

# 40

## How will Obama Set his Policies for Economic Recovery?

This is an exciting time for the US and for the world now that Obama has been elected President. The world is facing a financial crisis and the US is experiencing a serious recession. The most important task for Obama is to deal with the economic recession and to deal with it quickly.

Before his inauguration in January, Obama cannot take action to improve the economy. Even announcing his economic policy would undermine the authority of President Bush. He cannot be silent about his future policy because the current problems are urgent. In the meantime President Bush and his administration are observing the development of Obama's policy decisions and do not want to act to undermine his future policy, or to limit his actions in the future. Consider the example of how to spend the 700 billion dollars to rescue the troubled financial institutions, corporations, the real estate sector and the home owners, a subject which I discussed in a recent article in this paper. Treasury Secretary Paulson cannot commit too much spending and fail to leave enough for the new administration. In addition, he is facing a delicate balance between public and personal interests. Acting to promote public

interest itself is already difficult because of the need for immediate action and the need to leave room for the next administration to act. From the viewpoint of his personal interest, Secretary Paulson would not want to spend too much because he will be blamed if the economy shows no sign of recovery or perhaps even becomes worse after his action is taken. He would not want to spend too little because he will be blamed for not taking action when needed.

A safe strategy for Paulson and for the Bush administration is to consult with Obama's transition team and let the policies before inauguration be treated as the result of the deliberation of both administrations. This strategy is also good for Obama because it would allow him to act quickly without undermining Bush's authority. That is why the Bush administration and the Obama transition team are having joint meetings on important matters. Members of Obama's transition team are invited to attend important meetings of the Bush administration on national security, the economy and other matters of national interest. At these meetings Obama does not want to be identified too closely with the policies of the Bush administration, including the bailout package because in his opinion some policies are not well formulated and may fail.

What are the important economic policies that Obama has to deal with immediately? There are four major ones.

1. Policy on government expenditures to stimulate the economy. Soon after the US economy experienced a serious depression in the early 1930s, Keynes published *The General Theory of Employment, Interest and Money* in 1936 to suggest the use of government expenditure to increase aggregate demand in the macroeconomy. This has become the fiscal policy often used to regulate macroeconomic activities. The second component of macroeconomic policy consists of monetary policies which affect interest rate and money supply. We should await with interest the announcements of the Obama team or administration on what types of public infrastructure projects to finance. During the Eisenhower

administration, many federal highways were built to increase aggregate demand. Today old highways could be repaired or upgraded. American railroads could also be modernized. The speed of American trains is much lower than the best in the world.

The Chinese government has also increased government expenditures to stimulate the economy. During the Asian financial crisis of 1998–99, Premier Zhu Rongji increased government expenditures on highways, railroads and projects connected with the Western Development Strategy. On November 9, the State Council announced ten major policies to stimulate economic growth. These include policies on infrastructure building, taxes and income subsidies that are also in Obama's plan to speed up economic recovery. Policies on health, education and environment are on both China's and Obama's agendas.

2. The government will spend money to rescue the financial markets and the real estate sector. As I pointed out in the previous essay on financial crisis, how to spend the 700 billion dollars is a difficult problem. Which private economic institutions should be rescued? How much should be paid for each rescue effort? How can the government avoid the "moral hazard" problem of encouraging future financial institutions and consumers to take more risk and expect the government to bail them out? Spending part of the rescue money is not classified as fiscal policy because the latter refers to spending money for the government's own economic activities. Neither is it monetary policy because monetary policy regulates the rate of interest and the supply of money for the economy as a whole and is not directed at individual financial institutions or consumers. There is some sentiment that more money should be spent to bail out consumers in danger of having their houses foreclosed than to bail out the rich financial institutions. The former requires that the income of each potential beneficiary be checked. Otherwise those who can afford their mortgage

payments will claim that they cannot in order to receive bailout benefits. The latter faces the difficult problems of selecting the appropriate beneficiaries and of making sure that they will use the money to extend loans to businesses and consumers.

A current monetary policy in the US is for the Federal Reserve to purchase commercial papers directly from private enterprises, rather than the traditional indirect way of trying to increase the ability of commercial banks to do so. However, in the US the Federal Reserve System is independent of the executive branch of the government headed by the President, unlike the Chinese case where the People's Bank is part of the State Council under the direction of the Prime Minister. Since I am discussing the policies of Obama, a policy of the Federal Reserve is not the subject of this article.

3. The government will also spend money directly to increase the income of poor consumers by extending their unemployment and food stamp benefits. All possibilities to improve the conditions of consumers will be considered carefully by Obama's team, including the policy he announced in his campaign to lower the taxes of low- and middle-income workers. The Obama government will provide aid to states and assistance for the troubled automotive industry.
4. Obama can help revive the economy simply by influencing the psychology of the Americans. Through his leadership he can increase the people's confidence that the economic future is good. President Franklin D. Roosevelt made a famous speech during the Great Depression, saying, "The only thing we have to fear is fear itself." If people have confidence in the economic future, there is no need to worry about the economic future. Government policies can change expectations and expectations will change economic behavior. A good leader can improve economic expectations which are important in determining the speed of economic

recovery. Obama is in a position to inspire the American people to work toward a more prosperous economy.

Finally, Obama has announced that the current American economy is in a serious recession and no policy can lead to a rapid recovery in a short time. I believe that Obama has assembled or will soon assemble some of the best people to help him set his policies and carry them out. We can hope that his leadership and the economic policies of his administration will be as good as possible under the present difficult circumstances.