THE CONSEQUENCES FOR BUSINESS OF GOVERNMENT ACTION IN AN ECONOMIC DOWNTURN

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ABSTRACT

A nationwide recession is impossible to predict, even for the US government. However, whether or not a recession is formally confirmed, the Federal Government acts on several fronts to reverse the decline. Managers who know how to monitor a changing economic landscape and who can correctly forecast the powerful impact of government responses to a recession on their business are in position to optimize. This article reviews recent economic downturns in the United States and the Federal Government's responses to them to proffer crucial insights for managers when they face a recession.

In anticipation of worse tomorrow, producers and consumers become conservative spenders. Lower spending levels lead in short order to lower production, to lower employment, to lower spending. This period of economic decline is a recession. It is the contracting phase of the economic cycle and it ends when a critical mass of consumers realizes that the structure of the economy is sufficiently sound that tomorrow will in fact be a better day. They also realize and react to the belief that between now and then there are some incredibly good deals to be had in almost every marketplace.

THE NATURE OF RECESSIONS

The United States Government defines a recession as at least two consecutive quarters of falling Gross National Product. The GNP is the total value of final goods and services produced and consumed in the US. It is the broadest measure available of economic output and growth. Declines in industrial production, employment, and real disposable income also accompany recessions. Since World War II, the United States has experienced eight economic recessions, the latest of which ended in 1991. The average recession during this period lasted 11 months and reduced real GNP by 2.6%. Each downturn wreaked havoc on the economic well-being of many elements of society.

The 10-year span since the last recession is seen by a few analysts as supportive of their notion that recessions are under control due to the actions of governmental agencies. However, the vast majority of economists, including those employed by the Federal Government, look suspiciously at the length of the current prosperity. Since national growth peaks and ebbs, and since no post-war period has previously extended for a decade without a significant economic decline, forecasters are keeping a wary eye on indicators of the country's health.

Recessions are precipitated by- policy missteps, shocks to the economy, and structural adjustments, often in combination. The two recessions of the 1980's developed as the government attempted to bring down double-digit inflation by tightening the money supply. Investors anticipated that tight monetary policy and credit controls would generate a mild recession in 1980. They were right. The Dow shed 16% from February to April 1980, and the recession lasted from January to July 1980.

Convinced that the downturn was over in April 1980, investors mounted an exuberant and broad-based rally that featured a 35% rise in the blue chip index. However, the Federal Reserve Board tightened credit again in the fall of 1980. The result was a new recession that began in July 1981, and became the second most severe in post war times.

The Government Mandate

An evaluation of recessions must consider the Federal Government's role in economic cycles. Since the Depression, when 25% of all workers lost their jobs and majority of the US citizens encountered extreme hardships, the US government has created a number of programs to avoid deep recessions. Government policy makers try to reduce extreme variations in the business cycle through short-run stabilization policies.

Prior to the Great Depression, the consensus among economists was that the economy was self-regulating. However, by the end of World War II, Congress made explicit the federal government's responsibility to stabilize economic activity in the short-run. The Employment Act of 1946 declared that the federal government is responsible for promoting "maximum" employment, production, and purchasing power sufficient to smooth out fluctuations in economic activity.

To moderate recessionary periods, the Federal Government makes counter-cyclical payments to eligible unemployed or disabled citizens. It also designs fiscal and monetary policies to avoid recessions and extend recoveries. The success of these government efforts was seen in the most recent recovery period of 1992-1993, which was helped by substantial decreases in short-term interest rates that were initiated by the Federal Reserve Board.

The Business Cycle

Business cycles describe the fluctuations of economic activity that result from severe variations in the plans of buyers and sellers. Cycles consist of two phases: expansion and contraction. Increased inflation, business activity, and rising employment characterize the expansion phase. The contraction phase, which includes recessions, is characterized by stable or falling prices, excess production capacities, reduced interest rates, heavy corporate debt, reductions in corporate spending, stock market decline, rising business failures, declining real earnings, and high levels of unemployment.

Tools for Forecasting a Recession

There are many variables to measure and evaluate in trying to discover the causes and effects that result in a recession. This extremely complicated process defies timely, simple or certain analysis. Therefore, the resources of the Federal Government are needed to undertake the task. The US Department of Commerce gathers and publishes statistical data on the GNP and other leading economic indicators to aid in the prediction and interpretation of recessions. For example, GNP growth was a weak [1].1% in the fourth quarter of 2000 with all major non-government components decelerated or turned downward at the end of the year. Other recession warning signs that were included in the GNP report were that exports fell by 6.1% following robust growth in the previous two quarters, and that business IT investment decelerated sharply for the third consecutive quarter.

Perhaps the most popular and widely accepted methods for predicting an economic recession involve the examination of eleven leading, or foreshadowing, indicators of the overall trend of the economy. The data for the analysis of the

Index of Leading Indicators (LEI) includes stock prices, commodity prices, consumer expectations, consumer goods orders, the money supply, the length of the work week, the number of order backlogs, the number of plant and equipment orders, the number of unemployment-insurance claims, the number of building permits being issued and the length of vendor delivery times. A recession is technically said to exist when the LEI has declined for three consecutive months.

For most businesses, demand for goods and services can be directly related to one or more of these indicators. For example, the demand for semiconductor chips is well correlated with overall growth in industrial production. The shifts in the phases of the business cycle also can be invaluable in influencing decisions on production, inventory and manning levels, marketing strategies and pricing (Pearce & Michael, 1997; Sykes, 1993).

A lesser-known but more successful forecasting model is the experimental recession probability index (XRI). The XRI combines the coincident economic indicators (CEI) and the LEI. The CEI involves a weighted average of four factors: industrial production, real personal income less transfer payments, employee-hours in nonagricultural businesses and real manufacturing and trade sales.

Another econometric model is the Turning Point Recession Index (TPRI) that involves examining the peaks and valleys of the economic cycle. TPRI attempts to forecast a recession by predicting a behavioral switch in the economy from an expansion to a contraction. The model has performed well except in predicting the 1990-1991 recession. Relating economic changes in 1990 to past economic fluctuations, which is what the TRPI does, allowed the 1990-1991 recession to escape detection by the TRPI method (Huh, 1991).

Simple predictors of recession also have supporters. For example, until 1991, a recession followed whenever short-term interest rates rose above long-term rates. When this happens there is an inverted yield curve. The yield curve shows interest rates along the maturity spectrum from 3-month Treasury bills to 30-year Treasury bonds. Interest rates reflect the price of money and reveal consumer expectations about growth and inflation and their preferences for saving versus spending. Therefore, when the yield curve has a positive slope, the public is expecting economic growth and higher interest rates. When the curve flattens or is inverted, the opposite occurs, the public expects the economy to weaken and fall into a recession (Pennar, 1995). Unfortunately, because the yield curve was not inverted in 1990, many economists who relied on this approach failed to predict the recession correctly.

Other analysts rely on consumer perceptions to gauge a recession. The Survey Research Center of the University of Michigan and the Conference Board publish monthly statistical indicators based on household perceptions of the economy. The Survey Research Center's consumer sentiment index reflects consumers' attitudes toward the economy and the job market, and their perceptions about purchasing durable goods. The Conference Board's consumer confidence index similarly measures consumers' attitudes toward the economy, job market and their own financial situation. When these measures reflect negative changes, a recessionary climate exists since consumer spending accounts for approximately two-thirds of the GNP (Shama, 1993).

Additional economic forecasts are available to managers that may provide predictions more specifically geared to their industry or geographic area. The National Association of Purchasing Managers (NAPM), Blue Chip Indicators, National Bureau of Economic Research, Chicago Purchasing Managers index, the ECRI Future Inflation Gauge, and government reports of construction spending, factory orders, worker productivity, layoffs, and housing starts. Additionally, several research associations and financial institutions assess recessionary conditions. For example, as mentioned in the introduction, the monthly index of the National Association of Purchasing Management is seen as a precursor to the more encompassing measures of the GNP and LEI.

Lagging Measures

Due to the ex-post nature of economic measures, there is an inherent lag in obtaining data from the Government for managers to use in trying to interpret economic conditions. Not surprisingly, one of the primary hurdles for managers is in recognizing that a recession is underway in their industry. The evaluation problems are further complicated by the geographical variability of a recession. Recessions do not occur everywhere simultaneously.

A manager's recognition of unusual economic patterns and changes can be the difference between success and failure. In the late 1980's, those who failed to detect slow growth in the service sector, the saturated real estate market, the regulatory problems in the banking system, and the increasing consumer debt ratio found themselves less prepared than their economically attuned competitors to cope with the economic downturn of 1991.

INFLUENCES OF GOVERNMENT POLICY

To minimize the severity and duration of recessions, the US government relies on monetary and fiscal policy. The government is dependent on the implementation of economic policies to reduce the impact of recession by encouraging investment and economic growth, thereby reconfirming long-run economic stability.

Taxes allow the government to fund spending initiatives, thus funneling capital back into the business community through government spending. Savings held by financial institutions allow businesses to grow by providing funds for investment. Both government spending and investment stimulate business productivity and growth, leading to increased profits, income, and possibly employment.

The goal of both fiscal and monetary policy is to maintain a balance between aggregate demand and production capacity by inducing business and consumers to alter their spending habits. Government policies reflect the fact that even a relatively small fluctuation in the business cycle can greatly increase or decrease the influence of any other factor as the fluctuation's impact works its way through the money flow. With fiscal policy, the government adjusts personal and business taxes as well as government spending to influence the spending patterns of business and consumers. The Federal Reserve influences interest rates and controls monetary policy, which impact business and consumer behavior.

Fiscal Policy

Fiscal policy, determined by the President and Congress, can moderate or stimulate demand and provide incentives to work, save, and invest. Fiscal policy focuses specifically on government outlays or tax issues and is implemented either through automatic stabilizers or discretionary policy.

Automatic stabilizers are built-in mechanisms in the economy, put in place by the government to reduce the amount by which output will be impacted by changes in autonomous spending. Specifically, they act as economic buffers by automatically reducing taxes and increasing transfer payments, and they are an integral part of the government's overall fiscal policy.

An important automatic stabilizer in the US economy is the progressive income tax. One impact of the recession is that real wages decline. With a flat tax rate, this decline in real wages directly decreases individuals' ability to consume and decreases aggregate demand. Decreased consumption can intensify recessionary pressures by leading to an eventual decline in output and employment. As the Bush administration argues, with a progressive tax rate, aggregate demand is less likely to falter with fluctuations in the business cycle because taxes contract with a weakening in the real wages, thus preserving purchasing power.

Managers should consider the implications of the 2001 tax cut plan on their company and its effect in stimulating business activity. The Bush Administration program, with its across-the-board rate reductions, was useful in putting dollars directly into the hands of consumers. Individual taxpayers received a one-time $300 check from the government to re-energize spending. The initial, retroactive tax cuts were especially beneficial for business since taxpayers received tax refunds by mid 2001. Tax rate reductions will continue in subsequent years. All but the bottom tax bracket will drop by three percentage points over the next five years, and the top bracket will be cut by 4.6 percentage points. Thus, Bush's ten year, $1.35 trillion program provided some immediate tax relief designed to stimulate the economy, with most of its anti-recession effects expected long after the 2001 threat is over.

Another great-for-business option would be an immediate lowering of federal withholding from paychecks since workers would see more money in their paychecks. The larger the withholding cut, the better for business. Small tax cuts are often used by middle-income taxpayers to pay down high levels of debt rather than to make consumer purchases. Managers also want to watch for the size of any tax increases.

An increase in transfer payments is a second type of stabilizer. These include such government spending programs as unemployment compensation, food stamps, welfare programs, and Medicaid. Transfer payments are designed to reduce fluctuations in aggregate demand and automatically increase with a decline in real wages. With the implementation of automatic stabilizers, personal disposable income actually rises relative to GDP during a recession, because transfer payments increase while total income taxes collected are reduced.

While the goal of automatic stabilizers is to maintain a stable level of aggregate demand, they cannot be used too extensively without negatively affecting the overall performance of the economy. Heavy reliance on stabilizers can lead to a long-run increase in the federal budget deficit. The potential dangers of this problem were compounded by the 1990 revisions to the Gramm-Rudman-Hollings balanced budget law that allow an even higher federal budget deficit target when the economy falters (Berry, 1991).

The presence of automatic stabilizers benefits business by sustaining consumer demand. However, stabilizers only serve to cushion the impact of recessionary pressures. In the trough of the 1990-1991 recession, one-fourth of the households reported being more deliberate in their purchases and more sensitive to price. Because of increased anxiety that they felt when purchasing, consumers also forewent or delayed purchases (Goodell & Martin, 1992). Similarly, businesses that alter their own spending plans are better positioned to weather recession-prompted decreases in consumer spending. A final consideration is that automatic stabilizers become less effective with an increased budget deficit.

Fiscal and Monetary Policy

Stabilizers must be supplemented with comprehensive fiscal and monetary policy to reduce the impact of a recession more fully. Increasing government spending and cutting taxes are useful policy options. Government spending on such issues as health, education, roads, and technology are all effective methods of reducing the impact of recession by funneling government funds into the private sector. Tax cut targets include capital gains taxes and investment tax credits.

A cut in the "capital gains tax" is one way the government can reduce the impact of recession by stimulating private investment and employment. With lower capital gains taxes, investors realize capital gains more frequently on stocks and assets because they are less affect by any tax implications.

A temporary investment tax credit is another effective measure for stimulating economic growth and reducing the impact of a recession by encouraging businesses to invest in new equipment. It produces a short-run increase in investment spending currently planned and encourages unplanned expenditures (Murray, 1991).

Investment tax credits and capital gains tax cuts are both important to business. In their absence, many firms cut spending on R&D and product innovation during recessionary times, making recovery more difficult. Consequently, to reduce the impact of an economic recession, decreasing taxes and increasing government spending can be effective short-run tactics. However, they can also compromise the long-run viability of the economy by increasing the federal budget deficit. For example, because of the US's large budget deficit, federal government purchases and transfers did not increase as dramatically during the recovery of the 1991-92 recession as they had in past recoveries (The Economic Report of the President, 1993). Partially as a result, the recovery was the slowest on record.

Monetary Policy

The Federal Reserve, a quasi-independent federal agency, controls monetary policy through open-market operations that adjust the money supply and interest rates. These actions directly impact output and inflation. Business and consumers are particularly responsive to changes in the interest rate. A small decrease in interest rates has the potential to result in large increases in output and consumer income.

Monetary policy can be "expansionary" or "tight." Expansionary policies aggregate demand by increasing the money supply, which leads to lower short-run interest rates. Lower interest rates stimulate business and individual investment, output, income, and spending. Investment in interest-rate-sensitive sectors such as banks and utilities also tend to jump favorably from decreases in interesting rates.

Tight monetary policy is designed to control inflation. If economic growth exceeds the Fed's target of approximately 2.5%, action is taken to slow the growth. A decrease in the money supply increases interest rates. Therefore, consumers are more inclined to reduce consumption and increase savings. Obviously, decreases in spending impact business greatly. With purchases down, inventory levels rise, leading to excess supply and disequilibria. Consequently, firms will decrease production and supply, negatively influencing growth.

Monetary verses Fiscal Policy

To reduce the impact of the recession, total spending must be stimulated. Monetary growth aimed at the reduction of long-run inflation is usually more effective than changes in fiscal policy. Fiscal policy alone is discouraged because increased government spending and tax cuts provide only short-run solutions and can lead to increased deficits in the long run.

Consumer opinion also favors a less intense use of fiscal policy. A 1990 consumer poll found that only one in four of those surveyed favored increased government spending to reduce the impact of the recession. In contrast, two-thirds advocated no increase in government spending (Wessel, 1990).

Timing Issues

The timing of the impacts of fiscal and monetary policy varies because of the type of policy that is used and because of several lags that are inherent in the system. Policies are either rules-based or discretionary. A policy is "rules based" when it has previously been determined and is set in motion at a predetermined date or economic performance trigger point. Automatic stabilizers are a good example. On the other hand, discretionary policies invite substantial discussion and debate before implementation. Therefore, discretionary fiscal and monetary policy can be delayed due to lags between problem recognition, policy formulation, and economic response. To the extent feasible, managers who try to anticipate an economic recovery must take these lags into account.

With discretionary fiscal policy, the actual influence of a policy decision is not felt right away; there is a time lag. The time between when an economic disturbance occurs and when policy makers realize the need for action is a "recognition lag." Information about the state of the economy must be gathered and economists must try to determine precisely what is happening concurrently to capital formation, unemployment, changes in prices, and other economic performance indicators. Problematically, accurate information about the entire economy often lags actual performance for months. In other words, the government can rarely inform private sector managers that the economy is in a serious decline until several months after the slide has begun. Studies of policy making have identified the average recognition lag to be five months. This lag is shorter when the need is for expansionary policy and longer when restrictive policy is dictated.

The "policy formulation" lag is the time between the recognition of the need for action and the actual policy decision. This lag can be especially long for changes in fiscal policy involving tax laws meant to stabilize the economy. For example, the approval process for fiscal policy can include debate by both houses of the Congress, often a long and arduous process.

Monetary policy typically does not suffer from a policy formulation lag because the Board of Governors of Federal Reserve System meets thirteen times a year and can almost instantaneously put into effect upon which any policy it decides. Once the policy action has been taken, however, there remains one final delay, the "distributive lag." The effects of the increased government spending take time to work. Similarly, the effect lag of fiscal policy change can be distributed over a period of several years. Such variability in the length of distributive lags creates inherent problems in trying to stabilize the economy.

Consumer Expectations

Consumer and business expectations can greatly influence the effectiveness of fiscal and monetary policy. Fiscal policy can affect behavior by changing the consumers' level of disposable income. However, if consumers and businesses view this change as temporary, as should be the case with a tax surcharge, behavior will be affected less dramatically. Similarly, if the policy is not viewed as immediately important, as might occur with a tax investment incentive, business will have little motivation to invest during a period of declining growth. Additionally, when the federal government's deficit is large, consumers view tax cuts as temporary and do not change their spending (The Economic Report of the President, 1993).

Global Considerations

A decrease in the US interest rate can positively impact the trade balance. Low interest rates stimulate a capital outflow because investors will move their investments from the U.S to take advantage of higher returns in other countries. Falling demand for dollars by investors decreases the currency's relative value. A depreciation of the exchange rate makes US goods less expensive compared with foreign goods, shifting demand toward US domestic goods by increasing exports as well as discouraging consumers to substitute more expensive imports. These changes in consumer behavior positively impact domestic producers, leading to an increase in output and income. Thus, the government's recession policies impact consumer spending and interest rates impact trade and capital flows, directly influencing the well being of the economy.

Actions of the Federal Reserve

The Federal Reserve Bank of the United States occupies a unique position in the US economy. The Fed's goal for the US economy is to prevent inflation and promote long-term price stability as a strategy for achieving maximum long-run economic growth. The Fed acts on the economy by manipulating the Federal Funds Rate, the Required Reserve Ratio, and by selling and purchasing

Treasury securities. Whether the actions have the desired effects is determined by the subsequent responses of banks, businesses, and consumers.

A major problem for the Fed is the difficulty involved in measuring and analyzing the health and direction of the economy. The complexity of the economic environment makes it difficult for the Fed to know exactly what effect its actions will have on institutions, businesses, and individuals. Thus, the Fed indicates what it would like to see happen, adjusts a variable under its control, and waits to see the results.

It is useful for managers to have a sense of the mentality of the Federal Reserve. The Fed is dominated by "inflation hawks," led since August 1987 by Chairman Alan Greenspan. The inflation hawks believe that low inflation is the most important factor in fostering long-term price stability and growth in real output. Committee members often reconcile the two policy objectives by viewing price stability as a long-run goal and sustained real output growth as a short run goal.

The Fed also monitors the possibility of recession by analyzing key economic data - such as housing starts, consumer spending, and producer prices. At the sign of a downturn, like zero growth in the money supply, the Fed will consider action. Any policy decision is based on several factors, many of which are long-term, consistent with the Fed's stated willingness to forsake short-term economic booms to promote long-term stability.

Of the four main tools that the Fed has at its disposal - policy directives, Federal Funds Rate, M2 segment of the money supply, and total reserves held by banks - it tends to rely on two when an economic downturn threatens. The option that receives the most press attention is a lowering of the Federal Funds rate, the rate at which banks borrow funds from the Fed. Lowering this rate is intended to lower other interest rates and in turn spur lending, investment, and housing starts. Although the Fed cannot directly set interest rates, banks almost universally follow the Fed's lead as signaled by reductions in the Federal Funds rate.

The Fed cuts interest rates when the economy shows signs of decline. Lower rates decrease the cost of capital for businesses, thereby improving profit margins and encouraging expansion. Simultaneously, lower interest rates spur economic activity by encouraging consumer spending, particularly on mortgages. Finally, lower interest rates tend to have a positive effect on stock prices by improving the attractiveness in comparison to bonds and other fixed-income investments. In January 2001, the Fed cut interest rates by a full percentage point in an attempt to stave-off a recession. It was the biggest rate reduction in a single month in Greenspan's 13-year tenure as Fed Chairman. The federal funds rate was reduced in June 2001, by one-quarter point to 3.75%. This is the lowest of short-term market interest rates because it is the rate that banks charge each other on overnight loans. The Fed sets this rate by buying or selling government securities until the target level is achieved.1

The Fed's second high profile option is to lower the reserve ratio, the percentage of holdings that banks are required to keep in their accounts. This action is intended to promote lending and investment. Again, the Fed cannot directly control the flow of funds out of banks and into the hands of consumers and businesses, but can make the lending environment more receptive to borrowers. Additionally, increasing the money supply creates the possibility for inflation.

The advisability of either of these options presumes that inflation is not causing the downturn. In inflationary situations, the actions taken would be opposite. For example, if the inflation rate is high, the Fed might raise the Federal Funds rate to tighten the money supply in an attempt to introduce price stability.

The Fed's Impact on Business Plans

As shown in the experiences of prior recessions, the actions of the Federal Reserve can have a great impact on the viability of business plans. Therefore, it is important for managers to observe and understand certain things about the Fed:

1.	The Fed has direct and indirect impacts on interest rates. If managers watch the Fed, they can better track the course of interest rates over the short term, which may help them to anticipate their future cost of capital.
2.	Fed actions affect currency exchange rates. In 1990, American banks lost capital to foreign banks, as investors moved funds out of the country to take advantage of higher interest rates overseas and in response to predictions of a weakening dollar. Over the succeeding months, evidence mounted that companies dependent on foreign investment had good

	reason to be concerned about the effects of Fed action on interest rates and the value of the US dollar.
3.	The composition of the Federal Reserve Board of Governors is critically important. Personalities played a strong role in the 1990-1991 recession. Alan Greenspan's independent attitude shaped and shapes many Fed's actions. As a result, the Fed continues to have keeping inflation in check as a priority to goal.

EMERGING FROM RECESSION

Government initiatives, Federal Reserve Board actions, and monetary policy all impact managers' decisions during economic recovery from a recession. The Federal Reserve Board cut interest rates 18 times in attempting to accelerate the recovery from the 1990-1991 recession. These low short-term interest rates made borrowing more attractive, and thus increased sales for manufacturers. For example, the automobile industry reached a strong annual rate of 7.5 million cars in June 1992 after Ford and General Motors reported combined losses in the first quarter of 1991 of more than $2 billion.

Simultaneously, low interest rates encouraged corporations to streamline their balance sheets by removing high debt payments and replacing them with lower payments. For example, in 1992, Carnival Cruise Lines called a zero-coupon convertible paying an interest rate of 7.5% and replaced it with some bank borrowing and a $100 million convertible paying 4.5% interest.

Ryder System, one of the nation's largest truck rental and leasing companies, took advantage of favorable interest rates prompted by the recession to reduce its debt by $1.2 billion between 1990 and 1992. By decreasing the debt on its balance sheet, Ryder managers could focus on the long-term and begin to determine the best future use of their companies' assets.

Managers should look for a valuable but initially counter intuitive government action to help business recover from a recession - the government may raise taxes on individuals and corporations. The impact of these taxes at first would appear to reduce consumer income, and thus lower business cash flows, but in reality, the opposite is true. When consumer spending is dampened, worries about inflation decrease along with the need to raise interest rates. Therefore, critically important long-term interest rates to businesses are kept low.

Businesses then begin to increase their capital spending, which over time generates more cash flow than would a slight, brief surge in consumer spending.

Managers' decisions during a recovery are also affected by the response of financial institutions to changes in interest rates. After recessions, many banks are extremely cautious about extending business loans. Opting for lower risk, they invest in default-free government securities. In 1992, commercial banks cut back on their commercial and industrial loans to businesses by $28 billion, while they invested more than $115 billion in US Treasury securities.

Managers must also be watchful for the tendency of financial institutions to slash the rate they pay depositors while scarcely lowering their lending rates to borrowers. Certificates of deposit that were paying 7.0% interest before the 1990-1991 recession were only paying about to 3.0% in 1992. Such actions by banks lead to a decrease in disposable income for those who depended on their savings. With lower discretionary funds, these consumers shied away from corporate stock investments.

GOVERNMENT ALWAYS PLAYS A ROLE

The actions of the Federal Government profoundly impact the formation, duration, and reversal of an economic downturn. While it is an overstatement to claim that the Government can mandate change, it is true that Government action exerts the single greatest influence on the speed and severity of the contraction stage of the business cycle. Therefore, as managers improve their ability to anticipate major Government actions, they simultaneously heightened their ability to implement altered business strategies that best position their firms to deal with the vagaries of a recession.

Managers who have thoroughly considered the impact of a recession and of the fiscal and monetary policy responses that the President, Congress and the Federal Reserve Board have available are better prepared to benefit from the opportunities that such policies and actions provide. Further, while responses to past recessions are only modest predictors of future actions, the general dynamics of recessions are clear. Thus, the advantage before, during, and after a recession goes to the action-oriented managers who understand the nature, motivation and likely consequences of government action.

NOTES

[1] An option that is occasionally mentioned involves lowering the discount rate. It was reduced on October 2, 2001, for the ninth time in nine months to 2.00%. The discount rate applies to loans made directly to commercial banks by the Federal Reserve. This rate is generally set one-half percentage point below the federal funds rate. It is not discussed more fully here, because the Fed rarely makes such loans, and thus the discount rate is considered largely symbolic.

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