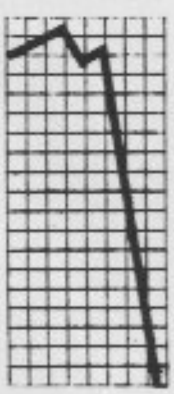
avoid a recession

The current turmoil in the foreign exchange and securities markets is indicative of the growing uncertainty about the course of the world economy. The U.S. economy has been growing at a less robust rate than forecast, leading to increased fears of an impending recession. But, recessions are almost always the result of policy mistakes, and if the United States and the world economy does fall into a recession in the next few months, it will be clearly because of policy mistakes. The villains will be apparent: the Japanese and German governments and a majority of the U.S. Congress.

The Japanese and Germans have engaged in excessive deflationary policies which have slowed their economic growth. The Japanese have also engaged in blatant protectionism which forces their own abused consumers to pay many times the world price for such items as rice, beef, citrus fruit, etc. Japanese mercantilist policies have caused not only their own citizens to suffer, but the rest of the world's people, in particular the populations of the developing countries which need the Japanese market for their exports.

The Germans and Europeans in general have contributed to the economic malaise by continuing to practice the economics of austerity rather than growth — they continue to pursue excessive taxation, government spending, and regulation.

Many members of the U.S. Congress, rather than acting responsibly by reducing the growth rate of government spending and making the tax system more internationally competitive, have instead been promoting economic suicide, through higher taxes, greater government spending and protectionism.



But it is not too late — there is still time to take corrective action. The following steps should be taken immediately:

1. The U.S. Congress needs not only to avoid passing a tax increase, but also to stop talking about the possibility of a tax increase — because such talk increases uncertainty. The empirical evidence is overwhelming: It is unambiguously clear that major tax increases seriously reduce the rate of economic growth.

Congress made a mistake last year in the tax reform process by substantially increasing the tax on capital and phasing in the rate cuts. To compound that mistake by delaying the tax cuts or increasing taxes would be dangerous and destructive folly.

2. The U.S. Congress needs to get serious about reducing the growth rate in spending. The evidence is conclusive that high levels of government spending reduce the rate of economic growth rather than enhance it. Many government spending programs are clearly counterproductive and result in higher levels of unemployment and economic misery. A responsible Congress, eager to avoid a recession, would get rid of much of the destructive spending and achieve the Gramm-Rudman-Hollings targets without gimmicks or tax increases.

3. Congress must not pass any protectionist trade measures. There isn't a responsible economist in the world who won't tell you that protectionism only leads to retaliation and higher domestic prices, which in turn slows economic growth and causes higher rates of unemployment and economic misery. The destructive effects of protectionism have been well-known for more than 200 years. Only the grossly irresponsible (and demagogues counting on public ignorance) would choose to go down the protectionist road.

4. The G-3 nations (Japan, Germany, and the United States) must come to an agreement on international monetary coordination, such as a commonly agreed "price rule." This is the most volatile part of the problem and must be addressed soon.

The economic ministers for the major countries should identify a group of internationally produced and traded commodities, or perhaps even gold, that have a one-world price, to which they can tie their monetary policy.

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Specifically, if the market basket of commodities begins to rise in price in one currency, that would be a cue for the monetary authorities to reduce the growth rate of that country's money supply, while if the market basket of commodities in another country begins to fall that would be a cue for that country's monetary authorities to increase the growth rate of the money supply.

Such explicit, coordinated monetary policy should over time reduce the wide swings in exchange rates, thus reducing investment risk, which in turn would lead to higher levels of investment and economic growth.

If an international "price rule" monetary agreement cannot be worked out, the U.S. Federal Reserve should adopt an explicit one as a domestic monetary policy guide.

Given that several of the current members of the Federal Reserve Board have publicly acknowledged that they do use certain commodity prices as an implicit policy guide, the transaction should be smooth.

It's really very simple: If responsible economic policy-makers want to avoid a recession, they need only to stop doing those things which are demonstratively destructive. Specifically, they need to seek price stability by using sensitive prices as a guide to monetary policy, avoid protectionist legislation and regulation, reduce the growth of real government spending, and avoid increasing taxes.

If we do get a recession, you can bet that one and probably more of the above rules will have been violated. It is cold comfort that, at that time at least, we will be able to identify those individuals who caused their fellow citizens the misery and pain of unemployment, diminished opportunities and a lower standard of living.