billion. Luckily for us, the Senate and the House cannot agree on who should reap the major benefit from their largesse, the unemployed or the very wealthy. That could wind up saving the Republic.

Given the mildness of the slowdown and given the amount of economic stimulus currently operating in the economy, there probably is little need for additional action. But this level of restraint is probably beyond our legislators. So, on the off-chance that such a bill is passed (and it probably will) here's a guide to whether it will push the economy back onto the path of strong growth or just generate the first inflationary cycle of the new century.

Do the incentives in the bill validate past actions or encourage future actions? Ideally, any stimulus package should cause behavior that will boost the economy. So things like investment incentives are good because they remedy what's wrong now. If the bill is heavy on capital gains relief, then it does nothing to help the economy out. Rather it provides lump-sum transfers as a reward for past behavior.

Do the provisions of the stimulus package speed up behavior or just increase the reward for what would have been done anyway? Following on the above, temporary investment incentives which persuade investors to do now what they would have done next year are better than "permanent" investment incentives that can be used at any time, or worse are "back-loaded" so they take effect far in the future.

Does the measure get income into the hands of those most likely to spend it? Consumption is two-thirds of GDP and if we want to stimulate the economy, we better get spending power into the hands of those most likely to consume. Generally, lower income households spend a greater percentage of their incomes than do higher income groups, so any stimulus that uses tax relief or grants should be targeted at lower incomes if it is to be effective.

The answers to these three questions will determine where the economy will be next fall. If the Congress does nothing, expect a slow recovery that builds strength through 2002 and puts us back on a course of strong growth by 2003. If the stimulus package becomes a reality and passes the three tests above, the economy will come roaring back in the second half of 2002. But if the wrong bill is passed, there will be a significant dose of inflation next year, and a long and painful recovery thereafter. So now you are an economic forecaster. Watch the news and plan accordingly.