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THREE *OTHER* PROPOSALS TO REMEDY THE CURRENT ECONOMIC SLOWDOWN

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The U.S. economy is a complex, decentralized system, based on private decision-making in which the actions taken by individuals and private groups are all important and largely outside federal government control. In 1913 the Federal Reserve System was established to help stabilize the economy by preventing a banking-sector crisis from spreading to other sectors. The Fed was unable to prevent or bring under control the Great Depression of the 1930s. In the early 1960s Keynesian economists embraced the idea that the economy could be fine-tuned through fiscal policy which would eliminate the business cycle. Their ideas which underscored the importance of the demand side of economic affairs were crushed under the weight of stagflation in the late 1960s and 1970s.

In the late 1970s the United States turned to the ideas of Milton Friedman who argued that fiscal policy is a clumsy interventionist instrument and recommended that the Fed concentrate on increasing the money supply by four percent per year. The Fed rejected this rule, raising interest rates to 21 percent in the early 1980s in order to bring inflation under control. The remedy worked but it drove the unemployment rate above ten percent for the first time in 40 years.

Monetary policy was set aside in the 1980s by President Reagan who promoted supply-side economics. Supply-siders argued that private producers are the critical decision-makers and that intervention should offer incentives to jump-start their businesses with the good effects "trickling down" to the rest of the economy. Years later, supply-siders claimed that those incentives triggered the longest economic expansion on record. Critics who called it "voodoo economics" argued that supply-side economics led to a doubling of the U.S. public debt by the end of the 1980s and was not able to prevent the 1990-91 recession.

Lesson learned: notwithstanding its considerable powers, the federal government is not able to control the economy and thereby *prevent* a recession anymore than an oncologist can prevent cancer in a patient. Further, the government can no more *cure* a recession once it occurs and keep it from re-occurring than an oncologist can guarantee a patient that the cancer will not re-occur after treatment. What the government can do is help *alleviate* the burdens of a recession just as an oncologist can help bring under control the nasty side-effects of treatment and relieve some of the patient's suffering if the cancer persists to a terminal stage.

Events in financial markets and the rest of the economy interact in mutually-reinforcing patterns. A bull market drives up the value of asset holdings and this added wealth encourages more consumer spending. The additional spending drives up the demand for shares in companies that are expanding operations to meet the increased demand for their products and services. A bear market drives down the value of asset holdings and the diminished wealth restrains consumer spending driving down the demand for shares in companies that are contracting to accommodate to a decreased demand.

A bull market driven by opportunities to make huge gains in asset values reinforces human acquisitive desire beyond reason which induces herd-like behavior that disregards due diligence and results in grossly inflated financial asset values. This in turn spikes demand for other assets including real estate and triggers a surge in demand throughout the economy and further drives the bull market. Recall that Fed chairman Alan Greenspan described the 1990s bull market as "irrational exuberance."

A bear market sets in when financial asset holders begin selling because they realize that their assets are overvalued and it's time to dump those assets in order to protect their gains. Others in herd-like fashion are frightened into selling by the prospect of the losses in store for those who hold on to their assets in the hope of a market rebound. This behavior spills over into other sectors of the economy where fearful consumers and producers cope with their anxieties by reining in spending, further propelling the bear market until somehow their fears are allayed. Recall what President Roosevelt said in the depths of the Great Depression: "we have nothing to fear but fear itself."

When greed and fear control decision-makers in financial markets and then spill over into the rest of the economy a syndrome develops that is hard to break. When an acquisitive desire overtakes due diligence and reason an economic expansion morphs into an unsustainable bubble until humans begin to act more prudently in economic affairs. In like manner, when fear grounded in a sense of insecurity overwhelms confidence, a contraction transforms into a crash until humans once again feel secure. Greed and fear are more dangerous today than in the past because the information-communication technology revolution allows us to communicate more quickly, more widely, and less expensively than ever before, making herd-like behavior more likely than ever before.

The President and House of Representatives have agreed to a stimulus package based on a single proposal of tax rebates. Mayo Research Institute argues for three other targeted proposals to address the behavior of those persons most fearful and insecure in the current downturn by reducing the risk that their incomes will be slashed and they will not be able to maintain their homes and provide for other basic human needs including health care.[1]

• Homeowners who cannot maintain their mortgage payments need assistance and counseling to avoid foreclosure and displacement. This could be accomplished with

[1] In Consumer Reports National Research Center November 2007 national sample survey of persons with income below $50,000 82 percent responded that they were concerned about being bankrupted by medical costs due to an illness or accident and 74 percent said that they were worried about losing health-care coverage due to being laid off or leaving their job.

temporary funding to financial institutions including credit unions to staff up programs of individualized assistance to those who are threatened by the loss of their homes. Those who refuse counseling services would not qualify for financial assistance.

• State unemployment insurance systems could temporarily raise the limits on weekly benefit amount and benefit duration so that the unemployed are better protected against a major loss of income while they try to find work. The federal government would pay for those additional costs with the states reimbursing the federal government when economic conditions improve. Claimants who do not qualify under the regular benefits program would not qualify under the temporary enhanced benefits program.

• No one should lose health insurance coverage because he has lost his job or be forced to drop coverage in order to make mortgage payments. The unemployment insurance system should be re-structured to include in the taxes paid by employers the cost of continuing health insurance at least until their laid-off workers exhaust their jobless benefits. Given the high and rising cost of health care, this reform probably should be made permanent.

These three initiatives are modest in scope and designed to limit the role of the federal government lest we make people so secure that they lose their sense of personal responsibility for their decisions, looking instead to the government to rescue them from their mistakes and thereby enabling them to set aside the due diligence, reason, and prudence that would constrain them from making such mistakes. Private decision-making in economic affairs requires limited and targeted government intervention in those affairs.

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