

The Political Forum

*A review of social and political trends and events
impacting the world's financial markets*

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THEY SAID IT

“Nobody in their right mind would buy a factory or buy a car if someone is going to drop anthrax on your head.”

John Rutledge, Chairman of Rutledge Research, as quoted in a *Washington Post* article dated February 25, and entitled “In U.S. Plants and Wallets, The Other Iraq Standoff.”

WELCOME STEVE SOUKUP: As noted in the announcement sent earlier today, having Steve on board will allow The Political Forum to cover a variety of sector-related issues, as well as greatly expand and reinvigorate the social and political commentary output. For the past two years Steve has been with Lehman Brothers’ Washington Research office, where he covered political and geopolitical developments, regulatory policy in the energy and agriculture sectors, and asbestos litigation reform.

A primer on the complicated issue of asbestos litigation will comprise a section of the newsletter today. In the not to distant future, we plan to have a new publication, published occasionally (when circumstances merit), that will address a host of sector-specific issues. In the meantime, we will include this coverage in the newsletter.

SOME THOUGHTS ON IRAQ AND THE “WAR ON TERROR.” Like most Americans, I have, over the past six months or so, spent many hours watching a seemingly endless stream of talking heads, “experts” of one kind or another, “ordinary” citizens, and more foreigners than you can shake a stick at, discussing the whys and wherefores of America’s complaint against Iraq.

During this process, I have heard one theory after another about a host of related issues, some that make sense, some that don’t, and some so dumb it makes you wonder where program directors find these people.

Relative to this last crowd, the theory that I find the most amusing is the one that holds that Saddam is “skillfully manipulating” the United Nations inspection process; expertly working the system to delay America’s proposed military attack past the time when it can fight in good

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weather, and possibly forcing President Bush to give up the idea entirely because the rest of the world is convinced, as a result of Saddam's "expert public relations skills," that he can be disarmed peacefully.

I think a better case could be made that it is President Bush who is "skillfully manipulating" the inspection process. I don't know this for sure, of course, but suppose that sometime early last fall, when the decision was made to go ahead with the military operation, someone questioned what was going to happen during the five or six months that it would take to get all the necessary troops in place over there and to get permission from the various neighboring countries to use their bases to launch the attack.

"Would Saddam be dumb enough just to sit on his hands and wait while America prepared to attack him, like he did the last time?" "Wouldn't a massive, global anti-war movement materialize that could make the whole buildup a public relations nightmare?" "I mean, what are we going to do and say during that long period while we're getting ready?"

Suppose President Bush said, in response to these concerns, "We'll focus all this negative energy on the U.N. 'peace process.'" First we'll say that we don't intend to attack Saddam but that we need some troops over there 'just in case.' And we'll send some. Then we'll say that negotiations only work if there is a credible threat of military action. And we'll send some more. And then we'll get the entire debate moved to the U.N., and focus the world's attention on a long-winded discussion about the "arms inspection process." And then, when we finally get all the troops in place, we'll attack."

Suppose he then said something like, "Saddam will talk with those two socialist morons that run France and Germany, expecting them to bail him out of this mess, while we're surrounding him with our military, infiltrating special forces into his countryside, bombing his antiaircraft installations under the auspices of 'policing the no-fly zones,' getting regular reports from the U.N. inspectors about his defenses, and demoralizing his political inner-circle as well as his military high command with endless uncertainties about their fate should they be captured in the aftermath of the war."

Indeed, Bush might add that, "If we can pull this off, the fact that he is about to die won't sink into Saddam's thick head until it is too late for him to do anything about it except complain that his buddies the French and the Germans had let him down and advise the citizens of Iraq to get a shovel and dig trenches in their gardens in which to hide when the shooting starts.

Now I certainly don't know if this scenario is credible. But I would argue that it makes more sense than the opposing one, which gives Saddam credit for being a cool, calculating, "master of deception." In fact, my guess is that right now "the butcher of Baghdad" more closely resembles Hitler in the final days, when his "most trusted" associates would pretend that he was sane when in his presence, while working on plans to hightail it to Brazil as quickly as possible when he was finally dead.

The implication of my scenario is, of course, that the military action against Iraq is an integral part of a long-term strategic plan, which was formulated months ago with clear goals in mind and set within a framework of a very specific worldview. A corollary is that everything that has

happened in the United Nations and Iraq since the plan was formed was without meaning. Another corollary is that President Bush's critics are correct when they charge that he doesn't give a damn what the rest of the world thinks.

And this brings up another theory that is being kicked around a lot lately in the media, namely that Bush's single minded determination to rid the Middle East of Saddam is not related exclusively to American security, as he keeps saying in his speeches; that it is evidence instead that Bush is being driven by a dangerous, messianic, Wilsonian-like view that America has some sort a God-given destiny to make the world a better place for everyone, and that he has been "chosen" to lead the way.

There is no question that Bush feeds this speculation with his frequent references to his religious beliefs and his dualistic view of the world. And last week in the aforementioned AEI speech, he fanned these flames even more when he spoke of his grandiose intentions "to transform that vital region, by bringing hope and progress into the lives of millions," and of his contention that "the world has a clear interest in the spread of Democratic values."

But I would argue that the real motivation for all this Wilsonian-like hype is window dressing for an historically unprecedented geopolitical move by the United States, namely to initiate the first action in Bush's new doctrine of preemption.

Now I don't doubt that Bush means it when he says that he would like to provide freedom and democracy and all that good stuff to the Iraqi people after he kills Saddam. But in my opinion, George Bush is no Woodrow Wilson, with stars in his eyes about being chosen by God to create a world government. And he is no Hillary Clinton, who once told the *Washington Post* about her "burning desire to make the world around me—kind of going out in concentric circles—better for everybody."

Bush is a devout Christian and therefore believes that "evil" exists in the world. And he is a highly competitive and aggressive individual, a former F-102 fighter pilot, part owner of a major league baseball team, and the winner of a close, highly contentious fight for the most powerful political office in the world. So it should not surprise anyone that he feels both an obligation and an inclination to act against evil when he sees it and has the means to do something about it.

But that is a far cry from setting a deliberate course of "nation building" around the world. I think he meant it when he said the following in answer to a question during the campaign: "I think what we need to do is convince people who live in the lands they live in to build the nations. Maybe I'm missing something here. I mean, we're going to have kind of a nation-building corps from America? Absolutely not."

The good thing is that even if I'm wrong, and Bush somehow gets seduced by some of the avowed "nation builders" in his administration, I don't think he would get very far. The problems that he will face just keeping order in a post-Saddam Iraq should stifle any desire he might harbor for constructing utopian societies out of medieval clay.

And finally, I'd like to say a few words about those commentators who have a tendency to divide the world of Islam into two camps: those who side with al Qaeda and those who side with the

United States. It would be nice if everything were that simple. But the fact is that there are many Muslims who hate the United States, and are actively engaged in efforts to injure its people and its interests, who weren't all that pleased when Osama and his thugs attacked America on September 11.

Surely they enjoyed the spectacle of a lot of "infidels" dying, and reveled in the fact that the Muslim world finally "did something" to injure the "great Satan." But when the dust settled, many groups and individuals must have wondered why these madmen had chosen to both wake and anger the sleeping giant, and in doing so disrupt their longer term plans to establish a Muslim network within America that could raise money to fight Israel, gain political power to help undermine American support for Israel, and establish a solid terrorist network within the borders of the United States that could someday sustain a lengthy attack on the nation's infrastructure.

One wonders, for example, what Sami al-Arian, the former University of South Florida professor who was arrested recently, thinks of the brouhaha stirred up by Osama. Al-Arian was living the good life in America, and, according to many observers, including our own Justice Department, helping to establish an elaborate, nationwide fundraising effort for terrorist activities aimed at Israel and spreading Islamist poison throughout the American Muslim community. At the same time, his children were being educated at American colleges. Such a deal.

The only real threat to Sami's world was Steve Emerson, who identified him as a dangerous criminal a decade ago. But Sami was holding his own against Emerson, with a lot of help from a host of radical Muslim organizations, such as the American Muslim Council (AMC) and the Council on American-Islamic Relations, (CAIR), until September 11, when Americans were awakened to the fact that Steve had been right all along.

And, of course, one wonders how Saddam feels. He too was holding his own against the United States too until September 11; building his stocks of chemical and biological weapons and merrily working on gaining access to nuclear materials, dreaming of the day when he could hold America and Israel hostage to his power. And along came Osama. And the next thing you know, Saddam is a few weeks away from becoming a martyr. Peace be upon him.

I mention this to emphasize a point that I think is worth remembering while considering the help America is getting from some Islamic governments in capturing al Qaeda operatives. Not all of those of who are helping are true friends of America. Some are just pursuing alternative plans to undermine its interests.

ASBESTOS LITIGATION REFORM: CAUTIOUS OPTIMISM. There is no question that asbestos litigation and associated runaway claims, bankruptcies, and economic damage have become a serious concern for the markets. I have been tracking the issue closely for some time and believe that the markets have reason to be cautiously optimistic.

In many ways, it is too early in the process to be confident about making a call about the prospects of reform litigation passing this year. But one can't ignore the fact that asbestos has generated considerable political momentum and is mentioned prominently in the agenda items set forth by some very powerful members of Congress. And since we are in the business of

making predictions, I would have to say, if pinned down, that I believe an asbestos litigation reform bill will indeed be enacted into law this year.

Having said that, I should note that the bills that will be considered by both houses have yet to be even introduced, and that there are many other important issues that will likely take precedent over asbestos litigation reform.

When I first began charting the possibilities of federal asbestos litigation reform legislation roughly a year ago, I noted that while the cries for a legislative solution were longstanding (dating back at least to the Supreme Court's ruling in the Georgine settlement) and growing louder, it was unlikely that anything would get done, at least in the 107th Congress.

As for the 108th, I believed that prospects depended in part on the outcome of the elections, though even a Republican sweep (as eventually occurred) would hardly guarantee enactment of legislation. A change in power in the Senate would not, I thought, dramatically increase the likelihood of enactment. The political hurdles would still be high and manifold, and the political power of those opposed to a legislative solution (most notably the plaintiffs' bar and labor unions) was impressive. The issue was in my opinion likely to generate a few headlines, but unlikely to produce a solution.

But a funny thing happened last September, something that altered dramatically the way in which most observers look at this issue. That month, Senator Pat Leahy (D-VT), then chairman of the Judiciary Committee and one of the Upper House's most prominent hard-left liberals, held a hearing on the asbestos litigation morass. Moreover, Leahy indicated through staffers that he had come to the conclusion that the issue was one that had to be remedied legislatively. He would, he indicated, be dedicated to the cause of reform, regardless of the outcome of November's elections. This, as they say, changed everything.

The hearing was purely informational; not an examination of proposed legislation. And despite Leahy's professed interest in finding a solution, it remained highly unlikely that the chairman's vision of "reform" would ever be anything like the far-reaching bills introduced in the 106th Congress, or like the reform proposals put forth by industry advocates.

Nevertheless, his entry into the debate had a very important emboldening effect on some of his Democratic colleagues. If it was okay for Leahy to take the side of reform, then it was, some reasoned, okay for them to do likewise. Beginning with Leahy's hearing, a number of Democratic Senators, including Herb Kohl (WI) and Ben Nelson (NE) expressed their desire to help broker a legislative solution. Nelson in particular has been heavily involved in the process, and as early as last November he publicly expressed his desire to play a significant role, offering to join with then-incoming Judiciary Chairman Orrin Hatch (R-UT) to author legislation.

But while the Leahy hearing provided early signs of momentum, the GOP sweep in November brought both reason for hope and cause for concern. My belief is that given the momentum for reform, a unified Republican government could well produce the long-anticipated, much-hoped-for solution to the problem. There is, in short, reason for hope.

Since November, I have been cautiously optimistic about the prospects of legislation. All of that said, the GOP sweep is a blade that cuts both ways. It is just as possible that the aforementioned momentum could be squandered by this GOP Congress. The threat to my optimism is Republican overreach.

If the GOP has the sense to pursue asbestos litigation reform as an independent undertaking, the odds are, I believe, rather reasonable that such reform can be passed. If, however, Republicans decide to fold asbestos reform into a push for greater tort reform, the issue becomes an instant loser. Democrats may, for a variety of reasons, be willing to break ranks on asbestos, but the odds are slim indeed that any one of them would wish to slit his or her own political throat by taking on the plaintiffs' lobby over broad tort reform.

Events of the last several weeks demonstrate that asbestos reform remains a white hot political issue. But they provide few definitive signs as to how exactly the debate will play out.

Perhaps the most significant recent development on the asbestos front took place last month when the American Bar Association's (ABA) House of Delegates endorsed a plan limiting asbestos litigants to those who meet specific medical criteria, a move which, by the ABA's own count, would reduce the number of prospective asbestos plaintiffs by 90%. And while the ABA does not speak for all lawyers, and certainly does not speak for those who have been most adamant about maintaining the status quo in asbestos litigation, it is the nation's largest lawyers' group, and, as such, its decisions carry significant weight.

Moreover, the ABA's decision to advocate a legislative solution provides empirical evidence of the split in the plaintiffs' bar between those advocating legislation as a means to ensure that funds will be available to compensate truly sick claimants in the future and those who believe that the system works fine and produces just results as is. This split had previously been merely anecdotal. And this confirms my belief that the reform movement has momentum and provides additional cover for those Democrats wishing to support legislation but are concerned about the perception of choosing big business over sick and dying petitioners.

Also last month, Senator Don Nickles (R-OK), chairman of the Budget Committee, introduced legislation tentatively titled, "A bill to provide for the fair and efficient judicial consideration of personal injury and wrongful death claims arising out of asbestos exposure, to ensure that individuals who suffer harm, now or in the future, from illnesses caused by exposure to asbestos receive compensation for their injuries, and for other purposes." This is the first asbestos-related bill of the new Congress. Nickles' Budget Committee had, several weeks earlier, held a hearing on the state of the economy and the impact of asbestos on the state of the economy. Apparently he was so impressed by what he heard that he decided to sit right down and pen a bill.

Unfortunately for advocates of reform, Nickles' bill appears to be an example of the Republican overreach that could threaten the process. While his legislation does promote the use of medical criteria (as advocated by the ABA), it also strays a bit from the specific topic, delving into such issues as venue shopping and class action reform. And though these issues do indeed have much to do with the asbestos morass, they are, quite likely, too hot (and too broad) for most Democrats to consider seriously. To this end, Nickles' legislation was immediately met with a hailstorm of

criticism from plaintiffs' attorneys groups and other traditionally Democratic constituencies. Among the harshest critics, was the AFL-CIO, which suggested that bill is clearly anti-worker.

The good news is that the Nickles bill was hardly the last one that we will see this session. Indeed, two other bills are likely to be introduced within the next several weeks, and one of these may well strike the delicate and elusive balance between protecting industry and workers, as well as the economy, the markets, et cetera. One may well be introduced by Leahy, who reportedly questions the establishment of medical criteria and favors the formation of a trust to provide for the continuing payment of damages to injured parties. The second will undoubtedly come from Judiciary Chairman Orrin Hatch. And when the committee considers legislation, it will almost certainly consider Hatch's bill first.

Now, specifics of Hatch's plan are not yet available, but given his experience, legal background, and general astuteness, I expect that his bill will be fairly even-handed. Hatch is known to support medical criteria and is said to be working with at least one Democrat to produce a bipartisan product. Some reports say that Hatch and Leahy are working in tandem; others have Hatch working with Nelson of Nebraska. In any case, we should know more later this week, as Hatch's committee is holding a hearing at 11:50 on Wednesday. The hearing is titled, "The Asbestos Litigation Crisis Continues – It is Time for Congress to Act," and like last September's hearing is billed as "informational." (As we go to print, a witness list is not yet available.)

On the House side, Reps. Chris Cannon (R-UT) and Cal Dooley (D-CA) have reportedly emerged as the leaders of the reform movement. They intend to introduce their own bi-partisan bill some time this session. As of now, there are no details available.

Given the rules of the House, though, it would not be a surprise if the bill that is eventually introduced and pushed through committee were more far-reaching than the Senate could stomach. Though it is too early to speculate on how such a development could affect conference negotiations, it is important to remember that the question of "overreach" applies here as well. If House members truly wish to see reform enacted, they will have to remain cognizant of the rules that govern the Senate, the most significant of which dictates that functional control of that body depends on the ability to garner 60 votes to break a filibuster and invoke cloture.

Prior to today, I have been unwilling to make a call as to whether or not legislation will pass. As noted at the start of this piece, this is due in large part to the fact that there are still many unknowns, the most significant of which is the content of the bills that will be considered. I have seen Nickles' bill and believe that it is, as written, unlikely to become law. I have not yet seen any other legislation, though I can guess at what might be included and what might not be. In my opinion, as I said earlier, Hatch's bill is the key to all of this. Stay tuned, the next several weeks will undoubtedly tell us a good deal about whether or not my optimism is justified.

THE POLITICAL FORUM

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From The Sidelines

Publisher Greg A. Smith

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The War and Other Issues

This past week, Fed Chairman Alan Greenspan mentioned that the U.S. faced some difficult issues with social programs as the population ages. He also pointed out that Japan and Europe face even greater problems. But that is only half of it. As I said last week, the big problem will be the sudden and worldwide drop in the birth rate that has occurred. The pool of workers who will have to pay for these aged people's benefits will be smaller than any government agency is now projecting.* But its nice to see that the Fed Chairman is on the same wavelength as I am.

The big issue now at hand is the possibility of war in Iraq. A lot is being said about whether this war has been discounted by the financial markets. It seems to me that investors and traders haven't been showing much confidence or patience. Take retail sales as an example. Several retailers indicated that the snowstorms up and down the east coast were hurting sales. Then several retailers indicated that February sales would be weak and the stocks went down. There are also disappointments in turnarounds, such as HPQ and GPS this past week. But how could there be any turnaround in the current economic climate? The stock reactions are telling me that most people in the stock market have little or no confidence in anything right now. This means that any unexpected news,

good or bad, could have a significant impact on stock and bond prices.

Applying this idea to the potential of a war in Iraq, I would say this. If there is a war and it goes well, which I would define as the price of oil coming down \$5 or more, it probably is very positive for stocks. Very positive could mean a rally of several hundred Dow points. But the 1991 war is probably not a good model beyond the immediate several trading days. Unlike then, the world inventory situation is much worse and the supply situation in key countries such as Venezuela is dicy at best. The key to the longevity of the rally will be how far oil prices fall. Under \$30 a barrel, the U.S. and world economy could get a strong boost by the second half of the year; with companies so cost control focused, the earnings leverage would be sufficient to cause real (not the requisite penny better) surprisingly better earnings.

I believe the current confusion about the economic outlook and the poor performance of virtually all styles of stock picking, has a lot of investors and traders on the sidelines. The equity mutual funds are generally not getting any new money and some still have redemptions, even though this is usually the time of year when retirement account inflows are the heaviest. But the hedge funds probably have lots of cash and some short positions. Individual investors also have lots of cash earning one percent or less.

We probably would see the dollar rise and that would bring money back to the U.S. stock market. We wouldn't need much. The trading volume has dropped with the rise in uncertainty - a few billions of dollars of buying and some short covering against little reason to sell would make for some spectacular moves upward.

What should we buy for this rally? To begin, the anti oil stocks, such as airlines, could go from being perceived as going out of business, to "they might just make it." Tech probably works as institutional investors look for more beta in their portfolios. Consumer cyclicals will work, on the idea that consumer confidence would rise and with it spending. For the equity mutual funds that are not getting any new money, to get more beta and anti oil they will have to swap stocks. So we could see the defensive stocks, including the REITs, go down while the more cyclical high beta stocks go up.

Whether it is just a rally, albeit a spectacular rally, will depend on the the behavior of energy prices as we move beyond the next several weeks. If the low inventories, the problems in Venezuela, and bad weather prevent an important fall in oil prices, say \$10 or so, then the rally is just that and we will return to a difficult market that probably rotates back to bonds and defensive stocks. But wouldn't it be nice to be in a rally that puts the market up for the year, even if its only temporary.

The tension in the financial markets, due to geopolitical problems and the consequential economic damage that is being done, must end in the next several weeks. A recent Gallup poll indicated that about a third of Americans think that the spike up in energy prices has caused economic hardship. Just ask me. I just got my gas and electric bill for February. It is about four times last February, due to an average temperature that is about half that of last year and the rise in fuel prices. Then there is the gasoline price increase. For a little while, it is not so bad, but beyond say March, I will start to lose my sense of humor – and I probably won't be alone.

Just about all modern U.S. economic recessions were caused because the Fed tightened monetary policy in part because of a rise in energy prices. Hopefully, this time is different. But it would be nice not to have to tempt that historical pattern. I still have problems believing that the stock market is priced for the likelihood that long term earnings growth is going to be slower than it has been for the past decade. But I would like to write about that again from higher prices than now.

* see From The Sidelines, *It's all about valuation*, February 21, 2003.

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