THE HAMILTON PROJECT

IF, WHEN, HOW?

PROSPECTS FOR FISCAL STIMULUS IN THE U.S. ECONOMY

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P R O C E E D I N G S

MR. RUBIN: Good morning. I'm Bob Rubin. And behalf on all of those involved with The Hamilton Project, let me welcome you to today's event. As you know, there will be a discussion of fiscal stimulus in the context of today's highly uncertain economic conditions.

The Hamilton Project's first work product, which was about two years ago, was a paper with respect to what we thought U.S. economic policy ought to be for the purposes of promoting growth, broad based participation in growth, and increased economic security.

Since then, we've had a succession of events. Each one of the events has dealt with a particular policy area. We've had highly respected academics, policy analysts presenting papers, and then we've had a panel discussing those papers and the area more generally. All of these papers were subject to rigorous academic review.

In late September, for the first time, we decided that we should have a different type of event. At that point, the ongoing financial disruptions had clearly become a serious economic risk and had clearly become a serious problem for American families. In our judgment, decisions had to be made and considered in a much faster time frame than could be addressed with our usual rigorous policy process.

We also felt that the Hamilton Project with its really quite unusual, I'd say extraordinary combination of academics, policy analysts,

and financial people was particularly well situated to discuss those financial disruptions.

So, what we did was we had a panel -- highly distinguished panel to discuss those disruptions but without the usual policy papers and the underlying rigorous academic process around those papers.

Today we're going to again present a panel on a highly topical subject because once again, it seems to us that the topic itself is of great importance and there isn't the time to do the usual -- the kind of policy processes we ordinarily do with the papers that relate to those processes.

The panel, as you know, will focus on the question of fiscal stimulus in the context of today's highly uncertain and complex economic outlook. We're going to begin with the discussion or presentation rather by Doug Elmendorf, senior fellow of the Brookings Institute and also senior staff member of The Hamilton Project.

Doug is going to synopsize the strategy paper on stimulus that you received on your way in. I had nothing to do with writing the paper, so I can say this. I thought it was a terrific job, both with respect to its comprehensiveness and also its thoughtfulness and insight about what is a more complicated subject once you get into it than it might sometimes appear on the surface.

After Doug's presentation, we're going to have a panel

discussion. The résumés of the panelists are in your materials, so I'm not going to repeat them. Let me just briefly introduce our panel.

Martin Feldstein, who is the George F. Baker Professor of Economics of Harvard University, he is the president and chief executive officer of the National Bureau of Economic Research, and he's one of the world's truly most distinguished and widely respected economists.

Jason Furman, senior fellow of the Brookings Institution and executive director of The Hamilton Project.

Alice Rivlin, senior fellow of the Brookings Institution, former vice chairman of the Federal Reserve Board and the highly distinguished and highly respected founding director of the Congressional Budget Office.

And Martin Zandi -- Mark Zandi rather, who is the chief economist and cofounder of Moody's Economy.com.

Before proceeding, let me also thank Karen Anderson. The Hamilton Project's original plan for the project -- for today's event and the work that was done around that event -- the original plan that we had had at the Hamilton Project was to focus on two functions; number one, developing serious intellectual work product and number two, promulgation of that product.

And if you look at the work of this -- on today's event, it shows you the truly outstanding work that Karen and her team of have

done in the second of our two functions, which is promulgating the policy and academic work product that we develop.

Let me start with a broad framing of the issues for today's panel and then I'll turn to Marty Feldstein, who will begin with a presentation with respect to these issues.

I think of the questions for the panel as falling into four -- or rather into three broad categories. What I'm going to try to do is conduct the discussion in a more or less orderly fashion in the order of those categories.

Category A for the panel is what are your views with respect to the outlook for the economy? What do you think the probability is of recession? Is there really an important distinction between recession and simply very slow growth with respect to this whole question of stimulus? If there is a recession or serious economic difficulty, do you think it's likely to be brief or prolonged?

And in the context of all of that, what are the pros and cons of having a stimulus and do you think we should have a stimulus? And in that context, if we do have a stimulus, should it have a trigger and should it be paid for in the outer years or not?

And I think for purposes of that set of questions, what we ought to assume is that if we have one, it will be timely and well constructed, although that's obviously a monumental assumption but it

helps us to isolate in on that set of questions.

The second category of questions will be exactly the -- what I just said, which is if we had an ideal world, which we are far from having, what should the content, timing, and size of a stimulus be with respect to content. We can talk about principles, we can talk about specific proposals.

With respect to timing, there's the, I think, rather interesting question of whether it should try to be a little bit ahead of the curve, recognizing the curve may never eventuate or should you wait until you're sure or relatively sure as to what's happening?

And then finally, category three or -- yeah, category 3, in a realistic world, what are the politics around stimulus? And what is the likelihood that our political system can produce a stimulus on a timely basis that is sensible? And the converse of that, what is the risk that the ultimate product would either be too late or badly constructed and as a consequence will do little good for the short-run and perhaps harm for the long run?

And a related question is are there any actions that we could think of that might increase the probability that the political process would be effective?

I'm only the moderator. But I am going to find time to take the liberty of injecting a comment or two. And I'd like to make one

comment up front, which is you can care very deeply about structural fiscal conditions in this country, now and for the long run. And I know I do and I know many members of the panel do. But I believe that that is a separate question from this question of whether or not we should have a stimulus.

I believe that you can be in favor of a stimulus or opposed to a stimulus and that that judgment is an independent -- is independent of this question of long-term fiscal health or even of current fiscal -- structural fiscal conditions.

At the end of the panel, we'll leave some time for questions. And then at the very end, I'm going to try to sum up in a few minutes and then ask the other members of the panel to add to or delete from what will undoubtedly be the inadequacy of my summary.

So, with that, I will turn the panel over to Doug.

MR. ELMENDORF: Thank you, Bob. And thanks very much to all of you for joining us here today. The paper that Jason and I have written has a straightforward message.

Fiscal stimulus can be an important complement to monetary stimulus if but only if it is timely, targeted, and temporary. Those criteria are not original to us and they're not controversial among analysts who have studied the effects of past fiscal actions.

This is a case where economists know what works and what

doesn't. So, these criteria are essential if we want stimulus to provide a real boost to the economy, not minimal boost or perhaps be counterproductive, but a real boost to the economy.

So, the challenge for everyone involved in a policy process is to be resolute in sticking with these criteria as alternative policy proposals are designed and debated in coming months.

Our paper isn't long, but it covers a number of points and presents a range of evidence. And I won't try to summarize all that for you. In any case, I'm confident that you will take the paper home, download more copies from the Brookings website, study carefully, send copies to your friends and families and so on.

So, I will use my few minutes here to flesh out these three criteria that we've emphasized, timely, targeted, and temporary.

First is the notion of timely stimulus. Making stimulus timely is crucial because the average recession does not last very long and because providing stimulus after the economy is already accelerating again will simply push up inflation or induce the Federal Reserve to run tighter monetary policy in order to offset inflation. Either way, stimulus that is delayed provides no boost to economic activity when it is most needed.

Unfortunately, making stimulus timely is as difficult as it is important. It's difficult in part because forecasting economic conditions is so hard. It's also difficult because the political process of deciding what to

do takes time. And then implementing fiscal changes takes time. And often, having those changes further affect household and business spending takes more time.

Therefore, to be effective, fiscal stimulus needs to be enacted quickly after the need for stimulus is recognized. And it needs to involve policy changes that can be administered quickly and can get money circulating in the economy quickly.

The second characteristic of effective fiscal stimulus is targeted stimulus. We use the word targeted in two senses. Stimulus is targeted in a macroeconomic sense if each dollar of lower taxes and higher spending produces the maximum possible increase in output, in GDP.

Stimulus is targeted in a fairness sense if each dollar of lower taxes or higher spending does the most to help those families that are most hurt by an economic downturn.

Fortunately, this is one of the rare cases where two goals in economics can be satisfied at once rather than being a cross purposes and forcing an unpleasant tradeoff.

Consider families further down the economic ladder, those people living closer to the economic edge. These families are likely to be hurt the most by a slowing economy.

They're also the ones who will spend the largest share of

any extra money they receive. Therefore, fiscal changes targeted to them will have the largest bang for the buck in both macroeconomic terms and fairness.

This conclusion is a matter of both logic and evidence. I've just summarized the logic briefly for you, and the paper reviews some of the evidence that economists have gleaned from past changes in taxes and other forms of fiscal policy.

The third element of effective stimulus is the notion of temporary stimulus. As everyone knows, the federal budget is slightly out of balance now and terribly out of balance in the long run. We cannot afford to make the long run budget outlook worse. But we don't need to make it worse in order to generate effective stimulus.

Indeed, permanent policy changes that make the long run budget outlook worse would generally have less stimulative effect than well-chosen temporary policy changes.

The logic again is simple. Temporary tax cuts or spending increases targeted at households who will spend a good share of the money they receive can provide a strong boost to total spending just when the economy needs it most.

Permanent tax cuts or spending changes may also encourage more household spending or business spending if targeted correctly. But, the expectation of higher future budget deficits will tend to

push up interest rates today and therefore, offset some of the direct stimulus.

Again, the paper discusses this logic at greater length and again presents the relevant evidence.

The question then becomes what do these principles, that policy be temporary, targeted, and timely, imply about specific types of fiscal stimulus that have been discussed.

One type of very effective stimulus is to expand programs that help people in economic difficulty, such as unemployment insurance payments or food stamps. On the government's ledgers, these policies would show up as higher spending, but economists would view increases in these programs and in these transfer payments as more analogous to reductions in taxes because the goal in both cases is to put more money into the pockets of households.

Regardless of the label, these policies would be very effective stimulus because the changes can be implemented quickly, because they are targeted to achieve the maximum bang for the buck, and because they can be done for a limited period.

However, such expansions would probably be fairly small compared with the overall size of our economy. In terms of policies that can be conducted on a larger scale, the most effective stimulus would likely come from personal income tax credits that are a flat amount per

household and that are refundable to households that do not have a positive tax liability.

Such flat, refundable tax credits would be effective stimulus again because the credits can be implemented quickly, because most of the money would flow to households who would spend a good share of what they received, and because the credits could be done on a one time basis that would provide stimulus when we need it without worsening the long run fiscal situation.

The paper expresses more doubts about the utility of increases and infrastructure investment for temporary investment tax incentives. To be very brief, it is difficult to design infrastructure investments that could take effect as quickly as stimulus might be needed. And the experience with the so-called bonused appreciation for businesses several years ago is that it provided only a small amount of stimulus to the economy at best.

The policies that would be least effective at providing stimulus and might even be counterproductive in a stimulus sense would be across the board tax rate cuts or an extension of a 2001 and 2003 rate cuts.

Whatever the merits or demerits of these policies in terms of long run efficiency, equity, economic growth, and budget balance, they simply would not provide much if any short-term boost to economic

activity.

In particular, making the 2001 and 2003 tax cuts permanent would hardly provide a timely boost because they would take effect several years from now. They would not be targeted households that would spend the largest share of money they received even several years from now. And the permanence of the change -- the permanent worsening of the fiscal balance would raise long-term interest rates today and crowd out some investment.

In closing, I want to emphasize that most economists are skeptical of fiscal stimulus, not for economic reasons, not because fiscal stimulus that is timely, targeted, and temporary is a bad idea, but because history suggests that these three criteria are often not satisfied.

It is up to all of us engaged in the policy process today to put a better example in the history books. Thank you very much.

(Applause)

MR. RUBIN: Okay. We'll now start the -- okay. We'll now start the panel, and we'll start with Marty.

MR. FELDSTEIN: Thanks very much, Bob. It was a pleasure to hear my former colleague whom I taught at Harvard for a number of years, Doug Elmendorf, talk about this interesting work.

I've got some disagreements about some of the specific things he said, but that's why we have a panel. What I want to do is to

make some general remarks first and then during the broader discussion come back to some of those issues.

I think we're all here because we are concerned that the U.S. economy could slip into a recession and that the recession could be a long, deep, severe one.

If you look at past recessions, you see that a combination of increase in oil prices and an increase in the federal funds interest rate has historically been followed by an economic downturn, by a recession. And we certainly have both of those with oil prices going from $30 to now $100 and with the fed funds interest rate rising from 1 percent to 6 percent before the fed started cutting.

But this time is more than just that. the reasons to worry about the likelihood and the potential severity of a recession now comes from three additional sources: the collapse in housing construction, something which, again, historically when it's happened has been followed by an economic downturn almost every time; the fall across the nation in house values and house prices, which is cutting into household wealth and therefore, potentially into consumer spending, a key driver of a economy; and perhaps hardest to take into account, hardest to quantify, the changes in our financial markets, where it's not just a question of a traditional shortage of liquidity but rather it is a lack of confidence on the part of financial institutions, confidence in themselves, in their own

balance sheet, confidence in the credit worthiness of other participants in the financial and non-financial sector, confidence in the value of securities. And we get news almost everyday to reinforce the reasons for that lack of confidence.

In addition to that, we see that what we thought of as well capitalized financial institutions now are short of capital. And if they're short of capital, that means they can't do the lending that would otherwise be possible.

So, the financial sector problems add significantly to the risk and the potential severity of the economic downturn.

But having said all of that, it's not a sure thing that we're going to have a recession or even if we have a recession, that it's going to last even as long as the typical downturn. The typical downturn from peak to trough has been 13 months. And some forecasters are saying oh, we'll have two quarters, maybe three quarters of downturn.

Why? Well, first because the U.S. economy really is very resilient and it has changed over time as less of the economy in cyclically sensitive sectors, more in sectors like healthcare, so that the loss of jobs associated with a slow down and demand may be less this time.

Moreover, the fed has only begun cutting in recent months, and therefore, once again, the lagged impact of those lower interest rates has not been felt yet. That may be enough, especially if the fed keeps

cutting. That may be enough to stop us from sliding into a recession or if we do, to turn that recession around quickly.

And finally, the dollar has become much more competitive. It still has, in my judgment, a long way to go, but the more competitive dollar is leading to a big increase in our exports. And that's helped to keep the strength of the economy.

So, a recession, in my judgment, looks more likely than not, but it's certainly not a sure thing. When somebody twists my arm and says well, Marty, come on, give us a probability, I'd say it's somewhere above 50 percent. I'm not sure how far above 50 percent, but I worry that if it does start, because of the structural weaknesses in the financial sector, because of the precarious nature of consumer spending, where we now have a negative household saving rate, it could be a more serious -- more serious downturn.

So, what to do? Well, first of all, I think the Federal Reserve should keep cutting interest rates. The futures market is telling us that the fed funds rate is likely to be cut to three percent of less in 2008, and I think that's the right direction. There's no reason why the fed shouldn't cut by 50 basis points when it meets later this month.

But easier money may not be as effective this time as it has been in previous economic downturns because of the special problems of the financial sector that I talked about. Simply lowing the fed funds rate or

engaging in broader open market operations may not be enough to bring the economy back to strength.

And that's why there is so much interest in the idea that supplementing monetary policy with a fiscal stimulus, getting cash into the hands of households and I would say, in addition to that, stimulating businesses to spend more on investment.

I think the purpose of it we should keep bearing in mind is to create jobs, to increase GDP, to raise all bodes. This is not an income maintenance program. I think that some of the things that Doug said about targeting may be appropriate in a long-term policy discussion, but I think here the key has to be about how do we get the economy to avoid a recession or to have a mild recession if one occurs.

So, a month ago, I made a specific proposal in testimony to the House Budget Committee and also in a Wall Street Journal article in which I proposed a conditional fiscal stimulus. And the idea is very simple.

It is that Congress ought, as quickly as possible, to pass legislation that spells out a specific cut in taxes and a specific set of increases and transfer payments and I don't -- I didn't make any particular proposal about the content of that, but that it should be large enough to have a significant impact in our nearly $14 trillion economy.

But the key thing is that they should pass it now but that it

should only trigger on -- it should only begin if we have clear evidence of an economic downturn. So, I don't think and I didn't think then that the evidence was strong enough for us to see that enacted today and to take effect today, but I think it should be enacted now but to take effect when it's -- when there is clear evidence that the economy is sliding into recession.

I suggested three months of downturn in employment. There may be better ways of triggering it, but it would have to be something in which the data come in quickly so that -- and unambiguously so that we would know when to start it and there would have to be some other trigger that turned it off because I agree with what's been said about this has to, of course, be temporary.

I think this would have two important advantages. First, it would get rid of the long legislative lag that has historically made fiscal policy a poor instrument. If we wait, say, three months from now, four months from now when the economy starts to show very serious signs of downturn, if it does, and Congress then spends a few months trying to decide what to do, we will have wasted some very valuable time, so better to have the policy in place to be triggered when the evidence indicates that it's needed.

And second, the very fact that that legislation has passed would have the favorable effect of telling the public, telling all of us that if

the economy starts to soften, there will be a stimulus package. And therefore, the worry that the economy will continue to decline significantly gets reduced.

So, it's a way of building confidence in the part of the American public that fiscal action, as well as action by the Federal Reserve will be there.

So, let me stop there and happy to come back to some of the specifics that are in this -- that Doug mentioned and that are in this paper when the panel opens up more generally.

MR. RUBIN: Why don't we go around the panel? But can I ask you just one question before, Marty?

MR. FELDSTEIN: Yes.

MR. RUBIN: My impression -- but I'm not an economist. I'm a retread lawyer so I could be wrong, but my impression is that post World War II recessions have sort of gotten milder for the most part on average; '80, '81 might have been -- you know, stronger, but on average.

Yet you seem to be concerned and I think Larry has the same -- Larry Summers, the same concern that this one actually could be deeper and so it could counter the trend. If that's the case, why wouldn't you err on the side of combating the risk of recession or of serious difficulty whether it's quite recession or not?

Why wouldn't you err on the side of that and act more

quickly, rather than use your trigger and wait for three months in order to avoid -- I guess you must be worried about inflation or something? I don't know why you'd do that. But why not err on the side of one risk rather than the other risk?

MR. FELDSTEIN: I may be wrong.

MR. RUBIN: What?

MR. FELDSTEIN: Because I may be wrong.

MR. RUBIN: Oh, okay.

MR. FELDSTEIN: That is -- you know, if you look at --

MR. RUBIN: He set himself up for this as having my teacher, so he can't position himself as advantageously.

MR. FELDSTEIN: Right. You look at the spectrum of opinion and the general opinion of forecasters who spend their time looking hard at the numbers is only beginning to get to the more likely than not.

MR. RUBIN: Yeah.

MR. FELDSTEIN: That's not a sure thing. And then, in general, the outlook is for relatively mild. So, by the time you say well, what's the probability of the recession and given a recession and given a recession, what's the probability of it being a deep recession, you're not -- I may -- I don't know exactly what that number is.

It depends on how deep is deep, but clearly a lot less than a

half. So, therefore, it may be premature to do this. You don't want to do it every time you sniff the probability of a recession. You don't want to spend $100 billion.

So, I would say this is a compromise. And I'd rather have that compromise than spend the money today. If you told me that the compromise wasn't possible, that Congress says either you spend the money today or you wait until it happens and then we do it in the traditional way, then I'd say do it today because I'm that worried.

MR. RUBIN: Alice?

MS. RIVLIN: First let me say that I thought the paper was terrific, and I urge you all to read it. and I think if the members of this panel or the people in this room could design a stimulus package that was timely, it was targeted, it was temporary, and also I think triggered, since we're into T words here, that if we could design such a thing, we probably ought to urge the Congress to vote for it.

I'm a little less gloomy than Marty, which shouldn't be taken too seriously because I'm always less gloomy than Marty. But, I want to raise a slightly different point. I think this set of economic conditions is peculiar in the sense that the things that triggered this whatever it's going to be, certainly a slow down in the economy, are a unique set of events.

We have, as Marty has talked about, the decline in housing prices. We have the foreclosure problem which grew out of sub prime but

isn't entirely limited to that, and we have the credit crunch in the financial market.

It seems to me that we ought -- that the chances of this not being a recession or a serious recession depend on our containing those things and that there are policies that we ought to be working on now. They aren't all public policy, but we need to be making sure -- there's nothing to do about the fact that we build too many houses. We've got to absorb that over time and that a lot of people borrowed money who can't make payments now is also a problem that is going to have to be worked through.

Containing the damage is going to take lenders and community organizations and probably a couple of levels of government working together very hard -- and this is difficult stuff to do, to keep families in their homes as many as possible and to make sure that when the foreclosures occur, there's an orderly transition that gets this house back into somebody's -- gets a family back into this house as quickly as possible. That's a very hard kind of policy, much harder than designing a stimulus package.

The other thing is what to do about the credit crunch. Some big financial institutions made bad mistakes. And they are now very reluctant to lend even credit worth borrowers or to lend to each other. What can be done about that?

This is primarily a job for the big banks and the big financial institutions themselves and I'm looking at Bog on purpose here. And they are doing it. they are getting infusions of capital. There are downsides of that for stockholders and for management, but somebody has to pay for mistakes.

And we need to re-capitalize the financial system, and we need to build confidence. But that may take a new kind of monetary policy, not -- and the fed knows this and has been trying to figure out what to do to get banks lending more. It isn't just hey, y'all come to the discount window because banks don't like to do that, so they devised another method and they are all working together on what seems to be a constructive front.

So, I would urge, before we jump into stimulus packages, which are sort of things we know how to do, that everybody works very hard on containing these specific things.

MR. RUBIN: I would very much relate to that. Let me ask you a question if I may, Alice. If you look at all the different things that can be done with respect to the mortgage issue and if you can contain that, I actually think it would help on the credit crunch part --

MS. RIVLIN: Yeah, right. They're related.

MR. RUBIN: Yeah. You said you thought the most important -- I think you said, maybe I'm -- but I think you said the most

important thing and it's something that I think as well that could be done would be to get community groups and others, states, cities, whomever it might be together with lenders to try to have a renegotiation process rather than a foreclosure process.

But my question to you, I guess, would be two fold. One, can that happen unless it's catalyzed in some way by the federal government? And number two, there are all kinds of legal liability questions in there and can you deal with that without legislation?

MS. RIVLIN: There are. And I don't think you can deal with that -- with it without legislation, and some of it may even be state legislation rather than federal legislation. But, I think that's the place to be putting our creative efforts right now, rather --

MR. RUBIN: But then -- then my follow up question, Alice, would be that after all this has been all front and center for some months now and the political system seems -- I have enormous respect for some of the people involved in this in the political system.

MS. RIVLIN: Right.

MR. RUBIN: But the system itself seems simply not to have been able to move forward on any of these fronts.

MS. RIVLIN: Right. That's a problem for stimulus packages as well, however --

MR. FURMAN: Well, that's true.

MS. RIVLIN: And I just think -- I'm just raising the question what should be our legislative priorities right now, and I think they are working on these specific things to contain those elements of the problem.

MR. FELDSTEIN: I --

MR. RUBIN: No, you go ahead.

MR. FELDSTEIN: I was going to say I don't know why you have to choose between these. These are two quite separate tracks trying to get the mortgage market and the real estate market working better. And as Alice said, that involves private organizations, governments at local levels, FHA. That's a very different agenda than the fiscal stimulus. So, I don't see that they're incompatible in any way.

MS. RIVLIN: No. I don't either. I think we ought to be having both conversations, but I'd give priority to the first.

MR. FELDSTEIN: It's the word priority that I'm not sure about.

MR. RUBIN: Marty was with you up until then. I guess the one place they intersect is simply -- it seems like the political system, Marty, is kind of mired or bogged down for whatever set of reasons. As I said, I have great respect for many of the people involved in that system, but it doesn't seem to be able to move forward.

MR. FELDSTEIN: The securitization, it just changed the nature of what you can do with this mortgages, and they haven't figured

out how to --

MR. RUBIN: Do you think it's a technical problem or a political problem?

MR. FELDSTEIN: It's partly a legal problem, and it's partly a technical problem.

MR. RUBIN: But the legal problem you could --

MR. FELDSTEIN: Well, you can tell the poor folks who bought pieces of CDOs and other securitized things that it's just tough luck; we're changing the rules of the game in midstream and they lose. That doesn't strike me as a good thing for the capital markets going forward.

So, and I don't see a way around that, and I don't see anybody else has come up with a way of dealing with that.

MR. RUBIN: Well, that is the -- that does get to the question. I think it's the Castle Amendment or something that deals with that. But anyway, that does get you to that question. You're right.

Mark?

MR. ZANDI: Well, I like --

MR. RUBIN: You can give us wisdom.

MR. ZANDI: I will, yeah. My three cents, my five cents, my nickel. I have three points. Point number one, I think recession odds are at best 50-50, probably over 50-50 at this point.

I think there are three -- oh, by the way, I -- there's probably a half a dozen regional economies of consequence that are in recession already, California, Arizona, Nevada, Florida, Michigan, Wisconsin. They're in recession. They account for 25-30 percent of the nation's GDP, so I think they're in recession. Unemployment is rising; employment is falling in those economies.

I think there are three broad forces that are weighing on the economy, and they're not going to go away. Policy won't be able to solve the problems. They're just going to weigh on the economy through most of '08.

Problem number one is housing. House prices are down seven percent from their peak based on the Case-Schiller Index, which is the best measure of prices over the past year. The consensus view is that they'll decline about 15 percent, and I think that's a reasonable view.

And that's going to occur all throughout 2008. And that means two and a half trillion dollars worth of household wealth is going to be -- is going to evaporate over this period. And that's going to be significant weight on spending as we make our way through '08 into '09. And I don't think there's anything policy can do about that.

Broad force number two, the problems in the credit markets, they're not going away. The financial institutions have written down $100 billion or so of their mortgage securities. If you do any kind of reasonable

calculation, they'll probably have to write down $250 to $300 billion worth when it's all said and done.

We're about a third of the way down the process. Until we're well down that process, I think credit markets remain in -- they're frozen. They're going to be semi frozen throughout the period and that's going to be a growing problem on the economy because of the cost and availability of credit. So, that's not going to go away.

And third, gasoline prices are going to rise. Oil at $95, $100 per barrel, if they stay there for a couple, three months and we get into the driving season, in preparation for the driving season, we'll find our margins are going to go back up. We're going to go from $3 for a gallon of gasoline to $4.

Every penny increase in a gallon of gasoline is a billion dollars annualized, so that's $100 billion. That's a tax increase from $100 billion that we're going to struggle with in the spring and summer. And there's nothing policy can do about that. And that's very likely to occur.

So, the economy is going to be under -- if not in recession, it's going to be under very severe pressure through the spring and summer, and I think that's inevitable. So, that's point number one.

Point number two, we need more monetary easing. I agree 50 basis points at the meeting in January makes imminent sense. Futures markets are anticipating three percent of funds rate by the end of the year.

I wouldn't argue with that.

And I agree with Marty, monetary policy has been neutered to a significant degree at least in the near term because the key link between monetary policy and the real economy runs through the housing market, and the housing market is shutdown. The nonconforming origination market is evaporated, and that was 50 percent of all loan originations in 2006, and we're losing lenders.

I mean, we've got the nation's biggest lender and servicer on the brink of bankruptcy. That is going to make the conduit through lower rates to the economy through the housing market work much less effectively. And so I think it's -- it will work eventually, but it's just going to take longer. So, I don't think we see benefit in the first half of '08 from lower interest rates.

And then, point number three, I think it's absolutely necessary to consider fiscal stimulus, and I don't think it should be conditional at all for two reasons. One -- I can't think of a good trigger. I mean, using employment as a trigger I think would be a mistake because at points in the business cycle like we're in currently, employment is a bad measure.

We know that it's overstating growth significantly. It will get revised substantively. The BLS says as of March of '07, the downward revision to the benchmark is going to be 300K. they're going to change

their birth death model and we're going to see a big revision down in unemployment. And even after that, we don't know really what's happening with jobs.

So, I -- I don't know why we would use that as a trigger. It just, I think would be difficult to use and wouldn't work well.

Secondly, the difference between a soft economy and a recession is confidence. That's all it is. It's investor confidence. It's business confidence. It's consumer confidence. If you tell people they're going to get a $300 or a $600 or a $1200 tax rebate check no matter what, that makes a big difference.

If you tell them it's -- well, if the economy is not really good, you're going to get it, it doesn't serve that purpose. It doesn't shore up confidence. So, I think it's vital that we move forward aggressively, and I think it's a totally separate track from what's going on in the mortgage market.

And moreover, it's another reason why we should -- the problem -- there is no good answer to the mortgage problem from a policy perspective. There is none. We can dabble around the edges here, and there's proposals to cram down mortgages and you know, indemnify mortgage servicers and try to facilitate loan modification efforts, but this is really on the margin.

And it's all happening right now, and we're not going to get

anything together quickly enough to really make a difference on that front. So, that's another reason why we need to pursue, I think, aggressive fiscal stimulus. And it has to be, at least on order of the magnitude of that tax increase that's coming from gasoline prices, $100 billion. I think that's absolutely necessary, and we should move forward on that.

MR. RUBIN: Let me ask you this question, Mark. Well, Alice a little bit less, but I think all of you sort of had a view that the probability of serious economic difficulty, want to call it recession or not is you know, another sort of nomenclature maybe and even the possibility of something quite serious is material enough to really worry about it, you know, Alice a little less, Marty a little more and so forth.

On the theory that nothing in life is certain, including economic forecasting --

MR. ZANDI: I come pretty close, by the way.

MR. RUBIN: You do?

MR. ZANDI: Yeah.

MR. RUBIN: Well, okay.

MR. ZANDI: At least recently.

MR. RUBIN: Recently, yeah. Maybe your track record is just not long enough so we can't judge, but live long enough, and you'll go back to the mean. But in any event, be that as it may, if it happens -- if it doesn't happen, what is going to surprise us on the upside? What can

cause that concern?

If we agree it's not 100 percent probability, what is the force that could head us in the other direction or at least lead to sort of a quite soft landing?

MR. ZANDI: Well, there's a number of reasons for optimism and Marty, I think, mentioned a couple and I'll just reiterate. Reason number one is the global economy outside of the U.S. is doing quite well. Europe and Canada are struggling a bit. They have lower rates, but the emerging economies, China, India, Peru, and Chili just increased interest rates overnight, so --

MR. RUBIN: What's Chili's GDP?

MR. ZANDI: I don't know. But my point is -- okay, okay. That's not fair. Emerging economies, if you add up all their GDP, is a third of the global GDP at this point, even on a reasonably valuing Chinese GDP. So, a third of the global GDP is booming, and another third is doing just fine. It's really our third, you know, that U.S. third that's struggling significantly.

You mix that in with a weaker dollar and you get a point on GDP growth. And that's what we got over the past year in trading. That will continue. I don't see any reason why that shouldn't continue.

Secondly, businesses outside of housing are in great financial shape literally. I mean, if you look at a balance sheet, there's not

-- there's no problem there. They have a lot of cash on the balance sheet. Profits have doubled in the last five years. Yes, they're starting to -- they're going to come down, margins, but margins are at record highs.

So, there's a lot of cash. They have a lot of financial firepower and they're going to use it. And you know, that's the reason why, I think, they're cautious, they're not hiring as aggressively, but they're not laying off.

You know, pick up today's UI claims, they fell. We're at 325,000, which is elevated but it doesn't indicate that layoffs are surging. So, they have cash and they're going to use that as a financial firewall.

And third, you know, we've been talking about the demise of the U.S. consumer. And I was saying yes, they're going to pull back. We've been talking about that for 25 years. And never underestimate the hedonism of the American consumer, so there's a good reason to be, you know, somewhat optimistic.

In fact, I picked up my Blackberry today and I follow the reat stocks and all of the realtor reat stocks came out and reported same story sales for December. I know this is all anecdotes, but we live off of anecdotes in this environment. You know, they were all well above expectations, street expectations, which were certainly lower but they weren't bad. My point is we could be completely underestimating the resilience of the American consumer.

MR. RUBIN: I guess that goes to Marty's point of why he'd like to have a trigger.

MR. FELDSTEIN: Yeah. But I think in terms of the American consumer point, the American consumer can only spend what they can finance. And they've been financing a lot of that spending, I believe, by home equity loans. And I think that's drying up, so they no longer have that source of financing for that extra bit that allowed the saving rate to drop from pitifully low, two to three percent to a now negative number.

And we're not going to see a further to minus two and a half percent. It's more likely that we're going to see consumers backing up in the opposite direction. And that will be a further drag on the economy.

MR. RUBIN: Marty, before we get to Jason, could I ask you one more question? Mark raises a very good point about the emerging market world and the robust growth there.

MR. FELDSTEIN: Uh-huh.

MR. RUBIN: And then there's this big debate, coupling or decoupling. If the United States has a recession or even a relatively serious recession, is the emerging market growth relatively immune to that, domestic demand growth there being enough or do they really start to undermine that?

MR. FELDSTEIN: I think it depends on the country you talk

about and how dependent they are on exports to the United States. But even China, which would be the largest of those exporters to the United States, most of their growth is domestic.

And so, I think that the things that are driving their economy is going to continue to drive their economy domestically. They may have weakness in their export sector. In the case of China, that could have some favorable effect because they could start asking themselves shouldn't we be less dependent on exports? Shouldn't we be boosting our domestic demand in other sectors? And that would be a good thing for the long run in terms of our economy.

MR. RUBIN: So, you're in more of the decoupling school than the --

MR. FELDSTEIN: I'm in the -- some people talk about the decoupling in terms of what's going to be the impact on them and some in terms of how it's going to feedback to us. I think -- I've never thought that those were as strong as a lot of people imagined. And I think it gets less so as these countries become -- have their own engines of growth domestically.

MR. RUBIN: Jason, would you like to include dollar in your discussion or not?

MR. FURMAN: I'll get to the dollar later.

MR. RUBIN: Okay.

MR. FURMAN: But for now, I'll pander to you by talking about uncertainty and balancing risks.

MR. RUBIN: Okay. Nothing wrong ever, Jason, with pandering.

MR. FURMAN: What I think makes this question so difficult is the tremendous amount of uncertainties. And we have both political uncertainties and economic uncertainties that we're trying to contend with simultaneously.

Imagine for a second that we had no political uncertainty so that fiscal policy -- short run fiscal policy at least were conducted as technocratically as the Federal Reserve conducts its monetary policy. Then the answer to this would be quite simple. Every six weeks, policymakers should come out from a closed room where they've discussed the latest data and announce the new target federal funds rate, the new level of taxes, and the new level of spending.

And then if the economy -- you know, they were a little bit too pessimistic and the economy starts to turn up again, well, six weeks later, they can again adjust the fed funds rate, adjust taxes, and adjust spending. It's obviously some administrative constraints on this scenario as well, but just to take a very exaggerated point of view about what a world would be like without political uncertainty.

There's no real economic argument against fiscal stimulus.

It's only an argument that a world in which fiscal policymakers walk into a room and every six weeks adjust fiscal policy based on their latest reading of the data is not a world that we're very likely to be living in today or at anytime in the future.

Now, imagine a world without any economic uncertainty, so we knew exactly where the economy would be and exactly when the economy would be there, but we still had some political uncertainty. That would also be really easy.

In that world, we would only use monetary policy because there's no economic uncertainty, so the fed would know next year, you know, growth is going to be, you know, minus x percent. So, if they cut the fed funds rate today by three percent points, then they can make growth exactly what they wanted to be a year from now and we could just use monetary policy to get out of it.

Unfortunately, the world we live in has both this political uncertainty and this economic uncertainty simultaneously. And that creates some rationales for fiscal stimulus. One is that it can effect the economy more quickly than monetary policy can.

If we're worried about where the economy is in the second quarter of this year or the third quarter of this year, that will have a little bit of an effect on what the fed did back in September, will effect that a little bit.

What the fed does today will have very, very little effect on what the economy looks like certainly in the second quarter and relatively little in the third quarter of this year.

If we could get rebate checks out, if we could get extra food stamp payments out, and one of the arguments for that, Marty, by the way, is administrative. It would be really easy to basically just press a button on a computer and everyone's food stamps would go up and they would spend all of that money. So, I think there's a strong economic and administrative argument for it.

That can affect us right away in a way that monetary policy can't. And second of all, whenever you're not sure how well any given instrument works, you want to diversify your instruments.

But with fiscal policy comes a big risk. And the big risk is that it's not timely, temporary, and targeted. And the way I would personally think about balancing that risk is if the economy were let's say a year into recession and the federal funds rate was 0.5 percentage points so there was nothing more a monetary policy could do and we were in a very serious situation, then I would say it's a no-brainer to take the risk on a stimulus package because we're in such a serious situation.

And if at the end of the day Congress had an up or down vote or the president had a veto decision on a package that even violated some of the timely, temporary, and targeted that we talked about, I might

say the economic situation is so absolutely grave that, you know, let's take the political risk, let's even violate some of our purity, because it's so important to do something about it.

We, however, are nowhere near that situation right now. We still have the luxury of an economy that is very unclear where it's going. Actually, the majority of professional forecasts and the median forecast actually is still below 50 percent for a recession.

If you look a month ago, macroeconomic advisors thought fourth quarter GDP was going to be negative and that was a pretty standard reading among forecasters based on the data. Now, people think it'll be about one and a half percent positive.

So, there are some things that actually moved in the positive direction. More have moved in the negative direction undoubtedly. But there is still considerable uncertainty about the economy, and the consensus forecast remains for somewhat decent growth starting at least in the middle of 2008.

So at least in terms of the economy, it doesn't seem to justify an absolute imperative of fiscal stimulus no matter what. Monetary policy also still has substantial room to maneuver.

So I think in a situation like this, we should only consider fiscal stimulus and be very, very strict about the timely targeted and temporary, and if we violate those conditions, then we're better off not doing it, because

it'll either hurt the short run growth or almost certainly hurt long run growth. But if we think we could get those right, then certainly at least if the economy -- the economic data continues to weaken, and we can talk more about Marty's trigger, I think that's one good way of thinking about it, I think it certainly could be a useful compliment and play a subordinate role to monetary policy and leading us out of our problem.

MR. RUBIN: Well, a question Jason, you said that the -- in terms of lag times, that that is a longer lag time, and this, I guess, is a shorter lag time. Why wouldn't you -- well, let me ask you a question; I would have thought, though, that in some sense, the fed can have immediate effect in the sense that what the fed does does effect confidence, it effects how the financial market is operated. You may not agree with this, but I at least have the view that what the fed does, in some ways, the confidence effect is more important -- the confidence effect can be more important, which is an immediate impact, than the effect of any particular rate decline; do you agree or disagree?

MR. FURMAN: Confidence is a very hard thing to include in an economic model.

MR. RUBIN: That's why economists are viewed the way they are.

MR. FURMAN: If you look at -- in the paper Doug and I wrote

MR. RUBIN: How can you say that?

MR. FURMAN: Let me tell you what I --

MR. RUBIN: Economies consist of people, right?

MR. FURMAN: Right.

MS. RIVLIN: Go on candor, just say yes.

MR. FURMAN: In the paper Doug and I wrote, and because this is on C-Span, I'll say that you can find it at www.hamiltonproject.org, we include some simulation using the fed's large scale model that Doug had done in a previous paper he co-wrote, and what he found was, if you increase the temporary tax rebate in a way that people would actually spend the money, and the same would go for food stamps or UI, it would elevate GDP by one percent in the first quarter. That's actually a four percent increase in annualized growth rate, which is what's reported.

Fed -- cuts the fed's funds rate by one percentage point. The fed model that they used, or at least the slightly older model they used to use, shows a 0.0 percentage point increase in the economy. So when you start with the economic base line, already there's a difference of four percent annualized growth and a zero, add in confidence, and I think that zero might go a bit higher, but it probably -- confidence will go in both of them, right, I mean it'll --

MR. FURMAN: I agree with --

MR. ZANDI: Bob, I'd like to -- can I gander? I absolutely agree with you, yeah, I do, yeah. I think a key -- a most immediate link

between monetary policy and the economy is confidence, particularly through the financial system at this point in time.

And it's not only important to cut rates, and it's very important to signal strongly that you're going to do whatever is necessary to ensure that the economy doesn't slip away in the statement with the cut in rates, and that was the mistake, I believe, that those were made when they interest rates in December.

They said, okay, we're cutting rates 25 basis points, but we really don't know whether we're going to cut rates more or not in the future. And I think ultimately that did more harm than good, because on that day, you tell me, I think the stock market was down 350 points on the Dow, so confidence was not restored.

MR. RUBIN: -- also, the morning that -- the fed one way or the other, but the reality was on the morning the -- actually working quite well -- and then afterwards they really --

MR. ZANDI : Right; so I think it's very, very important to not only lower rates, but to send a strong signal that we understand that this economy is very fragile, could slip away, and we're going to do whatever is necessary to make sure that it doesn't, it doesn't happen. And then they won't have to cut rates as much perhaps.

MR. FURMAN: If I could add a little bit more, I mean I think -- definitely matter, I think that's an important part of what the fed has done,

and it's supplying liquidity in addition to lowering the fed funds rate, I think it's been very important.

But part of why people are adjusting their consumption in a way that would lead us into a recession has nothing to do with their worries or confidence, it has to do with the fact that their wealth is lower than it was a year ago, and a rational person should actually adjust their confidence down.

One way to deal with that and buttress that is to -- not just improve their confidence, but basically to inject money into the economy, to give them money that they can spend.

MR. FELDSTEIN: But the triggered tax cut is a way of saying to people, if the economy starts to slow, what you're worried about is your job, and the government is going to take action to reduce the risk that you're going to lose your job, and that's already baked in. Now, it isn't today baked in, that's what we're talking about, whether there would be legislation on the books that would give people confidence that if the economy starts to slide, there will be a fiscal stimulus of some substantial size.

MR. RUBIN: Marty, let's do a thought exercise the other way, let's turn it around. Let's say that Congress -- the administration all listened to this and they -- on C-Span because it's on C-Span, and they decided, my

Lord, these people are right, so they did something, either with a trigger or without a trigger, but you do it your way either way. What's the worst risk we're taking?

In other words, you're going to error one side or the other, so if it turns out we're wrong, how much are we wrong by? How much adverse effect is that going to have? And then conversely, if we don't do it, and we really needed it, how much adverse effect would that have? So you can sort of weigh the two errors against each other.

MR. FELDSTEIN: Even the optimist can say we're going to have a -- if there is a down turn, it'll be over by summer time, and the economy will then be growing. I'm talking about growth that's below potential, so that the impact, unless they're wrong and there's a lot more strength coming from some place, the impact, in terms of pushing us into excess demand, rising inflation, the risk of that is pretty small, and I think that goes where I gather your question is going. If there's not much risk of over doing it, then why don't we do it? A hundred billion dollars is part of the answer to that.

MS. RIVLIN: But you're assuming that this is beautifully designed by us up here on the panel, perfectly targeted, and --

SPEAKER: -- something --

MS. RIVLIN: Yeah, right. And I like the picture of the administration sitting around watching us and saying, oh wow, let's do that,

but I don't think it's realistic.

MR. FELDSTEIN: But you know when they -- in 2001, when they did something, it basically was the kind of thing that's being discussed now, a flag per household or per tax payer amount. I don't think anybody is going to design some complicated marginal tax rate reduction for one year. No matter how much you believe, as I do, in the importance of marginal tax rates for one year, that's not the way you stimulate the economy, it's putting cash into peoples' pockets that they will spend. So I think some kind of very simple rebate is the most likely policy for Congress to come out on. And I think the food stamps, I think that's another good way of targeting. It's that part of the population that doesn't pay taxes and would be less politically troubling than making it rebateable to individuals on the basis of income taxes they haven't paid.

MR. FURMAN: Jason, you wanted to say something?

MR. FURMAN: -- get you on the record saying --

MR. FELDSTEIN: Looks like I am on the record.

MR. FURMAN: -- that making the Bush tax cuts permanent, cutting taxes in 2011, would not have a huge expense or impact on the economy this year?

MR. FELDSTEIN: No, the opposite, you had that wrong. If you tell me that my tax bill is going to be less, or put it the other way around, if you tell me that in 2011, my tax bill is going to go up a lot, then I'm going to

feel poorer today and I'm going to think twice about spending today. So there's a case where making it permanent would have a positive effect on the spending today of the people whose taxes would otherwise rise.

MR. RUBIN: Well, let me speak as one tax payer, I wouldn't spend more. But in any event --

MR. FELDSTEIN: That's because you maxed out.

MR. FURMAN: -- financial market participants, do you think there would be any danger if we added whatever, 13 trillion to the long run deficit, that interest rates would be higher and that would --

MR. RUBIN: This is a whole separate issue that I think we'll get to -- get into the -- going forward. Let us try to hope and pray that it doesn't -- because I guess I would have the same view as Jason, Marty wouldn't, and there will be plenty people supporting Marty's view and others supporting Jason's view and so forth. If the stimulus debate bleeds into this, we're never going to get a stimulus, which is the --

MR. FELDSTEIN: Right; I think it's really -- I think what you just said, it's very important, that we separate this, we focus on it as a way of stimulating GDP at a time when we're worried about recession, and we don't think about it in terms of tax reform, we don't link it to other things, and people will say let's pay for it by turning off the tax cuts in 2000. It's already turned off, to bury it even more. So I think that really ought to be off the table for this discussion. It ought to focus on what happens in the current year.

MR. FURMAN: I agree very much with that. I mean there's a lot of ideas I like, like universal health care, I'm not going to argue that there are a good way to stimulate aggregate demand in the short run. I think this debate would proceed best. I think part of why it would proceed best is absence of political uncertainty.

There's probably more agreement among economists about a more technocratic question of how to increase aggregate demand in the short run, and if you did a tax rebate or what have you, what that would do to the economy in the next quarter. There's quite a lot of agreement on that question, the way that there isn't on some of these other long run tax reform types of questions.

MR. FELDSTEIN: I think there's an interesting technical question about the food stamps versus unemployment benefits. Food stamps strikes me as a pure cash transfer to people with a high propensity to spend and people who would not benefit from a tax cut.

The unemployment benefit, those people are tax payers, they are going to get a tax refund, but what it does is increase the incentive to stay unemployed, because that increase in unemployment benefit, you'll only continue to get those checks the longer you are unemployed. And there's a lot of evidence on the sensitivity of the duration of unemployment to the level of unemployment benefits. So while I can understand from a distributional point of view why you might want to say, well, that's a group

that's been hard hit, I think from a stimulative point of view, that's probably bad targeting.

MR. ZANDI: Bob, are we in the part of the discussion about the specifics of the plan?

MR. RUBIN: I guess we're going to the specifics. I actually wanted -- before we end the whole thing, though, at some point we should -- can I just raise one more question before we get to the specifics and then we'll get to the specifics? Are any of you concerned that if we rely solely on monetary policy, that we have a somewhat -- at least we've had a somewhat vulnerable dollar, and that at some point you could begin to undermine a dollar?

I think Marty said he thinks a dollar is a long way to go, I don't know if that's right or it's wrong, but it's one thing if it's gradual, it's another thing if it's something that's very rapid like we had in the last '70's -- had to deal with. And so I'll put this as a question. If we can diversify our effort to grow stimulus, do we reduce the risk of something rapid and untoward happening?

MR. ZANDI: I think that's a significant risk, because the rest of the world, as we've been discussing, is in much better shape. The Bank of England and the Bank of Canada seem to be following slowly. The Bank of England yesterday said they're not lowering rates, so they're a bit more reticent.

The European Central Bank is not at all ready to ease interest rates. If we're in the process of lowering rates aggressively, and they're very reticent to do so, I think it does raise the risk that we could have a more disruptive decline in the value of a dollar, which means problems in our -- just adding to our problems in our financial system.

I mean for the dollar to fall, that means they're selling something, it means they're selling stocks, they're selling what bonds they still own, they're non-treasury, and other fixed income assets. So I think that is a reasonable thing to worry about.

MR. FELDSTEIN: You don't have to sell anything, the price just changed. So, you know, the bonds stay there. The foreign holding of the bonds can't go down unless we start running at the trade surplus, so that's not going to change. The fact is, we have an enormous trade deficit, and the only mechanism that's going to correct it, we're going to have to, on the one hand, save more relative to our investment, that has been happening, but unfortunately, the bad way, through a reduction in our investment primarily in housing. But the only way that the incentives are going to convert, whatever we do domestically to improve trade situation is for the dollar to become more competitive.

And I went back and I looked at what happened when we had the very sharp fall in the dollar in the 1980's. It fell more than 30 percent in two years. By anybody's definition, that would be a pretty sharp fall.

Nothing bad happened.

Now, the U.S. economy expanded with a lag, our trade deficit went down, interest rates didn't rise, inflation didn't rise, so I think this worry that a correction in the dollar that's going to have to be part of our trade adjustment is somehow going to be restabilizing, and I think that's exaggerated.

MR. FURMAN: We may someday now do a session on the dollar. Let me pull on Alice, and then I'd like just to frame a question, Marty, that may -- you may disagree with --

MS. RIVLIN: Well, I was just going to say, I'm with Marty on that one. We need at least a gradual continuing fall in the value of a dollar to get back to some semblance. But it's a nobody interest around the world to have free fall of a dollar. The major countries -- rush to the rescue if it looked like it was free falling

MR. RUBIN: Well, one would hope so. But -- and I'm not counting at all on the dollar, I have no idea what's going to happen, so let me just throw a hypothesis, Marty, and one would hope that you're right, Alice. But on your response to Mark's point, let's just say for the sake of discussion that whatever set of reasons that Alice's scenario didn't happen, and there was an enormous selling of Dow nominated securities, though interest rates went way up in this country, now, that would adjust our trade balance, but in the context of serious recession in this country, so there you would have the

kind of problems.

I'm not suggesting I think that seemed remotely possible, I'm not making any predictive comment, just sort of a hypothetical scenario.

MR. FELDSTEIN: That could certainly happen.

MR. RUBIN: And that would be you.

MR. FELDSTEIN: That's not a prediction either.

MR. RUBIN: No, this is totally a non-predictor. So that we are playing with -- there are important issues at stake here in this, and to get back to somehow or other, we'll get to this at the end, is there anything that any of us can think of to do that increases the probability of our political system will actually relate to all of this and act in some effective fashion?

Let's turn to the content now of stimulus. Anybody -- we've had some discussion of it, and maybe we've -- it's the time, which we discussed with the trigger, one thing, another, the size, which I guess we haven't really discussed, some allusion to it, and then is there anything further on the content, and let me in the content throw out one thing, I recollect that time that we had this whole stimulus discussion, there was tremendous political support for aids of states, and you can imagine that kind of support developing. Again, is that a good idea, a bad idea? Is there any condition under which it could be a good idea? Because there may be a lot of pressure to make that part of a package. Any comments from anybody?

MS. RIVLIN: Yes, I think it is a good idea, it was a good idea

the last time, it was done too small and too late, but the state feels, if we're going into the session, the states feel it very quickly and very drastically and do all the wrong things from a macro economics point of view. They raise taxes, they cut spending, and if we can forestall that with some revenues -- revenue sharing, I think it should be part of the package.

MR. RUBIN: Anybody have a different view on that?

MR. ZANDI: On the states?

MR. RUBIN: Yeah.

MR. ZANDI: Specifically?

MR. RUBIN: Oh, I don't know, yeah, the states, but --

MR. ZANDI: Well, I think the package should contain three things; one is, I would extend UI benefits. I don't agree with Marty. I think -- no one is more panicked than a person that loses their job, and no one cuts back on their spending more than someone who's lost their job and has been out of work for 26 weeks, I mean that's pure panic, and it's key to helping those folks.

I mean they've shown a propensity to want to work. I don't think we have to worry, at least in the near term, that they're not going to go back to work if they can find a job. I think we need to help them. They'll spend that money as soon as they get it, and I think that's vital to supporting confidence. Particularly those people who aren't unemployed, who are thinking that they might be unemployed, they feel like, you know, they're

going to have a safety net that extends out beyond 26 weeks, and I think that it's extremely helpful, it's very efficacious in terms of stimulating economic activity.

Secondly, I think some kind of tax, temporary tax cut, tax rebate, why not a payroll tax holiday? I think that's the reasonable thing to do. It helps people who don't pay income tax, but work, and that's a very simple, straight forward thing to do, it goes right into your checking account and you're off and running.

And third, I do think help to the states is important. It's less important now than it was back in 2002 or '03 or '04 because the states aren't in as bad a shape yet. Now, a year from now they will be, but so far their fiscal situation is measure -- California aside, and Florida, fiscal situation -- their fiscal situations are better, their budgets haven't really been effected yet, and it won't be for another six -- 12 months. So I think that's a good idea, but I don't think that's as pressing.

SPEAKER: I'd agree with that.

MR. FURMAN: If I could come in on the unemployment insurance discussion. This is another one we could have a whole panel on. I would state two things about it; I agree with Marty, and maybe it's because he taught the first economics class I took, that you need to balance what economists would call morale hazard, the disincentive effect to find a job against the safety net benefits of unemployment insurance.

I think how you draw that balance depends on how the economy is doing. So if the economy is doing really well, then you probably don't want to have unemployment insurance benefits that last for say two years and enable people to not, you know, look for one of the very plentiful jobs out there.

On the other times, if the economy is performing poorly and jobs are really hard to find, then where you strike that balance, you want to strike it in a different place. And it's clear to me that the economy today is performing poorly in this respect.

The long term unemployment rate, the percentage of the labor force that's been unemployed for 27 weeks or longer is today nearly twice as high as what it was going into the last recession at the beginning of 2001. That, to me, tells me that there's something about the job situation, the structure of our labor market that makes it harder for people to find jobs in a timely manner. So it also tells me that the way in which we want to balance those two risks of discouraging people from finding jobs and providing them a safety net shifts. In general we think it shifts during recession, which is why we extend the unemployment insurance benefits during recession. I think they're in every recession, and I think this one is no exception; in fact, if anything, the case is strengthened given that we're starting from an even worse place in terms of long term unemployment.

MR. RUBIN: Marty.

MR. FELDSTEIN: I think there is a lot of evidence that when people see their benefits running out, they find a job. It may not be the job that they would ideally like, it may not be the job that they would find if they had another three months to look for a job, but I think of studies like the one by Larry Katz but there are a number of others that show that when the benefits -- when people are getting close to that 26 weeks, suddenly the job finding increases substantially.

So I worry that this is not an effective way of stimulating the economy, but could have the opposite effect, because if I'm at 18 weeks and I know that I have not just another eight weeks to go, but 13 weeks beyond that, well, then I can be more relaxed about finding that job. It's not an income tested way of dealing with it. The benefits are higher the higher your income, they don't take into account your financial assets, they don't take into account whether you have a spouse who's bringing in income, so I just think it's the wrong kind of program in terms of targeting, and that is -- the goal is to target people with low incomes, the food stamp is a better way of doing it without any of these adverse incentives.

MR. RUBIN: What is your reaction, Marty, to Alice's view that -- that's unemployment; but what has the state aid done in the form that Alice described it, that have immediate and useful --

MR. FELDSTEIN: The states have rainy day funds, at least they seem to have rainy day funds designed to move through a period in

which their receipts come down. So I'm just not as enthusiastic as Alice about that. Maybe I'm not as knowledgeable about the speed with which the states would turn around and spend this money, but I'd be afraid that, again, you're just putting in another legislative lag while the states figure out what they're going to do.

MS. RIVLIN: I think Mark is right, that there is a lag there, and it isn't as urgent to get to the states. But if we have a prolonged recession, a serious recession, all the experience is, they run out of rainy day funds very fast, and then they start raising taxes because they have to balance the budget, and cutting back on benefits, and particularly cutting back on benefits for low income people who have less moxie in state capital.

MR. FELDSTEIN: We're not talking about -- what we're talking about now is a pre-emptive strike. What do you do to stop the economy turning down, and if it starts turning down, to make it milder? If it turns out that we're not pessimistic enough up here, and that the economy is going to be in very serious bad shape, then whatever we're talking about now is just stage one, is just a down payment in this process, and Congress and the administration will want to come back and do more.

If the unemployment rate were nine percent, not five percent, and it's been nine percent in recessions, then you're going to have a different kind of discussion than the one we're having today, including about the states.

MR. ZANDI: One additional argument for state aid would be that the -- the reason why we'd be going into a recession is, this is not a national recession, it's not every region is in recession. Texas is just fine. But California and Florida and Michigan are in recession. Their budgets reflect that. The state of California is in the middle of trying to find a way to fill a $14 billion hole, and that's going to mean cuts because of the realities of management state government.

So you could help -- that would immediately help preserve programs and spending in a state that -- in a part of the country that desperately needs it, and that would be I think efficacious.

MR. RUBIN: Before we turn to -- one -- I want to get back to whether we should have a stimulus -- a complete package. Before we turn to that, you mentioned that -- you made the -- you used the word pre-emptive, and so this is more kind of we're trying to, as you said, mitigate, if you will, than deal with something that's in a severe state. What size of members do the panel think the stimulus ought to be at this stage of the game?

MR. ZANDI: I've already said, I think it needs to be $100 billion. I think that is what we should expect to see in the form of a tax increase in the next three to six months in the form of gasoline prices. I mean certainly oil prices could fall and we could be wrong, but I think that's a reasonable assumption.

MR. RUBIN: You're assuming a constant price in the high 90's of oil?

MR. ZANDI: Ninety-five -- if we stay at 95, then if history is any guide, and crack spreads go back to their historical averages, which they will do as the refineries gear up for the driving season and their utilization rates rise, that would imply a $4 a gallon for 87 grade, that's what it would imply, yes.

MR. RUBIN: Alice.

MS. RIVLIN: I'd go with that. I think if we're going to do it, we should do it in a serious way. And the last time around, the rebate, which was $300 per person, got some derisive comment, I mean how is $300 going to turn around my life, and so it has to be a serious amount.

MR. RUBIN: Marty, Jason.

MR. FELDSTEIN: The number I've been thinking about is around $100 billion. But what I tried to do was to talk to other economists about what the relationship is between the size of the tax cut, assuming it's the kind of plain vanilla, same amount per household, and what happens to GDP after that, the so called fiscal multiplier. It is amazing how much diversity there is and what you would think of as a fundamental number in the economy. And so if you knew that that number was two, well, then you'd do less, and if you thought that number was a half, then you'd do more. And I can tell you that very respective economists will offer you both of those

numbers. And some will say, yes, you're going to get a big impact within the year, and others will say, well, it's going to be six months before you see much, and then it's going to go on for two years.

So it's very hard to put a number on this. Again, it comes back to what you were asking before, is there a danger of over doing. Well, if the multiplier was two and you did $200 billion, yes, there would be --

MR. RUBIN: I would suspect, Marty, that part of the problem is the inconvenience of human nature that Jason referred to before, that the economy consists of human beings rather than models.

MR. FURMAN: Right; I think one reason --

MR. RUBIN: And so then the question is, how much confidence effect do you have and things of that sort, I would guess, I don't know.

MR. FURMAN: I think one reason that economists prefer monetary policy to fiscal policy is that there are right now 200 economists at the federal reserve trying to figure out exactly how much to change the federal funds rate.

MR. FELDSTEIN: But they don't --

MR. FURMAN: And when it comes to fiscal stimulus, people tend to pick round numbers like 50 or 100, or sort of throw up their hands, because you have the economic uncertainty compounded with the political uncertainty.

MR. FELDSTEIN: I think the key thing that -- I think the key thing that fed has going for it is that it can change it again and again, as you said before.

MR. FURMAN: Well, I don't think they're perfect. I don't think they're perfect at all. I just can't imagine who's better.

MR. RUBIN: Let me inject one more question and then we'll get to our last category and then open it for questions. As Congress considers this, one of the questions they're going to, I presume ask is, if we do do a stimulus -- pay for in the outer years or not. And why don't we just very quickly see if we have any -- and is it possible that politically that can get in the way of moving ahead. Do we have any view on that, and how much do we care about that?

MR. FELDSTEIN: I mean I think that the -- rule, as a general rule for permanent programs makes sense. For a stimulative program, where you're trying to have a fiscal stimulus, you don't want to undo it. So I think the answer is, I wouldn't pay for it, I would just do it, I would waive the paygo.

MR. ZANDI: I would agree with that. I don't --

MR. RUBIN: Alice.

MS. RIVLIN: If we really design it right and it's really this simple thing, I would think that that was probably right. But I don't believe we could do that.

MR. FURMAN: I imagine the one thing that is critical that we shouldn't compromise on is the temporary. So if it does increase the deficit, and that's the whole goal of stimulus, is to increase the short run deficit, not the goal of it, but it's the way in which --

MR. RUBIN: No, the theory of the -- where you do it now and then you have to pay for it in outer years.

MR. FURMAN: The thing to not compromise on is the temporary. If it increases the deficit for one year and then thereafter does not increase the cash flow deficit, I think that would be terrible. I think it would be a little bit better, both for consistency within our fiscal system and even some economic benefits in terms of not having forward looking financial markets, raising long term interest rates, and curbing some of the stimulus if it were combined in the out years with some way of paying for it. I think that would make it economically even more effective. I think it's perfectly economically justifiable on a temporary basis.

MR. FELDSTEIN: To not --

MR. FURMAN: To not -- I think it would be even slightly better.

MR. RUBIN: And that leads us into the third category. I would have thought, Jason, that one advantage of not having out of year pay force is, you avoid the whole debate of what -- pay force, which debate could then undermine you -- with some expedition here. All right. None of us

are practicing politicians, and I don't know, none of us are quite licensed to practice politics. We've all been around this process a fair bit. What do we think the probability is that our political system will do all of this in a timely and sensible fashion?

And do we think the risk that they'll do it -- well, what I said at the beginning of this thing, how much risk is there that, by the time it gets done and the form in which it gets done, it'll produce very little long term -- short term benefit and have a lot of long term counter productive effect? And is there anything we can think of that would contribute to our political system functioning more effectively, along more or less the lines that we've been discussing?

MR. FELDSTEIN: I guess I'm more optimistic than --

MR. RUBIN: That's a question, not a --

MR. FELDSTEIN: -- the way you put the question, yes, but I mean it was a question to which the answer was, oh yeah, it'll never work. But I'm not there. The administration has certainly been signaling, and the newspapers are full of it, that the White House is thinking about this and thinking about alternatives.

If Congressional leadership were to say, yeah, this is a good idea and we like the kind of simple thing that this report talks about or that happened in 2001, that would go a long way, I would think, toward advancing the process. We've got a State of the Union coming up soon and

that would be a time in which -- and again, if the President does say something in the State of the Union about this, the response that comes from the democrats immediately after that can be, oh, what a terrible idea, or it can be, yes, we've been thinking along these lines, let's sit down and work on it, and it would be very nice if that could be pre-ordained.

MR. RUBIN: I have no idea what anybody is going to say in response to anybody. But it does seem to me on the part of all concerned, if they can keep all the other agendas out of this thing and just focus on this, it seems to me the system ought to be able to come together on some of the troubles.

Every time the system, I shouldn't say that. Too often when the system starts down that road, then people see something moving and they see an opportunity to add other things onto it, and that's, I guess, what troubles me, Marty. But --

MR. FELDSTEIN: Clean bill I guess is the word.

MR. RUBIN: Well, and a clean focus on this issue. Let's not worry about the debates about long term marginal tax rates, infrastructure, social spending, all of which are extremely important issues, and -- the long term future of our country, the people -- and just focus on this. Okay. Does anybody want to make -- we'll come back at the end and just briefly summarize what we think we discussed. But we should open up the questions, unless somebody has another comment they'd like to make

before we get -- oh, I wanted to ask one more question. Marty, you said you thought the dollar had a long way to go. I just can't sit here and not be curious, how much further you think the dollar has to go.

MR. FELDSTEIN: I don't have a number. But -

MR. RUBIN: More than 20 percent?

MR. ZANDI: On a broad trade weighted basis, 20 percent.

MR. FELDSTEIN: It could do that.

MR. ZANDI: It's down 20 percent from the -- and it's at 150 on the euro, parody was the C dollar, $2 to the pound. I mean that -- most people would argue that's -- we're a little bit beyond that.

MR. RUBIN: Answer the question.

MR. ZANDI: Oh, well, I'll give you my --

MR. RUBIN: Oh -- I don't have a view.

MR. ZANDI: -- I'm not as worried about -- markets, so I'll give you my five cents about that. It's -- I gave you three cents on the other stuff, I'll give you five cents on this. The broad trade dollar is down 20 percent, probably has only another five percent to go. I don't see why it should fall against the euro, the pound, the Canadian dollar, we're beyond that.

MR. RUBIN: Oh, but put on the Asian side, it hasn't fallen very much?

MR. ZANDI: No; and there we will see further depreciation.

MR. RUBIN: Looking for a redressing, in effect?

MR. ZANDI: Exactly, right. So on that, on a real broad trade weighted basis, I think we're pretty done the process, not to mean it won't have tremendous tail wind to trade and the lags are quite long.

MR. RUBIN: You must think the trade -- the trade effects are quite lag and just --

MR. ZANDI: Quite lag, a couple three years, and so we'll see the benefits of what happened well into the next session.

MR. RUBIN: Either --

MR. FELDSTEIN: We're beginning to see the effects on trade, there's more to come, but if you ask whether we're going to shrink what is now five percent of GDP to a number --

MR. FURMAN: That's the current account deficit.

MR. FELDSTEIN: -- that's the current account deficit, we're going to shrink that down to close to balance, with another five percent on the dollar, I don't think that's --

MR. ZANDI: I don't think we're ever going to get that close to balance. I mean --

MR. FELDSTEIN: The world is going to keep sending us money, and we're going to keep sending them back IOU's, and they're going to say thank you for these nice pieces of paper, and when they come due, please send us new pieces of paper, we like the pieces of paper, we don't ever want to get goods from you, all we want are these pieces of paper.

MR. ZANDI: That's exactly what's going to happen for as long as we're living.

MR. RUBIN: We better get --

MR. FELDSTEIN: It's a wonderful world to be in, where we just keep getting these --

MR. RUBIN: It's clear we need good designers for these good pieces of paper. Jason, a final thing, then let's open it to questions.

MR. FURMAN: One issue we haven't discussed, which I think is quite important, I want to just put it down on the table as a flag for the future is, thinking about how to build better long run policy that both is consistent with protecting people in down terms and might even be consistent with reducing the length of those down terms. Unemployment insurance, for example, is a system that 37 percent, or about a third of people who are unemployed are eligible for benefits right now. There are ways to fix that system, to modernize it, and, in fact, some of those ways I think were passed by the House last year and are waiting action by the Senate that would deal with the increased part-time nature of work, the increased temporary nature of jobs, increased job mobility.

And then there's even bigger, more ambitious reforms. Marty has proposed one, Jeff Kling has proposed one that has, at the risk of smearing it, some elements of that proposal.

And the Hamilton Project has also released another plan by

Kletzer and Rosen along these lines, I think in terms of thinking about health insurance, so you don't lose that when you lose your job, thinking about refundable tax credits in a way that would actually improve the automatic stabilizers, and other ways to improve the automatic stabilizers, so that as the economy turns down, money is automatically injected into it, it's automatically injected to help the families who need to smooth their consumption the most. So I don't think that's what needs to be part of the stimulus bill itself, but I think this is an important context for us to debate, how to improve our long run social safety net in a way that's both consistent with protecting families from risk, improving the automatic stabilizer, and helping the economy.

MR. RUBIN: Jason had instructed me as moderator to raise this question, and I deliberately ignored that instruction, and the reason -- it's a very important question, Jason, but I think if that question gets raised in our political process and context of trying to deal with stimulus, we will immediately bleed into a whole bunch of stuff and reduce the chance of getting stimulus.

MR. FURMAN: The one exception is this unemployment insurance system which is very badly -- where the House has actually already passed the bill and it has gone over to the Senate. So I'm --

MR. RUBIN: Well, maybe that should be done separately, on a separate --

MR. FURMAN: Oh, separate or however, I don't know.

MR. RUBIN: I think we just sort of try to keep, at least in my view, keep everything else out of the stimulus discussion. But obviously, you raised a very important set of questions. Okay. We would be delighted to respond to questions, I suppose. We'll start here. You better stand up and use a microphone. Yeah, you'll need a mic because you otherwise -- you might as well stand up. In fact, identify who you are, where you're from, or --

MR. YOUNG: Thomas Young, Capital Magazine.

MR. RUBIN: From what?

MR. YOUNG: Capital Magazine, business magazine, Germany. How important do you see a reform of rated agencies in terms of creating the crisis and preventing another mess like that?

MR. RUBIN: Well, the question is reform of the rating agencies, it's an issue that's going to get a lot of attention, and a lot of people think it's a very important issue, but hopefully that issue won't intrude on this process, so that would be my response to that, in the context of this discussion. Yes, ma'am.

MS. GOULD: Linda Gould with the National Association of Realtors. First a comment; it's been my observation that everyone loves a free market until it behaves like one. And so we're in that mode now, and so my questions that are related to housing is, first of all, what do we know

about how the economy responds in a world where housing values are decreasing? And then my other question that's related to that is, because the questions come to me and I'll pass it to you, and that is, how should the tax writers target something specifically to housing?

MR. RUBIN: Well, anybody, yes.

MR. ZANDI: I mean housing -- run deep into the economy, and the links are numerous, some are obvious, construction the most direct, and then, of course, the decline of house prices, which effects consumer spending through the so called wealth effect.

There's some debate among economists about the importance of equity withdrawal. As you know, when prices were surging, lending was aggressive, there was a lot of home equity borrowing, and that at one point was ten percent of disposable income at the peak back in 2005, and that's evaporating, and just how much that's weighing on spending is a matter of debate.

Some folks think it's quite significant, other folks think it's not quite significant. It also is effecting obviously the financial system. Because of the erosion in mortgage quality, which is due to the decline in housing values primarily, it's creating the turmoil in the financial system more broadly. It's effecting state and local government, particularly local government, because they rely on property tax revenue, and that's one of the reasons why we're starting to see some budgetary problems, particularly in places

that are hard hit with --

SPEAKER: (off mic)

RUBIN: Well, the question -- I guess in the context of that, I guess the question is, should there be anything in the stimulus on the tax side that relates to housing, is I think the other piece of your question.

MR. FURMAN: If I could say a little bit about that.

MR. RUBIN: Jason.

MR. FURMAN: I mean I think there are some things you can do on housing, and I'm not an expert on it, some of it has been done, more needs to be done, FHA and other areas. I don't think when you're thinking about the -- and you don't want people foreclosed on who don't need to be, where there's something that could better -- the aggregate economy, though, I don't think the goal of our fiscal stimulus should be to prop up one sector of the economy.

I don't think fiscal policy makers should say this part of the economy should be investing at this rate, or even the prices in this area of the economy should be, you know, this rather than that. I think the goal of our stimulus should be the economy as a whole, and whatever sectors of the economy are most able to pick up the slack when interest rates fall and when consumers spend money, that's the most productive way to get us out of this, not try to prevent the big macro economic adjustments -- again, while consistent with protecting families, but not in a way that's designed really to

stimulate the economy.

MR. RUBIN: Okay. Way in the back, yes, ma'am.

MS. BUCHE: Heather Buche, Congressional Joint Economic Committee. In our discussions about whether or not we think there's going to be a recession, I'm curious whether or not any of you think that instead of a recession or maybe on top of one we might be seeing a protracted period of slower economic growth, and so I was wondering if you could speak to that issue?

MR. RUBIN: You mean sort of a more secular kind of slower growth?

MS. BUCHE: Yeah, kind of like what happened in Japan in the 1990's, after their housing bubble collapsed.

MR. RUBIN: Marty.

MR. FELDSTEIN: Again, I don't think it's on point to the thing we're focusing on today, but this is not Japan. The problems of the banking system in Japan, of the real estate markets in Japan were really very different, in the commercial real estate markets in Japan are really very different from the problems that we have here. So I don't think that -- now, there's a separate issue as to whether productivity growth is going to slow down. I tend to be optimistic about productivity growth.

I think the forces that have made for strong productivity growth over the last 15 years have more room to run, so I think we'll continue to get

that, but the demographics are changing. And so from an overall GDP, we'll see slower growth of GDP simply because the labor force will not be growing as rapidly as it did over that period.

MR. RUBIN: I'd like to add just one thing to that comment, if I may, which is that we are facing an increasingly competitive global economy, obviously, and it is a real transition, at least in my -- a real transition going with global economy.

And another argument for stimulus now is you sort of see the weighing of -- the balancing of risk is that I think we need a stronger economy now in order to invest -- not only do we need to get our long term fiscal house in order, but -- public education, basic research, energy, health care, and so many other areas if we're going to be competitive globally. And so I think part of the answer -- lies rather in whether we have public policy that's responsive to our long term challenge or don't, and we're in a much better position to have that kind of public policy if we have a -- if we avoid undue weakness in the shorter term in our economy. So they're not unrelated questions in a way. I don't know, way in the back, the -- yeah, the eager hand, yeah, that's it, okay.

MR. LEE: Thanks; it's about the risks of temporary --

MR. RUBIN: Would you stand up and say who you are and where you're from?

MR. LEE: Oh, sorry. I'm Daniel Lee from the IMF. It's about

the risks that the discretionary stimulus might not be temporary. Could the panel provide more historical examples where powerful discretionary fiscal package is put in place and that was really promptly removed after the growth picked up?

MR. FELSTEIN: Go ahead, that's a good example.

MR. FURMAN: In the bonus depreciation in 2002 and 2003, I don't actually think that's a great stimulus policy, but it is an example of something that was intended as stimulus, and policy makers stuck to it, they let it expire -- to the states function in the same way. And the one thing I'm a little bit more hopeful about the debate this time around than the last business cycle is -- esentially there were certain pre-existing agendas, and they hitched their horses to stimulus to move them forward. This time it feels to me at least like there's a little bit less of that and a little bit more of a commitment to things that are genuinely temporary on all sides of the debate. And I might be proven overly optimistic.

MR. FELDSTEIN: The bonus depreciation is just the most recent of a whole series of investment incentives. There's a so called investment tax credit which turned on and off and on and off over 40 years, depending on cycle conditions. So I think Congress has the ability to do it despite the obvious interest of both the manufacturers of equipment that benefit from the investment tax credit and the companies that receive the investment tax credit. Congress said, no, this is a stimulus package and we

turn it on when we want it and turn it off when we're finished.

MR. RUBIN: Does anybody have a real quick view on the panel, because we did forget -- we didn't include that in our discussion, accelerated depreciation that's really constructed to be temporary, so that -- people, if they're going to do it, they have to do it now; do we think that's a good idea or a bad idea in terms of -- to other uses that can be made of stimulus?

MR. FELDSTEIN: We're seeing the manufacturing sector in some trouble. The most recent ISM numbers -- managers showed that, for the first time now, the manufacturing sector is contracting by a variety of different measures. This is one way of making sure that that doesn't get left out in the process.

And in terms of the timing, once it -- the legislation gets passed or becomes effective, companies will start making decisions, placing orders and doing things like that. So I think it is a thing that ought to be part of the factor.

MR. RUBIN: The contrary argument, I suppose, would be that if the problem of manufacturing is -- demand, and that there might be better -- you might get more effect on manufacturing by virtue of stimulating demand than you would, but that's the debate I guess that will take place.

MR. ZANDI: I think in terms of bang for the buck, it's lower on the list. I mean I think it provides -- if it is truly temporary and it isn't

renewed, I mean I think, if memory serves, we had a plan, and then we extended it, and then didn't we extend it again? So I think if we say that it's going to be January of '08 to December of '08, that might be helpful, that might work. But I think on the list of things we could do, which is what we talked about, I think it's towards the bottom of the list.

Now, if it makes it more palatable to get passed, I mean I consider the constituency that says, oh, well, we're giving everything to consumers and nothing to businesses, and let's give something to the businesses to make this work, politically I think that makes --

MR. RUBIN: Oh boy, there. I think we adjourn at 12:00; is that correct? Somebody said yeah.

SPEAKER: Henry (inaudible) with the Embassy of Switzerland. My question to the panel is, why would you think of a rule, a fiscal rule that would permit deficit to -- recession and require the federal budget to -- during time of growth, kind of a pay as you go over the business cycle that would build an element of fiscal stimulus permits to avoid -- expectations that you mentioned? Would the system -- be a good idea, and would it be politically feasible?

MR. RUBIN: Why don't we ask one member of the panel to respond. Who wants to respond? Anybody have a strong view on that?

MR. FURMAN: I nominate Alice.

MR. RUBIN: You nominate Alice, okay.

MS. RIVLIN: Oh, I think it's the economist -- it used to be at least the economist dream that you could do that, it's just not practical, too many things happen that, you know, you have a war and you need to legislate more spending and the -- well, you know, it is very difficult to construct such a thing that doesn't fall apart politically, and so I think it's hopeless.

MR. RUBIN: You're relatively negative on it. Yes, ma'am.

SPEAKER: Chief, may I call on Mr. -- the investment from Japan? How do you rate uncertainty regarding micro economic situation? For example, fiscal stimulus can do that; number two, uncertainty regarding their future losses at the Financial Institution sector is clearly recognized by the government or whatever, the financial authority.

MR. RUBIN: What was the last question? The financial office -- the institute -- of Financial -- what?

MR. FELDSTEIN: Is it being recognized?

MR. RUBIN: Oh, is it being recognized?

SPEAKER: Yeah, recognized.

MR. RUBIN: Who would like to respond to that? I know who doesn't want to respond to it.

MR. ZANDI: Can you repeat the question?

MR. RUBIN: I think the question is, how do you deal with the question of uncertainty; yeah, will fiscal stimulus help on the confidence

uncertainty issue; and secondly, are you asking whether the political system recognizes the issues in the financial system?

SPEAKER: (off mic)

MR. RUBIN: Right.

SPEAKER: (off mic)

MR. ZANDI: Can it be recognized by the government?

MR. RUBIN: Well, let's handle it this way. On the question of whether stimulus could help with respect to uncertainty -- I'll give you one person's view, I think it really could, I think it could be really an immediate benefit. On the question of the financial institutions and their losses, there's obviously a tremendous amount of discussion of that, and this is an issue that's getting enormous focus, so I don't think it's -- I don't think it's under focused in official circles on that set of issues.

MR. ZANDI: Yeah, I mean I think maybe, completely independent of the discussion, I mean not with respect to fiscal stimulus, but I mean there are certain accounting issues and legal issues that relate to when financial institutions, major financial institutions recognize their losses and how they recognize those losses and how exactly are they valuing securities on their balance sheet. But I think that's an issue for --

MR. RUBIN: Another day.

MR. ZANDI: -- another day, another decade.

MR. RUBIN: Yes, sir.

MR. JONES: Yeah, hi, Creighten Jones with the Larush Pack. My question to you is, I was wondering if you could comment or your thoughts on a stimulus package that we've been promoting called the Homeowner and Bank Protection Act, which calls for an immediate freeze on foreclosures, a downward adjustment of payment, sort of the rental payments that those homeowners would make, which then be used to recapitalize the banks, state and local banks to finance long term infrastructure projects, and do that in the context of freeing those banks from the securitized obligation, mortgage backed securities, through a massive multi trillion dollar write-off of those securities.

MR. RUBIN: Who would like to respond to that?

MR. ZANDI: The blanket freeze on foreclosure, I think that would be a huge mistake, because it would just create more turmoil in the housing and mortgage markets, lead to less credit, I think it would just exacerbate the problems that we have. I think that would be a monumental error.

MR. RUBIN: Yes, sir.

MR. SIDEMAN: I'm Larry Sideman, I'm a Professor of Economics, University of Delaware, and I just wanted to urge the fiscal package with all four T's, that's the timely, temporary, targeted, and triggered, all think all four are crucial elements.

After the last recession, some of us felt that we needed to go

to work and have a pre-enacted -- Congress to pre-enact the package that would be triggered when either employment fell or the unemployment rate rose. But when we talked to congressional staff, some of us were told at the time, well, look, now the sun is shining on the economy, come back the next time the recession is blooming.

Now it's blooming. We don't know if we're going to have it, how serious it is. But to finally put on the books a pre-enacted package with political compromised across the board that would be triggered, so that's a -- position that we permanently have, we can always, if the recession gets worse, raise the amount of the stimulus, but that's a permanent change that would improve the stability and confidence of the economy. The four T's for fiscal policy package, I think it's very important to try to get that enacted as soon as possible.

MR. RUBIN: So you would have a trigger, unlike me, who probably wouldn't, okay. Yes, ma'am.

MS. FRIEDMON: Rochelle Friedmon with the Coalition on Human Needs. Tax rebates seem to fulfill the criteria of temporary and timely, but not necessarily targeted to those who will spend them or necessarily need them. I'm wondering if any on the panel would comment on what you think of using an income tax rebate if, indeed, some sort of a stimulus is called for.

MR. RUBIN: A refundable tax credit of some kind.

MR. FURMAN: Certainly an idea we discussed in our paper, and one particularly important thing, though, is, it's not just an income tax rebate. That's what it was in 2001, and you leave out tens of millions of people, and the people you leave out are just from a purely crass macro economic point of view, the ones who are likely to spend the largest fraction of that money. So I think it's very important that you make sure it's refundable, that it goes for everyone, maybe even disproportionately.

MR. FELDSTEIN: You make that a hard line, you're going to, I suspect, run into opposition because that was a line that the President drew back then. How many of those people who would not get it -- it isn't refundable, how many of those people would benefit from the food stamps?

MR. FURMAN: There are other -- here would know, and I think there are about -- somebody did a -- run of the Center on Budget that showed that there were about 20 million people who paid payroll taxes who would not get the income tax refund. I don't know, Bob, if you want to tell us how many people would benefit from the food stamps.

MR. GREENSTEIN: Bob Greenstein, Center on Budget and Policy Priorities. I don't remember the household number, but we probably got something like maybe 12 million households that get food stamps. You've got, Marty, I think close to a third of the population that doesn't earn enough to owe income tax.

You miss tens of millions of near poor working families that are

not on food stamps. You also have -- once you get above 75 percent of the poverty line with working families, the food stamp participation rate starts dropping. So if you really want to get lots of working families of $15, $20, $25, $30,000 a year who have a high propensity to spend, you've got to have a tax rebate that covers those people. You can have it go to everybody who files income tax, in which case you would include people who get the EITC or the refundable component of the -- tax credit. But if you leave them out, I think you're greatly lowering the bang for the buck.

MR. RUBIN: I actually have not recollected until Marty said it; did the President last time draw a hard line on refundable tax credits?

MR. FELDSTEIN: I don't want to misquote, but I thought so. I mean at some point he did, but I don't remember how it all came out in the very end.

MR. FURMAN: Is there any economic -- I under the economic trade-off in unemployment insurance -- is there any trade-off in giving tax credits to people who pay payroll taxes, for example, income taxes?

MR. FELDSTEIN: Well, you give them -- somebody said a payroll tax holiday, meaning if you actually literally did that, you'd have less money going into the so called trust fund.

MR. FURMAN: No, I said the tax credit.

MR. FELDSTEIN: You would give a tax credit --

MR. FURMAN: Whatever, it's something that goes to people

who don't pay income taxes.

MR. FELDSTEIN: There isn't an incentive reason, it becomes a question of whether you want to use the tax system for that kind of new transfer and what it opens up in the future in terms of transfer policy

MR. RUBIN: I had forgotten about that refundable tax credit, because I'm not -- about refundable tax credits, I had forgotten about the political debate about whether they should be a hard line. If that actually is going to be a position somebody is going to take, you can now begin to see how this is going to become very difficult politically, because a lot of people think that's the most effective thing to do. I'm not making a base case -- I sort of relate to that, but you can see how complicated it's going to be.

MR. FELDSTEIN: And the American public seems to have a marginal -- consume 80 percent, including high income individuals, though. If you have it on an equal per household basis, we're now talking about the difference between 100 percent marginal propensity to consume and some number higher than 80, that's really --

MR. FURMAN: I mean I don't -- I mean I can understand their distributional --

SPEAKER: Yeah --

MR. FELDSTEIN: -- arguments about who you want to help, if you want to help the poor and so on.

SPEAKER: Right.

MR. FELDSTEIN: That's -- as you said, this ought to be about stimulus, and we ought to try not to get into other issues.

SPEAKER: Yeah, but, Marty --

SPEAKER: I think it was marginal --

MR. RUBIN: -- but if it is just -- but if it's just about stimulus, and you don't want to deal with distributional issues, how do you justify -- what is your -- for a hard line on not being a refundable tax credit?

MR. FELDSTEIN: The line would be -- if people pay taxes, we may cut their tax bills; if they don't pay taxes, we can't cut their tax bills.

MR. RUBIN: But what if they pay payroll taxes?

MR. FELDSTEIN: That's always been a separate system. We don't cut their payroll taxes. The payroll taxes have been on a separate -- and we get earmarked for a particular person.

MR. RUBIN: Well, I think we're seeing one of the debates you're going to see.

MS. RIVLIN: It seems to me it doesn't matter that it's a separate system. If you want to send checks out, what you basically need is a list of people to send checks out to.

MR. RUBIN: That pay taxes in.

MS. RIVLIN: And the payroll tax list is a pretty good list.

MR. RUBIN: And they all pay taxes. But we're not going to resolve that on this panel. But you can -- that is -- all right. I guess we have

time for one more question, so we've got to decide who we're going to ask that of. The gentleman sitting in the back.

MR. MILLER: I'm Dick Miller with Federal Funds Information for -- Senator -- had a proposal last time for a payroll tax forgiveness to be reimbursed from the general fund, that's not what my question is, though. I want to re-enforce what Mark Zandi said, he said about the reasonable nature of this recession.

Unlike any we've seen before, the energy states are fine, the farm states are fine, the financial sectors like New York have been fine, at least, but you have those six states that he named that are already in recession. Well, they do have a third of the national population, so it's not like they're insignificant. But the way the federal system is set up, the reimbursement to those states are set up, if a five year lag in the structure, so that Florida's -- five years ago will govern how much it gets in Medicaid next year. Florida will have to spend out of state funds, a half a billion dollars more in 2009 -- 2007 program.

So the nation doesn't need the kind of stimulus, I don't think, that we had last time for all states. But if we have a real issue with a lot of states want to be able to provide for their citizens not to do the kinds of things -- I mean -- things that we don't want them to do.

MR. RUBIN: Okay. That's a point of view rather than a question, but that's okay. We have about one minute left, if Alice's watch is

right. No, we're not going to do a question, we're going to -- let me just very briefly -- I didn't -- I'm not going to do this any comprehensive way -- time, but let me -- I think the panel all has a view that, while there are different degrees here concern about the economy, there's a lot of uncertainty, and there's at least enough risk of serious difficulty, so we think the political system should be proactive in dealing with it, even though it may have somewhat different views, the degree of that risk -- enough proactive. Number two, we think a stimulus should be part of that. Number three, some of us think there should be a trigger, some of us maybe are a little more skeptical about -- some of us might be a little more inclined to act more quickly, and therefore, might not have a trigger, so there's a good debate.

But I think all of us would agree that whether it comes out with a trigger or without a trigger, we should probably -- we should almost surely have a stimulus, I think we -- that shouldn't get in the way of having a stimulus. Probably more people think we should have a trigger than don't, if I counted correctly.

I think none of us think that a long term pay force should get in the way of having a stimulus. Some of us might think we should have one, some of us think we shouldn't, but we shouldn't let it get in the way.

We all think that it should be temporary, timely, and targeted. We have some differences about exactly what that targeted ought to be, but I think we probably all feel the political system ought to try to reach across

party and ideological lines to find common ground, even though nobody is totally happy. And if I missed anything, I don't know what it is. So that is my summary. What have I missed?

Oh, size, yeah. I mean everybody seems -- I didn't have a view, but everybody seems to think it should be in the area of 100 billion.

MR. FURMAN: I didn't express my view, I would have gone lower than that if we -- I wouldn't ever argue with Larry Summers-- he said 50 to 75 trillion.

MR. FELDSTEIN: He had a very high implicit multiplier in his calculations and that scored higher than the typical one. So if he signed on for the multiplier that a number of people would use, he would end up with, I suppose, arguing for a larger number.

MR. RUBIN: Good; and we thank you all for joining us. Thank you.

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