A jolt from Washington

by the St. Louis Post-Dispatch

The United States seems to be edging closer to recession. In Washington, this bad news provides a convenient excuse for politicians to engage in two of their favorite activities: cutting taxes and spending money.

From the White House to Capitol Hill, cries are rising for an economic "stimulus package" - a burst of spending, tax-cutting or both, designed to prime the economic pump. Unfortunately it would also throw the country deeper into debt, which is why it shouldn't be tried unless it's absolutely necessary.

President George W. Bush is considering proposing a stimulus plan in his State of the Union speech Jan. 28; the betting is that he will recommend tax cuts and refunds. Democrats, meanwhile, are pondering a mix of tax cuts and spending increases.

All sides should slow down. Despite last month's gloomy jobs report, it's not certain that the economy is headed into a serious downturn. And the Federal Reserve is on the case, busily lowering interest rates. That alone could be enough to float the economy past the rocks.

Support for stimulus is coming from financial graybeards on both sides of the political divide, economists as diverse as Laurence Summers, treasury secretary under President Bill Clinton, and Martin Feldstein, chairman of the Council of Economic Advisers under President Ronald Reagan.

Feldstein has the best suggestion: Pass a stimulus plan, but hold it in reserve until employment declines over three straight months - a convincing sign that a recession actually is here. The automatic trigger would make sure the money isn't spent unless it's needed. Meanwhile, the fact that the plan is in place could help revive confidence.

The economy is weakening under the housing price slide and a flood of foreclosures. Losses on subprime mortgages are forcing banks into red ink. In response, they are hoarding cash instead of lending it. Now the job market seems to have taken sick. The unemployment rate jumped from 4.7 to 5 percent in December as the nation created only 18,000 new jobs.

Once a recession gets rolling, it feeds on itself. Worried about their jobs, consumers cut back spending. That slows factories and stores, leading to more job losses. Round and round it goes.

Stimulus is meant to break that cycle by putting money in consumers' pockets so that they'll start spending again and business will recover. But there are smart ways and dumb ways to stimulate the economy. Tax cuts are among the dumber choices.

Tax cuts are stimulus in slow motion. The effect is spread over a whole year, adding just a few extra dollars to each paycheck, so there's no sudden pickup in spending. Tax cuts for the wealthy are an even worse idea, because the wealthy tend to save their extra cash rather than spend it. Expansion incentives for business also have long lag times before they kick in.

The best way to stimulate the economy is to give large chunks of cash, quickly, to people most likely to spend it - the poor and middle class. As Summers wrote in The Financial Times this month, "Fiscal stimulus only works if it is spent, so it must be targeted."

He suggested a package of between $50 billion and $75 billion, enough to add 1 percent to national economic output. That money would be piled atop the federal deficit, which is why it shouldn't be spent unless needed.

Stimulus should be temporary, not an entitlement running up the national debt year after year, as did Bush's 2001 tax cuts. Those cuts helped lead to massive deficits for the next six years, and they're still with us. A one-time splurge designed to lift the nation out of the doldrums is one thing. Permanent profligacy is another.

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