

# Op-Ed: Time to Step In

## Federal spending is needed before deflationary psychology sets in

M. ALLEN JACOBSON AND JASON N. SCHMITT

Capitalism does a wonderful job of orchestrating human economic activity in a way that harnesses self-interest for the common good of society. Yet, it can fall victim to this same self-interest when inflationary or deflationary psychology becomes too widespread. In these situations government intervention is usually needed. When inflationary psychology becomes the problem, it is in your self-interest to borrow and buy now because the cost will likely be higher next year. First-time homeowners want to buy a house ASAP since they may not be able to afford one later. If enough people do this, it drives prices higher. Companies build excess inventories, expecting prices to be higher when they have to replenish their stock. The U.S. Federal Reserve Bank had to raise interest rates to twenty percent in the late seventies to stop inflation from spiraling out of control. If not stopped, money will eventually lose all value and only real assets will have value. The textbook example of this is the Weimar Republic in Germany in 1923, when you had to take a cart full of money to the store to return with a bag full of groceries. In contrast, when deflationary psychology becomes too widespread, it will be in your self-interest to save or pay down debt and defer major purchases because they will likely cost less next year, and you might be laid off. Businesses will cut production and prices, as well as lay off employees, to avoid building inventory that they may end up selling at a loss. Therefore the economy spirals downward. Government then needs to step in with increased spending to help maintain employment and incomes, while providing low interest rates to make debt more bearable. If not, eventually only money will have value and real assets (i.e., property, stocks and commodities) will be worth pennies on the dollar. The textbook example of this is the Great Depression of the United States. We are fortunate that in this period of deflationary psychology we have the opportunity to learn from the mistakes of the U.S. in the thirties and Japan in the nineties of doing too little too late. During the Great Depression, the only real stimulus package was gearing up for WWII almost ten years after the crash of 1929. Even the Works Progress Administration didn't start until 1936. It is generally agreed that infighting between political parties and cronyism between business and government kept Japan from responding promptly and adequately to their banking crisis and the ensuing deflationary pressures. It is encouraging that the current economic instability is being addressed in almost every major country. And some are more prompt than others. China, for example, recently announced they were expanding a stimulus package of more than \$500 billion. Since their economy is about one-fifth the size of ours, that translates to a \$2.5 trillion spending package in the United States. Federal spending needs to help offset the falloff in private spending before deflationary psychology gets too firmly embedded. It will be a wasted opportunity if federal stimulus spending isn't as productive as possible and doesn't move us toward our national economic goals such as energy independence and combating global warming. Yet, the most important consideration is that it quickly injects money and jobs into the economy. Military spending for WWII succeeded in pulling us out of the Great Depression, yet tanks, bombs and ammunition made no productive contribution to society. Of course they helped us win World War II and no dollar amount can adequately measure that. We hasten to add that we are fully aware that federal spending is far easier to ramp up than to rein in. However, economic stability is now the more urgent problem. *M. Allen Jacobson, Ph.D., and Jason N. Schmitt, CFP of Jacobson & Schmitt Advisors, LLC, can be reached at [ajacobson@jandsadvisors.com](mailto:ajacobson@jandsadvisors.com) and [jschmitt@jandsadvisors.com](mailto:jschmitt@jandsadvisors.com).*

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