It's been an interesting few months here in Lake Wobegon. The lunch bunch at the Chatterbox Café was hospitalized briefly – seems they came down with *e coli* from the meat loaf special. And Pastor Lindquist was almost forced to step down after two members of the fellowship youth were caught with a bottle of peach schnapps on the group's annual overnighter in the Twin Cities.

Wait; wrong intro. This is Santa Monica, where all the children really are above average. And the publication is the *Milken Institute Review*, your quarterly feast of economic policy. In this issue:

Larry Kotlikoff of Boston University lays out the long-term fiscal consequences of tax cuts combined with hefty new government obligations.

"With the new drug benefit," Kotlikoff writes, "the fiscal gap now totals roughly $51 trillion. Roughly speaking, that's five times the United States' GDP and – perhaps most chilling – far larger than total U.S. private wealth."

"Coming up with $51 trillion through any means will be extraordinarily unpleasant," he adds. "One way would be to raise federal personal and corporate income taxes immediately and permanently by 78 percent. Another option would be to cut all Social Security and Medicare benefits in half."

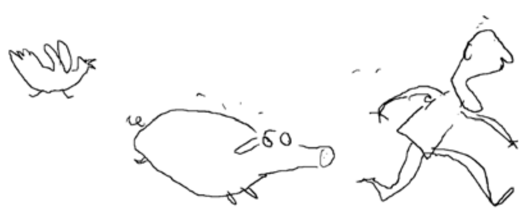
Catherine Mann of the Institute for International Economics in Washington explains how America's ballooning trade deficit is likely to affect global economic stability and prosperity.

"Several factors point to the reality that other countries have a vested interest in large and chronic U.S. trade deficits – that the U.S. deficit persistence is linked to global co-dependency," she writes. They have made "a bargain with the devil in the sense that when their own currencies eventually do appreciate, not only will their exports fall, but so, too, will the value of the dollar-denominated assets in their portfolios."

Robert Barro and **Rachel McCleary** of Harvard take a new look at a very old debate: the relationship between economic growth and organized religion.

"The main impact of religion on growth is a positive response to an increase in believing relative to belonging (attending)," they write. "We conjecture that religious beliefs stimulate growth because they help to sustain aspects of individual behavior – honesty, thrift, work ethic – that enhance productivity."

"Note that our statistical estimates do not imply that greater church attendance has a net negative influence on economic growth.



SERGE BLOCH

Rather, the net effect depends on the extent to which an increase in attendance leads to stronger beliefs. Having many religious holidays or requiring congregants to attend services does not necessarily translate into more believers."

WILLIAM RIESER

John Crudele, an economics writer for *The New York Post* and **Walter Williams**, an independent economic consultant, offer a novel way to supplement fiscal and monetary stimulus in an era of mega-deficits.

"In addition to cutting interest rates or taxes," they suggest, "Washington could offer people limited-time-only access to their retirement savings accounts without penalties or tax consequences. This would augment private spending when the economy needs it, increasing demand directly for consumer goods and indirectly for new productive capacity."

Jared Bernstein of the Economic Policy Institute in Washington gets up close and personal with the living wage movement – the grassroots effort to raise minimum wages to the level needed to support a family.

"Living wage provisions are now in effect in more than 100 cities, counties and other entities, such as universities, and the pace of adoption seems to be accelerating," he notes.

"By remaining limited in their coverage, their advocates have been able to convince city officials – and by proxy, taxpayers – that they will accomplish their stated goals without leading to significant layoffs, tax hikes or reduced competition for contracts.… But the marginal coverage of the policy limits its impact to raising the living standards of a tiny fraction of America's working poor."

John F. McDonald, an economist and dean at the University of Illinois's Chicago campus, takes on the fashionable view that American society is going to hell in a handbasket.

"Yes, the decade of supercharged economic growth and vanishing unemployment seems a distant dream," he writes. "But, believe it or not, many of the social and economic challenges that seemed so formidable a few decades ago are becoming more manageable. And – dare I say it – the liberal dream of progress in America is alive and well."

Jim Barth and **Rob Koepp** of the Milken Institute, writing with **Zhongfei Zhou** of Shanghai University, offer a progress report on long overdue bank reform in China.

"Lately it has become fashionable to predict that China's non-performing loan problem will gradually eat away at the economy's performance. While critics are right to be concerned, they ignore the potential upside from successful banking reforms. Indeed, we believe that China's banking sector has the potential to catalyze the next steps in the economy's ongoing transformation."

And don't forget the extras – an idea from Nobel Prize-winning economist **Gary Becker** on how to shorten the pipeline to life-saving pharmaceuticals, an excerpt from journalist **Matt Miller**'s book, *The Two Percent Solution*, and a charticle from the Institute's very own demographer, **Bill Frey**. Happy reading.

— Peter Passell