Fiscal policy lags

Fiscal Policy Lags Management of the National Economy In the United States there are only a few avenues available to the government for management of the economy.

These opportunities fall under the broad headings of monetary and fiscal policy. Monetary policy is under the primary control of the Federal Reserve Board. Its tools include interest rates and the supply of money. Fiscal policy, on the other hand, is open to the purview of the legislative and executive branches of government. It refers to government policy using taxes and spending to influence the economy .

The subject of controlling the national economy presents professionals and ordinary citizens alike with fodder for lively discussion and debate. It is also a topic whose popularity ebbs and flows with the times. The focus in recent years has been on the use of monetary policy. But do not tell that to the politicians. Some people will not let go of what they are familiar with and to what gets them votes. So Congress and the President constantly battle to find the most " correct" fiscal policy to pursue given their assessment of the economic conditions at any point in time.

And therein lays a potential weakness in the argument that favors the use of fiscal policy to smooth the troughs and peaks of the United States economic machines. Fiscal Policy Lags In order for there to be a reasonable chance of achieving the outcome desired from the application of particular economic policies it is important for there to be an ability to recognize the existence of a challenge, to correctly diagnose the condition, to take action in accordance with the approved policy, for all of it to be timed appropriately and to have some luck. This one rather tedious sentence encompasses the array of arguments against the use of fiscal policy for control of our national economy. Put another way, we are describing recognition lag, decision lag, implementation lag and take-effect lag. These “ lagging” concepts are fairly self-explanatory. Recognition lag speaks to the relative difficulty of identifying economic conditions in “ real time”.

The National Bureau of Economic Research’s (NBER) Business Cycle Dating Committee is generally considered to be the official arbiter on the timing of broad economic cycles. The mere definition of a business cycle as representing changes, spread across the economy, lasting more than a few months, visible in industrial production, employment, real income, and wholesale trade suggests that it is something that will be recognized officially a good bit after it starts. So politicians must arrive at a consensus about the state of the economy fast enough to allow them to move to the next step of the fiscal process – to craft an appropriate action plan and push it through the approval process. This issue has been labeled the decision lag.

Once a problem has been recognized and diagnosed and an action plan has been cobbled together, the next challenge is in implementing that plan. This “ implementation” or “ action” lag” involves the logistics associated with the policy itself. And upon implementation of the policy there is yet another time factor in play. And that is the time required for public attitude to be sufficiently impacted by it. This is known as the “ take-effect lag” . Lagging Doubts, ingrimayne.

com This article provides a real world example of the concepts described herein by drawing on events that occurred over 30 years ago and have since been well studied. In particular, the article describes the struggles of then-President Gerald Ford with management of the inflation-riddled economy of the early to mid-1970s. The authors describe a fairly clear case of recognition lag – President Ford names inflation public enemy #1 at about the time the economy is beginning its stream downhill toward recession. Before his policy of raising income taxes in order to stifle aggregate demand can be implemented he finds himself having to change horses and ask for a tax cut to stimulate an economy that is sagging in January, 2005. The chart below shows the impact that lags can have on the effectiveness with which the government can manage the economy using fiscal policy.

Critical Analysis Although the article does not mention it specifically there is a relevant parallel to the economic conditions of today. The Federal Reserve recognized as far back as the summer of 2007 that action on the monetary front was in order. Economic pundits and politicians are still debating today about the possibility that the economy is in a recession. Congress and the President agreed on a tax rebate plan in February. Implementation of the plan is starting in May.

The debate about whether and how people will " spend" the money is a raucous one. And it will be months before the jury decides whether or not attitudes about the state of the economy have changed for the better. And these circumstances and the conditions of the 1970s are by no means unique. It is my opinion that the authors of the article make a compelling case that fiscal policy has only limited usefulness as a tool for managing the economy of the United States. In much the same way that a President can have a positive jawboning impact, actions of our politicians can influence national behavior and beliefs.

But it is a tool that requires relatively quick action and a unified face. When properly coordinated with the Federal Reserve's monetary policies, fiscal policy can have a positive outcome. To those who rely on it too strongly or intend to use it independently of the other avenues, caveat emptor.

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wikipedia. org/wiki/Fiscal_policy Macroeconomics, R. Glenn Hubbard, Anthony Patrick O'Brien, 2nd edition Lagging Doubts, http://imgrimayne. com/econ/FiscalDead/Lags. html