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It's Still the Economy, Stupid

The Republicans Need an Economic Recovery Plan

Summary

If Republicans don't start enacting aggressive policies to revive our ailing economy, they risk losing the midterm elections in 2002.

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By Stephen Moore

Almost every economic recession of the last 100 years was caused by policy mistakes in Washington. Our current economic downturn is no exception. Policy errors at the Fed and in Congress have played a big part in the plunge in the stock market, the economic drought in the manufacturing and high tech sectors, and the corporate layoffs that have caused increased worker angst in recent months.

Although we are not officially in a recession now (which requires two straight quarters of negative economic growth), to many Americans this feels like a recession. The economy grew a meager one percent in the 4th quarter of 2000 and the growth rate for the 1st quarter of 2001 was an anemic 1.2 percent. The manufacturing sector of the economy has been in recession for almost a year now.

There are three primary explanations for the current economic miasma. First, the Federal Reserve Board enacted a series of monetary policy mistakes. In the last three months of 1999, the Fed lowered interest rates and increased the money supply as a precaution against the Y2K scare. The notion then was that people were hoarding dollars to safeguard against a Y2K crisis. In response, the Fed had to pump more money into circulation. When Y2K turned out to be a grand hoax, the Fed was forced to contract the money supply to remove the excess liquidity it had created a few months before. At about this same time, Alan Greenspan became obsessed with slowing the high growth rate of the economy, which had reached five to six percent in the first half of 2000. (The Fed is still influenced by Keynesian economists who even today believe in the discredited Phillips Curve notion that growth causes inflation, when, of course, it is the absence of growth that causes inflation.)

The federal tax burden has surged from 18 to 21 percent of GDP since 1995 as a result of real income bracket creep. Former Federal Reserve Board member Wayne Angel has found that virtually every time the tax burden has risen above 20 percent, the economy has slid into recession.

In any case, a series of interest rate hikes engineered by the Fed caused a rapid contraction of the money supply, a credit crunch, and several months of deflationary monetary policy. The signs of deflation were evident in the low price of gold and falling commodity prices (except for oil). The adverse consequences of this overly constrictive monetary policy is being felt now, because there's a 6 to 12 month lag in the impact of monetary policy on the real economy.

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Throughout the 1st half of this year, Mr. Greenspan has taken huge steps in reversing this policy error by repeatedly cutting interest rates. (Better late than never.) Most of the necessary correction is now in place.

A second severe policy malfunction has occurred in tax policy. The federal tax burden has surged from 18 to 21 percent of GDP since 1995 as a result of real income bracket creep. Former Federal Reserve Board member Wayne Angel has found that virtually every time the tax burden has risen above 20 percent, the economy has slid into recession. This tax anchor has to be lifted by enacting a very large and immediate supply side tax rate cut.

The recently passed Bush tax plan provides too little relief in the short term to ease this burden anytime soon. About 80 percent of the Bush tax cut occurs after 2003. The economy needs a tax cut now.

A third factor has hamstrung our economy. Energy policy. Since 1997 oil prices have surged from $9 a barrel to as high as $30 a barrel. Since the U.S. is a major importer of oil, the higher prices cost American businesses and consumers about $60 billion a year. That's like a massive tax on the American economy imposed by the OPEC cartel. Add to this the manmade electricity crisis in California, and energy policy, or the lack thereof, is causing real havoc to the U.S. economy.

Here, the Bush administration policy is exactly right. We need aggressive measures to increase domestic production; we need to start attacking and reversing the policies of left wing environmental extremists who have blocked the construction of energy generation plants and electricity transmission lines in states like California; and we need an aggressive counterassault against the OPEC monopoly by withholding economic and military aid to our so-called allies who are gouging American consumers. Nations like Kuwait, Saudi Arabia, and Venezuela are still treated by the U.S. government as strategic partners, when in fact they are inflicting serious damage on our economy.

In 2000, George W. Bush captured 54 percent of the vote of investors. These voters want bullish economic policies implemented quickly. If Republicans don't stop worrying about the budget surplus and start passing bold economic revival policies—including a retroactive cut in the capital gains tax and faster reductions in tax rates—they risk losing these voters in the 2002 midterm elections.

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(Stephen Moore is president of the Club for Growth and a member of the Board of Governors of the Virginia Institute for Public Policy, an education and research organization headquartered in Potomac Falls, Virginia. **Permission to reprint in whole or in part is hereby granted, provided the author and his affiliations are cited.)**

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