PUTTING THE CART BEFORE THE HORSE:
IS ECONOMIC POLICY OUT-OF-STEP?

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Suppose you encounter a serious traffic accident. What to do? There is a progression of measures to take. First, stop the bleeding to make sure that matters don't get worse. Then rush the victim to the hospital where he can start on the road to recovery. And only then, as a third step, should you even consider what needs to be done to prevent another accident.

This sequence of actions, (1) immediate relief, (2) medium-term treatment, and (3) longer-term preventive measures, seems so obvious that it hardly needs repeating. And yet the measures proposed by so many on economic policy in the US and other countries have been seriously out-of-step.

Let us recall what transpired since the Great Recession appeared. For the most part, policy-makers in the US and elsewhere took the right first step and adopted immediate relief measures to prevent the economy from imploding. After Lehman Brothers failed, there was real danger that the patient could die. *A capitalist economy requires the institutions of capitalism for survival.* Leading financial institutions received critical capital injections, and the Fed provided necessary liquidity to avoid a systemic collapse. The bleeding was stopped; and this progress was properly noted in the patient's chart as the Dow-Jones index rose from a low of 6627 in March of 2009 to over 10,000 just ten months later.

Then, while the patient remained in the hospital, medium-term measures were tried. The Fed pursued monetary easing by lowering interest rates to virtually zero, and began purchasing massive quantities of government and private securities. Congress passed a stimulus package which sought to get the patient on his feet again. However, these measures were not sufficient, as clearly reflected in his chart. The Dow has remained relatively flat, although it recently passed through 11,000.

Unfortunately, further stimulus is not even being proposed. Indeed, some politicians are labeling the initial relief actions as unnecessary bailouts and seeking to undo recent medium-term macroeconomic policies by insisting that the administration reduce government spending to balance the budget. To be sure, that is an appropriate Phase 3 concern which must be addressed when the economy recovers. But doing so now will only make matters worse. What the patient currently needs is just the reverse: higher government spending and lower taxes for those who will actually spend their tax savings. In the face of sluggish consumption and business activities, and with stubbornly high unemployment and troublesome deflation tendencies, we need to promote recovery before even thinking of how to deal with longer term reform measures.

In what may be the most self-defeating action of all, bank regulators in the US and abroad have required banks to avoid making risky loans and increase their capital reserves that together have substantially tightened credit standards. This is all in the interest of preventing another financial meltdown, which is fine for a patient who has recovered from the accident but hardly appropriate when he is still in hospital and needs all the support he can get.

The patient is barely out of bed, and it is not yet time for prevention. The need to find a "cure" remains the order of the day.