

# BIC LLC News Release

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## The Conservative Argument for Fiscal Stimulus

President Obama's fiscal stimulus plan is going to work -- if it is responsibly done. The economic conditions are right for Federal spending over tax cuts to revive our moribund economy. Conservative economist Milton Freedom explains in his book *Capitalism and Freedom*, fiscal stimulus will work if two rare conditions exist. Consumers must be completely indifferent to holding government bonds versus money and, no change in interest rates will impact potential borrowers spending patterns. In economists' speak; the investment marginal efficiency schedule is perfectly inelastic with respect to changes in interest rates.

Condition one is definitely satisfied. If anything, people prefer holding government Bonds, Notes and Bills over cash: witness recent investor willingness to accept zero percent T-Bill rates. Under more typical circumstances, an increase in government borrowing to fund spending would require and result

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in an increase in interest rates, both public and private. High interest rates would discourage private investment to the point where the net benefit of fiscal stimulus (change in government spending minus change in private investment) is near to zero. With conditions as they are the government can issue debt without having to induce buyers with higher rates. Therefore private borrowing costs have no reason to go higher, private spending will continue as per usual and the stimulus spending will be additive to our national income.

Condition two is also well satisfied. Today, spending patterns are completely insensitive to changes in interest rates. Just look at the housing market. Mortgage lending rates are at an historically low level; yet, nobody is buying. If borrowers were rate change sensitive then lower mortgage rates should have resulted in a buying frenzy. Similar arguments can be made for spending outside of housing. Does anyone believe zero percent auto loans would coax car buying?

The present economic environment is the first since the Great Depression that a clear and convincing case can be made for increasing government spending relative to tax receipts to grow national income. The stagflationary environment of the 1970s called for just the opposite -- cutting taxes to stimulate the economy. This explains why Jimmy Carter's Presidency was a disaster from an economic stand point. Carter taxed and spent at

a time when the economy needed lower taxes, which would eventually have led to lower prices and interest rates and improved investment returns. Fortunately, Ronald Reagan got it right for the 1980s.

Our economy will recover with the help of a credible fiscal stimulus plan. We have a word or two to the wise for our legislators, however. The plan must be focused on investment rather than frivolous spending. Before acting, understand the long-term return potential of your spending/investing. If the expected return is positive then move ahead. If not, holster the idea for a better day. Infrastructure, energy independence, education and the environment are all terrific places to invest. Wasteful spending such as \$160 million to sod the Mall will prove fruitless. Besides, my boys and I would like to bring our tiller and spreader from Illinois and take care of the job, for say, \$1.0 million apiece. The government can supply the water and pay for the seed.

It is time to get behind Obama's plan. If done with an eye towards positive return generating investments, it will work.

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