

Economic Policy Survey

NABE Panel Supports Fed Independence, Sees Current Monetary and Fiscal Policy as Appropriate, but Expresses Concern About Deficit

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The NABE Economic Policy Survey presents the consensus of a panel of 203 members of the National Association for Business Economics. Conducted semiannually, this survey was taken Feb. 4-22, 2010. May be reprinted in whole or in part with credit given to NABE. View the survey results, including complete tabulations, online at www.nabe.com. This is one of three surveys conducted by NABE. The other two are the NABE Outlook and the NABE Industry Survey.

***Douglas Duncan**, Fannie Mae; **Michael Fratantoni**, Mortgage Bankers Association; **Jose Guardado**, American Medical Association; **Chad Moutray**, U.S. Small Business Administration; and **Clifford Rossi**, Center on Financial Policy, University of Maryland, conducted the analysis for this report.*

The March 2010 National Association for Business Economics (NABE) Policy Survey reveals that two-thirds of the respondents believe that Federal Reserve monetary policy is appropriate at the moment. However, a majority believes that a rise in interest rates is both likely and appropriate in the next several months.

"Although the poll of our economists reveals different opinions on a number of policy options, the view of the importance of Federal Reserve independence is nearly unanimous," according to NABE President **Lynn Reaser**, who is also chief economist for Point Loma Nazarene University.

Less than half of the respondents, but a significantly higher share than in last August's survey, believe that fiscal policy is appropriate at present. Eight out of ten respondents do not believe another stimulus package is warranted at this time. In the event that a jobs initiative were to be adopted, the top policy choice for effective job creation would be the elimination of capital gains taxes on small business.

Fiscal concerns are evident in this latest polling of economists, with eight out of ten suggesting that the long-term imbalance of the federal budget might impact the country's ability to borrow. The top choice for fiscal improvement on the tax side is tax simplification and loophole reduction. On the spending side, the leading recommendation is Social Security reform through a further increase in the eligibility age for benefits.

Relative to the health-care debate, fewer than half of the respondents feel that the current proposals would maintain quality while broadening coverage and reducing costs.

Finally, a review of opinions on a range of financial market reforms finds mixed views, with the exception that nearly two-thirds of respondents believe that greater explicit subsidization of the government sponsored enterprises would not be beneficial in improving the long-run health of the mortgage market.



Monetary Policy

The NABE membership generally thinks that monetary policy is appropriate at the current time, but that the withdrawal of special support for the housing market via purchase of mortgage-backed securities will bring higher mortgage rates. The economists also believe that some (but not all) proposals for restricting the Federal Reserve's powers or its regulatory oversight will reduce its effectiveness in conducting monetary policy. Simultaneously, they feel the Fed's independence is very important. However, they also do not hold the Fed blameless in the run-up to the financial crisis.

Two-thirds of respondents view the current posture of monetary policy as about right. This is down from 70 percent in August of 2009, but up from 63 percent a year ago. Thirty percent view current policy as too stimulative.

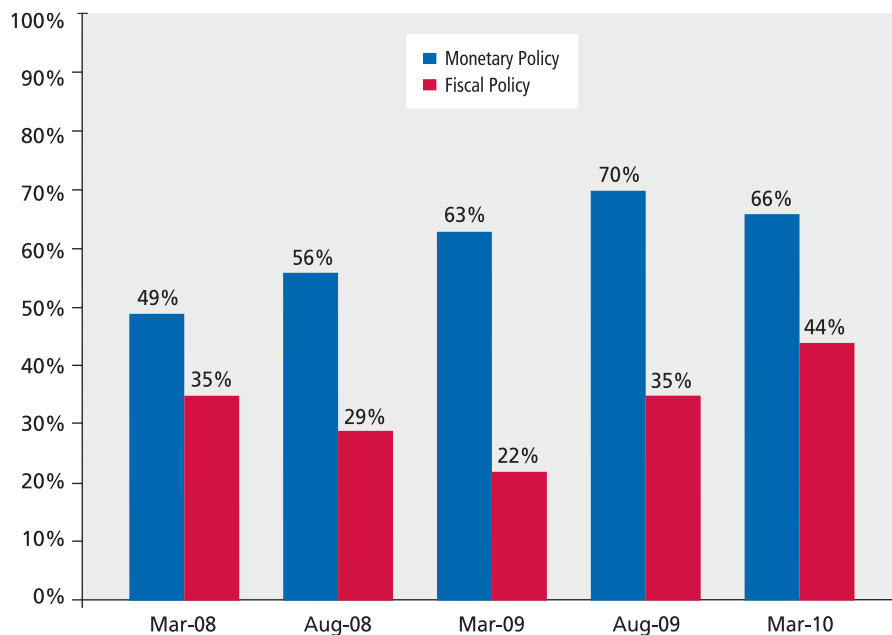
When asked what posture they would prefer in the next six months, 54 percent want a more restrictive policy vs. 41 percent who favor no change. However, 63 percent of respondents expect that the Federal Funds target will be increased, with most expecting a 25- or 50-basis-point rise.

Survey participants were also asked what impact they expect the end of the Fed's mortgage-backed securities (MBS) purchase program to have. The nearly unanimous view is that mortgage rates will rise. Twenty-eight percent think that rates will rise up to 25 basis points, while another 42 percent think rates will rise up to 50 basis points.

A 58 percent majority of respondents believes that removal or reduction of the Fed's regulatory power would make its conduct of monetary policy less effective, while 30 percent see no impact. A similar share, 59 percent, sees the imposition of an audit by the Government Accountability Office (GAO) as reducing effectiveness, while only 25 percent feels it would have no impact. A majority of 54 percent of survey respondents believe that a reduction of the Fed's consumer protection role would have no impact on the effectiveness of monetary policy actions.

Even though almost 90 percent of respondents think that the Fed's independence is very important, 44 percent believe that inadequate regulatory oversight was the primary contributor to the financial crisis and another 36 percent say the cause was about equally due to lax regulatory oversight and inappropriate monetary policy.

Percent of NABE Panelists Who Consider Current Policy to be "About Right"



Fiscal Policy

Forty-four percent of survey participants report that the stance of current fiscal policy is “about right,” an increase from the 35 percent who held that view in August 2009 and the highest percentage since 2007. Among those who disagree, a much larger proportion think that policy is too stimulative (39 percent) compared to those who feel that it is too restrictive (16 percent). Forty-eight percent of respondents indicate that fiscal policy *should* be more restrictive over the next six months, while 68 percent expect that fiscal policy *will* be more restrictive two years from now.

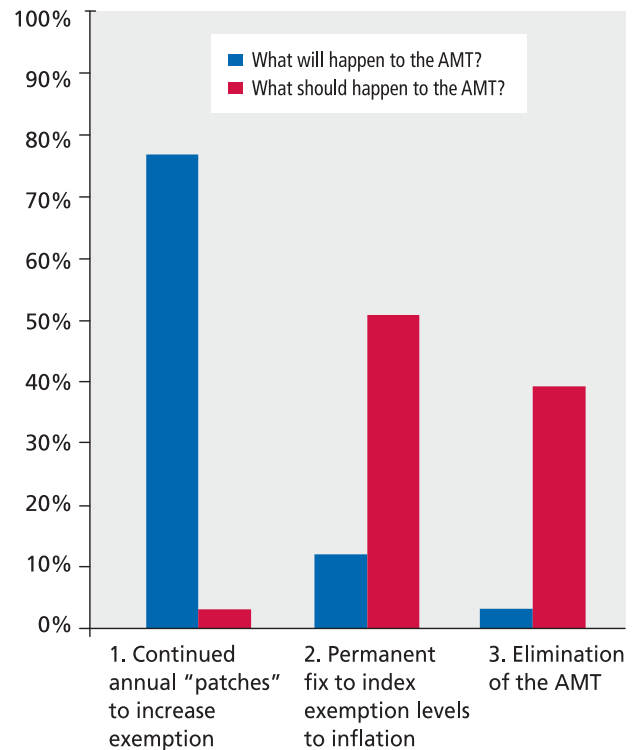
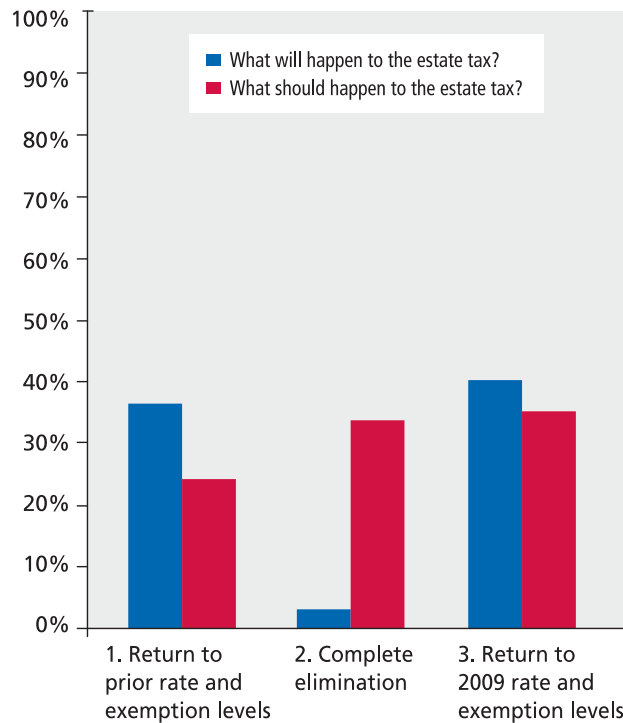
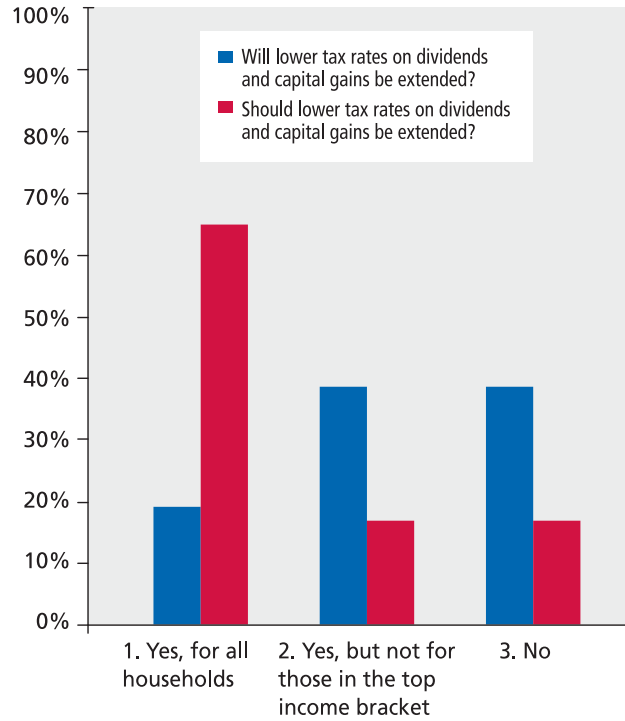
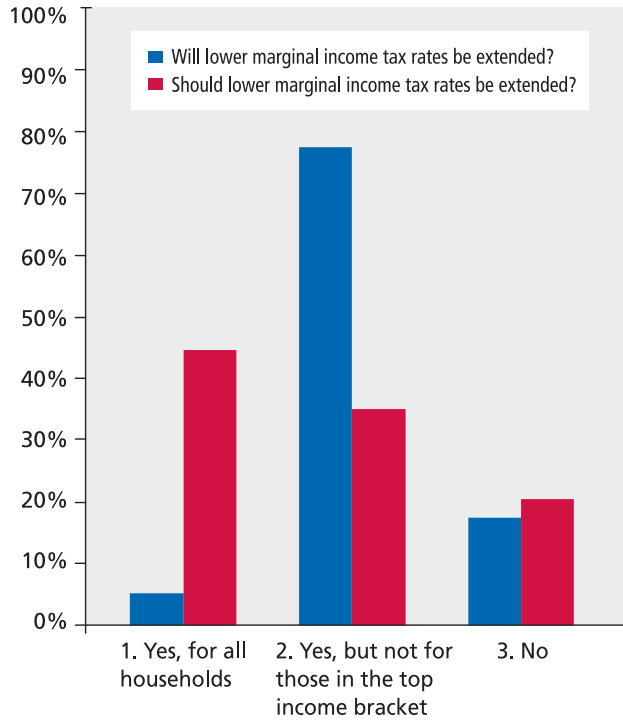
Given the answers regarding the appropriate stance of fiscal policy, it is perhaps not surprising that 71 percent of the NABE Economic Policy Survey Panel do not believe that another fiscal stimulus package is warranted at this time. Eighty-three percent believe that GDP is currently higher than it would have been without the 2009 stimulus package (ARRA). However, only 53 percent of respondents view the 2009 stimulus package as a positive factor for the economy *over the longer term*, likely reflecting the negative impact of substantial and growing federal budget deficits and debt.

One of the more significant fiscal policy decisions to be decided by the current Congress is the treatment of tax provisions (included under the tax-cut legislation enacted earlier this decade), which are due to expire at the end of this year. A substantial majority of economists in the survey believe that Congress will act to extend many of these provisions for middle-income households but will allow taxes to increase for those in the top income bracket. At the same time, most survey respondents do not view this outcome as best for the US economy, with the majority of the panel expressing a preference for retaining the current levels of personal marginal tax rates, as well as those on dividends and capital gains.

Specifically:

- 75 percent of respondents indicate that lower marginal income tax rates will likely be extended for all taxpayers except those in the top income bracket. A plurality—45 percent—indicate that maintaining lower marginal rates for all taxpayers would elicit the best economic outcome.
- 38 percent of economists think that lower tax rates on dividends and capital gains will not be extended. Another 38 percent believe that lower tax rates on dividends and capital gains will only be extended for those taxpayers outside the top income bracket. Almost two thirds of the panel (65 percent) feel that extending lower rates on dividends and capital gains across the board would produce the best economic outcome.
- Three percent of economists participating in the survey believe that the estate tax will be eliminated. Thirty-three percent think that eliminating the estate tax would be the best economic outcome. Most respondents, however, think that the estate tax will return to rates and exemption levels from 2009 or earlier.
- 77 percent of respondents think that Congress will continue to respond to the tax burden of the ever-growing share of households paying the Alternative Minimum Tax (AMT) by annually providing a “patch” to increase exemption levels. More than half—51 percent—of the economists surveyed think that the best economic outcome would be to implement a permanent fix, which would index exemption levels to inflation.

The proposal viewed as the most effective means of spurring hiring and creating jobs was the elimination of capital gains taxes on small business investment. A broad-based reduction in corporate income taxes is seen as the second most effective option. Mandates for lenders to increase the flow of credit to small business are viewed as the least likely to stimulate job growth.



Deficit Reduction

There is general bipartisan agreement that the U.S. cannot sustain its current fiscal path, with budget deficits exceeding \$1 trillion annually and debt rising steadily relative to GDP. This near-term problem will only worsen in the medium-term as the entitlements wave begins to crest. Almost 80 percent of the economists responding to this survey suggest that the country's long-term budget imbalance might impact the nation's ability to borrow.

Survey respondents were asked to rank a series of proposed solutions both in terms of their own preferences and in terms of effectiveness for bringing down the deficits. The table below shows the responses on various policy options.

The top preference is to simplify the income tax code and to reduce the number of loopholes. Indeed, when panelists were asked for other ways to reduce the deficit beyond the 13 listed, many cited tax changes. Some preferred marginal tax rate changes, while others expressed a desire for more structural changes (e.g., adding an income tax surcharge on higher-income groups, adoption of a flat or "fair" tax, switching to a national sales or consumption tax, or changing tax deductibility). Perhaps mirroring this discussion, the NABE Economic Policy Survey Panel scores the adoption of a value-added tax (VAT) as the top candidate for effectiveness in deficit reduction.

Respondents stress how important it will be for the president and Congress to delve into entitlement spending in order to make any serious dent in national spending. After tax reform, the second-most highly rated preference and effective choice is to increase the eligibility age for receiving Social Security benefits. Other changes to Social Security, Medicare, and Medicaid benefits were also noted.

Attempts to slow the growth in entitlement spending will be difficult politically. It is for that reason that many politicians and deficit hawks have asked for a bipartisan commission to make policy recommendations that will solve the deficit problem. Survey respondents strongly prefer such a commission that could make binding recommendations that would be voted on in the Congress without amendments—similar to the BRAC commission—to one that would not.

The third-highest-ranking option both from a preference and effectiveness perspective indicated by the panelists is the reinstatement of pay-as-you-go (PAYGO) rules, under which all new expenditures or tax cuts would need to be paid for. This was recently enacted by the Congress, and the economists surveyed think that it would be helpful. Giving the president some form of line-item veto authority also is popular among the economists surveyed.

Perhaps surprisingly—or as a reflection of how much the debate has shifted in the past couple of decades—the lowest-ranking option both in preference and effectiveness is passage of a Balanced Budget Amendment. Similarly, the re-introduction of restraints on spending similar to the Gramm-Rudman-Hollings provisions of the 1980s ranks poorly, and across-the-board spending cuts in discretionary programs receives mixed reviews. Nonetheless, several respondents cite a desire to cap spending or to set deficit reduction targets to some level of Gross Domestic Product.

Even with 13 options from which to choose, the list of possible alternatives was never meant to be all-inclusive. As noted, most of the survey respondents provide other ideas for reducing the deficit that are not listed on the table. Among the most noteworthy (not previously mentioned) include: (1) passing some form of comprehensive health-care reform to control medical costs in Medicare and Medicaid, (2) reducing defense expenditures—mainly by curtailing U.S. involvement in Iraq and Afghanistan, and (3) instituting multi-year budgeting or some other form of budget reform.

Deficit Reduction

Survey responses ranking various solutions for reducing the federal budget deficit (Ordinal ranking in parentheses)

	Respondent's personal preferences			Potential for helping to bring the nation's budget into balance		
	Avg. score	% Top choice	% Top 5 choices	Avg. score	% Top choice	% Top 5 choices
Creating a bipartisan commission that would make specific fiscal policy recommendations to reduce spending and increase revenues	8.22 (11)	3.45% (10)	24.14% (11)	8.19 (11)	7.39% (4)	26.11% (12)
Creating a bipartisan commission that would make specific fiscal policy recommendations that are binding and would be voted on without amendment by Congress (similar to the BRAC commission findings)	6.42 (5)	16.75% (2)	34.98% (8)	6.73 (7)	12.81% (2)	34.00% (6)
Increasing the eligibility age for receiving Social Security benefits	5.20 (2)	16.75% (2)	49.26% (2)	5.29 (2)	16.75% (1)	48.77% (1)
Reducing the benefits of upper-income Social Security recipients	6.50 (6)	4.93% (6)	35.96% (7)	6.52 (6)	3.94% (11)	33.99% (7)
Increasing deductibles or increasing premiums for Medicare	6.54 (7)	3.45% (10)	36.45% (6)	6.24 (5)	4.93% (10)	38.42% (4)
Instituting an across-the-board spending cut for discretionary programs, not including entitlements such as Social Security, Medicare, Medicaid, or interest on the national debt	7.22 (10)	5.42% (5)	25.62% (10)	6.82 (8)	6.40% (6)	29.56% (11)
Reinstating effective pay-as-you-go (PAYGO) provisions of the budget	5.57 (3)	8.87% (4)	43.84% (3)	5.61 (3)	6.40% (6)	43.35% (2)
Passing a Balanced Budget Amendment to the U.S. Constitution	10.21 (13)	4.93% (6)	15.27% (13)	9.82 (13)	5.42% (9)	17.24% (13)
Enabling the president, whether through legislation or an amendment, to have line-item veto authority	6.20 (4)	2.96% (13)	42.36% (4)	6.94 (9)	2.46% (13)	30.05% (10)
Introducing strict balanced-budget-spending constraints similar to Gramm-Rudman-Hollings provisions that were in place in the late 1980s	6.56 (8)	3.45% (10)	38.42% (5)	8.47 (12)	3.45% (12)	33.50% (8)
Introducing a value-added tax (VAT)	7.68 (9)	4.93% (6)	23.65% (12)	4.27 (1)	6.40% (6)	30.54% (9)
Simplifying the income tax code and reducing the number of loopholes	4.27 (1)	19.70% (1)	57.14% (1)	5.78 (4)	11.82% (3)	42.86% (3)
Raising the top marginal tax rate for earners above a certain threshold	8.27 (12)	4.93% (6)	26.11% (9)	7.31 (10)	6.90% (5)	36.45% (5)

Health Care Reform

NABE members were asked to consider the effectiveness of current health-care reform proposals in meeting their objectives. When asked to assess whether those proposals' combined effects on the cost, quality, and access to care would improve our current health-care system, only 46 percent of survey respondents thought it would. The Survey Panel was then asked a series of questions on each element of reform separately.

Nearly two-thirds of our panel (65 percent) think that health insurance reform meant to expand access to high-quality care at an affordable cost would not meet this objective. As far as the impact of health insurance reform on the cost and quality of care is concerned, 44 percent expect a decrease in quality and an increase in cost. Only 19 percent think that such reform will increase quality and lower cost.

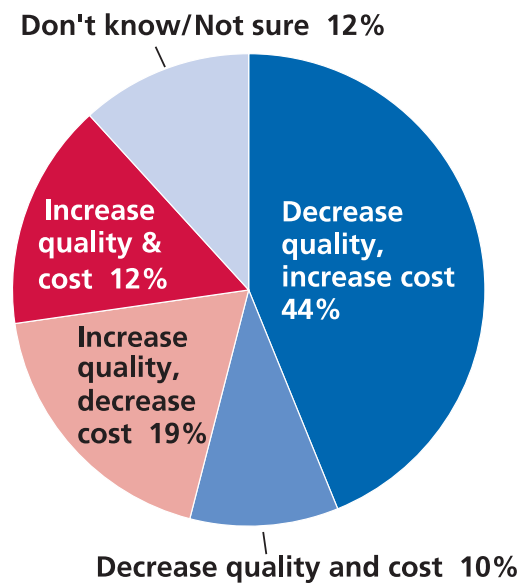
When asked which particular reform proposals would offer the best chance of improving health care quality at an acceptable cost, the highest-ranked option was the creation of insurance exchanges where small businesses, self-employed, and unemployed persons can purchase coverage. Moreover, eighty percent of respondents think that a combination of such reforms would generate a superior outcome to any single option. Importantly, despite respondents' pessimism about the prospects of current proposals to improve the system, the lowest-ranked option to improve quality at an acceptable cost was to not implement any reform at all.

The survey also asked respondents which reforms they thought would most effectively reduce the cost of health care without compromising its quality. The most popular choice was to limit patent protection of prescription drugs in order to reduce their cost, followed by basing reimbursement to providers on a per-patient basis rather than maintaining the current fee-for-service model. The lowest-ranked choice was the imposition of a tax on high-cost ("Cadillac") insurance plans.

When asked about the likely impact of the current proposals on the long-term cost growth of health care, 44 percent of survey respondents expect a somewhat or significant reduction of costs, while 40 percent expect costs to increase.

While slightly more than half of respondents are not optimistic about the current proposals' prospects for achieving their objectives, the vast majority of them are concerned about US business competitiveness due to health-care costs. Seventy-nine percent of survey participants think that rising health-care costs have a somewhat or significant adverse impact on the ability of US businesses to compete.

What impact do you think reforms to expand health insurance coverage will have on the average quality and the average cost of health care to Americans who currently have health insurance coverage?



Financial Regulatory Reform

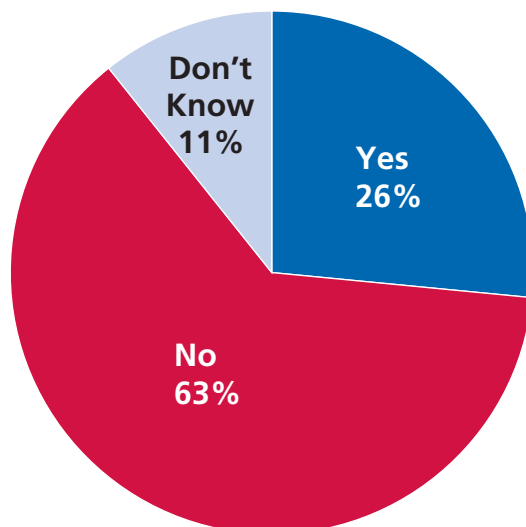
With comprehensive reform of the financial services industry slated for 2010 in Congress, a number of questions in the March 2010 survey focused on this subject. Of interest in this survey were some new proposals this year offered by the Obama administration on regulating large banks, establishing an independent consumer financial protection agency, and reforming Fannie Mae and Freddie Mac.

The burgeoning federal deficit in the wake of the financial crisis in part has led to a proposal for a Financial Crisis Responsibility fee to be imposed on large banking institutions to help defray some of the costs of the crisis. A potential unintended consequence of the proposal is whether or not this fee could be passed along to consumers. Two-thirds of survey respondents (66 percent) do not believe that this fee will be positive for bank customers.

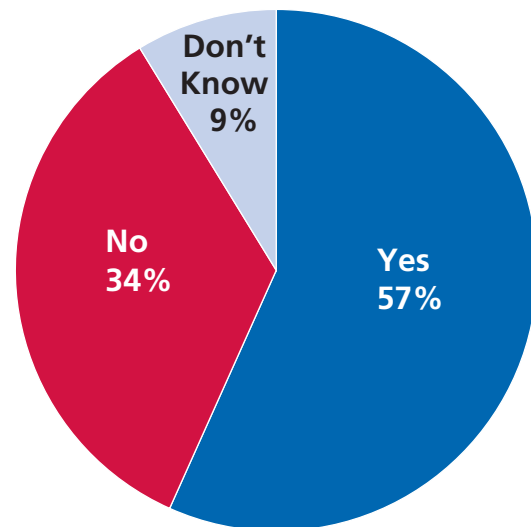
Responses were mixed on the question of whether or not the FDIC should take the quality of senior executive compensation plans and board oversight into consideration when pricing deposit insurance. Nearly 46 percent of respondents believe that such a proposal would not improve the alignment of shareholder interests and risk-taking by banks, while almost 42 percent believe it would be an improvement.

A key point of discussion in Congressional deliberations on financial services regulatory reform has been the establishment of an independent agency focused on consumer financial protection. Fifty-four percent of survey respondents feel that creating such an agency would not impair safety and soundness regulation; 25 percent believed it would be detrimental. On a related issue, 43 percent of respondents indicate that a consumer financial protection agency would not impair access to credit while 39 percent believed it would.

Will the long-term health of the mortgage market be promoted by greater explicit subsidization of the GSEs?



Will barring depository institutions from proprietary trading and hedge fund operations mitigate systemic risk to the financial sector?



With both Fannie Mae and Freddie Mac under federal conservatorship, a number of proposals to reform these government-sponsored enterprises have been presented. In part, the issue of how much subsidization should be required of both agencies to support a vibrant mortgage market is an important housing policy issue. Sixty-three percent of respondents believe that greater explicit subsidization of the agencies would *not* be beneficial in promoting the long-term health of the mortgage market. In contrast, 26 percent responded that subsidizing the GSEs would help improve mortgage markets over the long term.

The Obama administration introduced a proposal to further restrict activities of large depository institutions that would limit the size of these companies and prohibit certain proprietary trading activities in an effort to address Too-Big-To-Fail issues surrounding some large firms. With that proposal as a backdrop, 59 percent of survey respondents believe that imposing size restrictions on these companies would not be an effective means of addressing the Too-Big-To-Fail issue. Further, almost 57 percent of those surveyed believe that a ban on proprietary trading on large depositories would mitigate potential systemic risk in the financial services industry.

