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Testimony of

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to the

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(1). <u>The U. S. economy is now very weak and could get substantially weaker.</u>

There is likely to be virtually no increase in real GDP in the current quarter. Virtually every economic indicator – including credit conditions, housing, and consumer sentiment – has deteriorated significantly during the past month.

I believe that the probability of a recession in 2008 has now reached 50 percent. If it occurs, it could be deeper and longer than the recessions of the recent past.

(2) <u>The Federal Reserve should reduce the fed funds rate at its December meeting and should continue cutting that rate toward three percent in 2008 unless there is a clear sign of an economic improvement.</u>

The current 4.5 percent federal funds rate is essentially neutral – not low enough to stimulate growth.

Because of current credit market conditions, there is a risk that interest rate cuts will not be as effective in stimulating the economy as they were in the past.

But rate cuts can still help – lowering monthly payments on adjustable rate mortgages, decreasing the cost of borrowed funds, and making the dollar more competitive.

(3) <u>The lower interest rate should be supplemented by enacting a tax cut now that is triggered to</u>

take effect if the economy deteriorates substantially in 2008.

There are many possible forms of stimulus, including a flat rebate per taxpayer or a percentage reduction in each taxpayer's liability.

There are also a variety of possible triggering events. The most suitable of these would be a three month cumulative decline in payroll employment. The fiscal stimulus would automatically end when employment began to rise or when it reached its pre-downturn level.

(4) Enacting such a conditional stimulus would have two desirable effects.

First, it would immediately boost the confidence of households and businesses since they would know that a significant slowdown would be met immediately by a substantial fiscal stimulus.

Second, if there is a decline of employment (and therefore of output and incomes), a fiscal stimulus would begin without the usual delays of the legislative process. In effect, such a pre-enacted conditional fiscal stimulus would be an automatic stabilizer in the same way that the payout of unemployment benefits is now.

(5) The advantage of the pre-enacted conditional tax cut is that it would eliminate the legislative lag that has made economists critical of countercyclical fiscal policy.

It would also make the countercyclical fiscal action respond to actual economic weakness rather than potentially unreliable economic forecasts.

(6) The case for using fiscal as well as monetary policy when the economy weakens is not limited to the current situation.

The excessive asset price increases caused by some past monetary expansions – especially the induced rise in the prices of real estate – provide a further reason to use fiscal as well as monetary policy.

(7) The falling dollar is not only a necessary part of reducing the massive U.S. trade deficit but will be a source of demand and growth in 2008 and 2009.

A more competitive dollar should not be seen as a problem for the United States.