CURRENT POLICY CONUNDRUM

1) **ORGANIC: We hoped manufacturing would take up the slack for weak housing & consumers. This isn't happening as yet.**

2) **FISCAL: Deficits must close or the retirement problems will increase. But short-term deficit reduction would be contractionary and further weaken the economy.**

3) **MONETARY: Fed policy has limited impact. Like 2001, demand for credit is falling and banks are tightening lending standards.**

4) **FOREIGN: Exports will help, but to what extent? And a large stimulus would probably require a significant reduction in the value of the dollar. Is this acceptable?**

5) **"COMBO" APPROACHES: Might a combination of the above or some other "comprehensive approach" work ?**

"COMBO" POLICY IDEA from Joe Stiglitz, 2001 Nobel in Economics

1) Cut Govt. Expenditures & Entitlements

2) Cut Taxes on Low Incom

3) Raise Taxes on Higher Income

How to Fix the Global Econom

By Joseph E. Stiglitz

HE International M tary Fund meetin Singapore last m came at a time o creasing worry a the sustainability o nancial imbalances: For ho an the global economy endu ca's enormous trade deficit United States borrows close t on a day — or China's growing surplus of almost $500 million

se imbalances simply can't go ever. The good news is that is a growing consensus to this The bad news is that no coun- ieves its policies are to blame. ited States points its finger at s undervalued currency, while t of the world singles out the merican fiscal and trade def-

its credit, the International ary Fund has started to focus issue after 15 years of pre- tion with development and ion. Regrettably, however, the approach has been to monitor country's economic policies, a y that risks addressing symp- ithout confronting the larger ic problem.

ting the symptoms could actu- ke matters worse, at least in rt run. Take, for instance, the n of China's undervalued ex- rate and the country's re- surplus, which the United Treasury suggests is at the the problem. Even if China hened its yuan relative to the nd eliminated its $114 billion rade surplus with the United and even if that immediately ed into a reduction in the an multilateral trade deficit, ted States would still be bor- more than $2 billion a day: an ment, but hardly a solution. urse, it is even more likely re would be no significant in America's multilateral ficit at all. The United States simply buy fewer textiles ina and more from Bangla- mbodia and other develop- tries.

while, because a stronger uld make imported Ameri- cheaper in China, the poor- ese — the farmers — would r incomes fall as domestic r agriculture dipped. China oose to counter the depress- t of America's huge agricul- sidies by diverting money eded for industrial develop- o subsidies for its farmers. rowth might accordingly be which would slow growth

gl ... llows well th... rms of its hidden "deal" with the United States: China helps finance the American deficits by buying treasury bonds with the money it gets from its exports. If it doesn't, the dollar will weaken further, which will lower the value of China's dollar reserves (by the end of the year, these will exceed $1 trillion). Any

Start with a responsible fiscal policy at home.

country that might benefit from China's loss of export market share would put its money into a strong currency, like the euro, rather than the unstable and weakening dollar — or it might choose to invest the money at home, rather than holding more reserves. In short, the United States would find it increasingly difficult to finance its deficits, and the world as a whole might face greater, not less, instability.

Nothing significant can be done about these global imbalances unless the United States attacks its own problems. No one seriously proposes that businesses save money instead of investing in expanding production simply to correct the problem of the trade deficit; and while there may be sermons aplenty about why Americans should save more — certainly more than the negative amount households saved last year — no one

er political party has devised a fail-proof way of ensuring that they do so. The Bush tax cuts didn't do it. Expanded incentives for saving didn't do it.

Indeed, most calculations show that these actually reduce national savings, since the cost to the government in lost revenue is greater than the increased household savings. The common wisdom is that there is but one alternative: reducing the government's deficit.

Imagine that the Bush administration suddenly got religion (at least, the religion of fiscal responsibility) and cut expenditures. Assume that raising taxes is unlikely for an administration that has been arguing for further tax cuts. The expenditure cuts by themselves would lead to a weakening of the American and global economy. The Federal Reserve might try to offset this by lowering interest rates, and this might protect the American economy — by encouraging debt-ridden American households to try to take even more money out of their home-equity loans to pay for spending. But that would make America's future even more precarious.

There is one way out of this seeming impasse: expenditure cuts combined with an increase in taxes on upper-income Americans and a reduction in taxes on lower-income Americans. The expenditure cuts would, of course, by themselves reduce spending, but because poor individuals consume a larger fraction of their income than the rich, the "switch" in taxes would, by itself, increase spending. If appropriately designed, such a combination could simultaneously sustain the American economy and reduce the deficit.

Thomas

Not surprisingly, these recom dations did not emerge from th ternational Monetary Fund meet in Singapore. The United State tains a veto there, making it unli that the fund will recommend icies that aren't to the liking o American administration.

Underlying the current im ances are fundamental struc problems with the global res system. John Maynard Ke called attention to these prob three-quarters of a century ago ideas on how to reform the g monetary system, including cre a new reserve system based new international currency, with a little work, be adapted t day's economy. Until we attac structural problems, the wor likely to continue to be plague imbalances that threaten the f cial stability and economic we ing of us all.

Stiglitz, a professor of eco- t Columbia and the author, ently, of "Making Globaliza- k," was awarded the Nobel nic science in 2001.