

## BCA Market Perspective ©

### Managing The Recovery

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During past economic recoveries, increased government spending and tax policies (fiscal policies), in conjunction with the Federal Reserve (Fed) reducing borrowing costs, have been effective in stimulating the real economy.

So here is how it is supposed to work. The U.S government agrees to manage both public and private sector policies to promote social stability, full employment, sustained economic growth and increasing federal tax receipts. Across the street, the Fed stands by to stimulate a weakening economy by adding liquidity or lowering borrowing costs. It also has the power to slow down an overly inflated economy by raising borrowing costs. With fiscal policy, the U.S. Government manages spending appropriations and inks the tax code with provisions that direct or promote where the public sector invests or spends capital. Thus, government spending and tax policies steer resources into the economy. For example, oil & gas companies receive handsome accounting write-offs or tax incentives to find energy. Renewable energy companies receive 30% tax credits to promote wind and solar power. Research and development costs among manufacturers are often reimbursed by way of tax credits. The tax code (fiscal policy) encourages companies to purchase equipment by allowing for accelerated depreciation – a means of reducing current income taxes, thus freeing up capital for other purposes that should stimulate the economy.

To put this all together, the federal government spends a lot of money and influences or directs how the private sector spends money. This type of stimulation is known as fiscal policy. Monetary policy involves the Fed coordinating policies designed to promote economic conditions for full employment and to cool the economy when inflation becomes a problem. Monetary policy is most often associated with the Fed raising or lowering interest rates.

Since 2009, the U.S. economy has not experienced a robust economic recovery. The economy has instead been nursed along by a Fed policy of historically low interest rates and restrictive private lending. At the same time, new banking regulations have been installed – thus tightening lending standards and making it more difficult for the private sector to borrow. Many believe it is this lack of credit that has held back the U.S. recovery since 2009. Sure, the stock market has fully recovered – but not the real economy. Credit availability allows for capital formation and investment. This fundamental economic principle is an essential growth mechanism that leads to increased orders of building materials, chemicals, motor fuel, food, clothing, and just about everything else - which leads to more purchases and the need for new hires. State and federal tax revenues increase and budgets become easier to balance.

Fiscal policy stimulation has been an effective tool – primarily by lowering federal income tax rates. The impact on consumer spending and growth is almost immediate. But in the recent past, lawmakers have been unable to reduce spending in non-essential areas to control growing budget deficits.

Back to the economy: It is possible to return to a real growing economy if the citizens, entrepreneurs, and lawmakers are given the freedom to create and take risks. Allow for credit expansion and tax cuts - then prosperity will soon follow as it has in the past.

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