Job One: The Economy

Democrats must balance their desire to stimulate the economy with public nervousness about Big Government and rising debt.

Bailout Fatigue

The administration plans to extend its bank bailout authority through the end of 2010 in the face of public skepticism about bailouts.

By Brian Friel

With the federal government’s investment of hundreds of billions of dollars in giant corporations such as American International Group, Chrysler, Citigroup, and General Motors fresh on his mind, Sen. Mark Warner, D-Va., offered a quip recently to a group of people in the private equity business. “I said, ‘I’m in the United States Senate. I guess I’m in private equity, too,’ ” Warner’s joke points to the uneasiness that many lawmakers feel about Uncle Sam’s dramatically expanded role in the private sector after last fall’s financial-markets collapse. He has been hearing about it all year from constituents, who have deep concerns about Big Government, most notably the $700 billion bank bailout that Congress passed last October. But Warner also subscribes to the prevailing view among Democratic economists that a dramatic cutback in federal spending—such as a repeal of the unspent funds from the $787 billion economic stimulus package enacted in February—would hurt the already weak economy.

So the former Virginia governor believes that Congress needs to demonstrate, both to taxpayers and to the markets, that Uncle Sam’s adventures in economic recovery will not last forever. “There are little things we can do,” Warner said. “Some of this is about sending signals.”

He and Sen. Bob Corker, R-Tenn., have introduced a bill that would put independent trustees in charge of the four large companies in which the federal government has at least a 10 percent stake. “We can have a goal of making it clear, we’re going to dispose of [our stake] by the end of next year,” Warner said. Similarly, he has proposed a review of federal spending to identify targets for deficit reduction and for the elimination of ineffective programs. “We have to show we can start to go down the path toward greater fiscal discipline,” he said.

With just over a year to go until the midterm congressional elections, it’s clear to most lawmakers that the economy is foremost on voters’ minds. Although President Obama told Congress on September 9 that his administration has “pulled this economy back from the brink,” a poll the same month by the Economic Policy Institute found that 85 percent of respondents still believe that the country is in a recession. Eight in 10 see unemployment as a big problem, and six in 10 expect it will still be a big problem a year from now.

“When I’m home back in Indiana, what I hear about more than anything else is jobs,” Rep. Mike Pence, R-Ind., the chairman of the House Republican Conference, told reporters on September 30. Sen. Sherrod Brown, D-Ohio, echoed Pence’s sentiment the same day: “The biggest problem is jobs.”

To create additional jobs, Brown is focused on trying to pry more credit loose from the financial industry for manufacturers. “We’ve got to find ways to help manufacturers get credit,” he said, noting that he’s pushing Treasury Secretary Timothy Geithner to encourage more lending. “As we start to grow out the economy, they don’t have the access to credit they ought to have.”

Other lawmakers, such as Sen. Johnny Isakson, R-Ga., are pressing Congress to extend tax credits for homebuyers that are slated to expire in December, as a way of resuscitating the housing market—the industry at the heart of the economic collapse.

Many Republicans argue that the best way to boost the economy would be to roll back the bank bailout and the economic stimulus package, which they say are crowding out private-sector
spending. "If they really want to stimulate the economy, they should take all those dollars they’re planning to spend and just give them back—give them to individual Americans to spend," Diana Furchtgott-Roth, a Bush administration economist now at the Hudson Institute, said after a House Republican Conference summit on the economy last month. "People can stimulate the economy on their own."

The Obama administration won’t heed such advice. Geithner has already told Congress that he intends to extend the $700 billion bank bailout authority he controls for another year, through the end of 2010—a move he can make without congressional approval. To make that action more politically palatable, Congress could consider proposals like Warner’s that signal an eventual return to normalcy. It could also pass financial regulatory reform legislation to respond to fears that nothing has been done to prevent a rerun of last fall’s financial woes. Those moves could also help the administration if its financial team feels compelled to ask Congress for another extension of the bank bailout authority, which would be necessary beyond December 2010.

Democratic economists worry more that stimulus funds may dry up too quickly—before an economic recovery is sustainable on its own—than that they do that the government’s deficit-financed spending spree will stifle private investment next year. In 2010, if the economy remains as weak as many economists predict, Congress is likely to face significant pressure from state and local governments and other beneficiaries of stimulus money to keep the funds flowing, even after they are scheduled to start drying up next September.

"You want to make sure that their termination doesn’t push the economy down into another contraction," said Robert Reischauer, president of the Urban Institute. "We’re going to have a very hard time turning off in any kind of abrupt way the resources we’ve given the state and local governments. They are really hurting, and if we were to precipitously stop those flows of money, people would be out of jobs in large numbers. I think the Congress, be it Republicans or Democrats, will look favorably upon some extension."

David Malpass, a former Reagan administration official and the president of Encima Global, a research and consulting firm, said at the House GOP summit that under Democratic control of Washington, more spending is surely on the way. "I think it probably won’t be called the second fiscal stimulus, but there will be more and more spending, meaning appropriations bills that are big and that understate their cost and commitments," he predicted.

Countervailing pressures from the markets and voters could nonetheless force Congress to take some steps to show that the federal debt—projected by the administration to grow from 37 percent of gross domestic product in 2008 to 69 percent in 2019—will not remain on such an unsustainable path. Democratic economists at a September gathering of the liberal Center on Budget and Policy Priorities and Center for American Progress predicted that the markets, including foreign creditors buying up federal debt, could revolt next year if Congress and the administration don’t lay out a combination of spending cuts and tax increases to reduce deficits.

"The most important thing we can do for these creditors as well as for ourselves is precommit to a long-term deficit-reduction policy," said Laura D’Andrea Tyson, who chaired the National Economic Council during the Clinton administration.

Roger Altman, a former Treasury Department official, went a step further, arguing that the government would need to commit to $500 billion to $700 billion in annual deficit reduction, with some of the reductions kicking in before 2013. "We will not get through this first Obama term without actually implementing, rather than committing to later implementing, at least the beginnings of long-term deficit reduction," Altman said.

Those economists maintained that congressional Democrats should seize the reins on such deficit-reduction plans next year because they may not enjoy the majorities they have now for a long time. "My gut feeling is that the current lineup we have in the Congress and the White House is probably going to be more in tune with the progressive agenda now than any we will see in the next 10 years, after the midterm elections," Reischauer said.

But the biggest factor affecting Washington’s actions on economic matters in the next year may well be uncertainty. Reischauer said that the potential political, social, and international consequences of the global financial meltdown that could crop up in 2010 are more worrisome than the likelihood of a deeper economic crisis. "If history tells us anything, it suggests that when world economies are fragile, unstable, and there’s a general lack of confidence in the financial system, economic collapses can be triggered by non-economic events," he said. "If recent months have shown us anything, it’s that we’re living in a very uncertain world."

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