Insight

Obama’s Next Economic Test

DOUGLAS HOLTZ-EAKIN | MARCH 9, 2010

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President Obama’s Federal Reserve appointments will be a key signal regarding the seriousness of his economic policy objectives.

Despite its recent battering in the public and Congressional opinion polls, the Fed remains the single most important economic policy body in the United States, and perhaps the world. Its innovative and aggressive response to the financial crisis is the single most important reason that the panic was as short-lived as it was, and that the economic fallout was not far worse. Forget the TARP. Forget the stimulus. Never forget the Fed.

The Bush Administration experience is illustrative. Nobody – regardless of the merits – has accused George W. Bush of excessive economic literacy. Neither has his Administration been considered either economically innovative or especially successful. But then-President Bush appointed to the Fed the current Chairman of the Board of Governors, Ben Bernanke, and the current Vice-Chairman, Donald Kohn. Both were first-rate picks that featured leading expertise in monetary policy and the economics of financial crises (Bernanke) and an unparalleled portfolio of experience in and about the Fed (Kohn). Bush’s discipline to push aside other considerations and choose top-quality Governors is a tribute.

The public should hope for the same from President Obama. But there are reasons to be concerned. The Administration out-sourced the stimulus package to Congress, resulting in a bloated bill that flunked the traditional test of timely, targeted and temporary in favor of permanent, partisan, and pork-barrel. Will he again put aside principle in favor of somebody else’s preferred Fed pick?

In healthcare, the President opted to focus on the wrong issue – expanding coverage – at the expense of solving the real problem of higher costs. Will he make the same mistake and fail to recognize the top challenge for the Fed is to exit its extraordinary interventions without re-igniting inflation? The handwriting is on the wall. The U.S. will face a prolonged period of painful unemployment. Will he also single-handedly revive the Carter-era misery index by stacking the Board of Governors with inflation doves?

Finally, the President must address this as a management issue. His (and every) economic team is populated with ambitious, upwardly-mobile types who want to either be the next pick or prevail for a favored friend. He needs to impose a vetting regime that favors experience, expertise, and excellence.

Over the next few weeks, the names of potential Fed picks will begin to circulate. The quality of these picks will be a central test of the seriousness of the Administration.