

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

“While we are having a debate about diversity and race-based policies, can’t we all agree that no one should be defending nepotism? In one of 4 billion columns attacking President Bush last year, *Times* columnist Maureen Dowd accused him of getting into Yale only because he was a legacy. She sneered at the argument of White House aides that Bush also earned a degree from Harvard Business School though no Bush family member went there. Dowd responded: ‘They seemed genuinely surprised when told that Harvard would certainly have recognized the surname and wagered on the future success of the person with it.’

“I believe Sulzberger is a pretty well known name, too. The Sulzberger-Ochs dynasty has controlled the *Times* for a century and a half. A college admissions committee would not have to wager on young Pinch’s future success. It was his birthright to run the most powerful newspaper in the world someday. No messy elections could stand in his way. And yet, it appears that Harvard managed to turn *him* down. He was a legacy at Columbia University, but they didn’t want him either. (Those must have been some low SAT scores.) Maureen might want to stay mum on the subject of dumb rich kids, at least for the next three or four decades. . .

“Uday Hussein had more right to be in charge of Iraq’s Olympic committee than Pinch Sulzberger does to be running a newspaper.”

“The Weather’s Great, Wish I Were Here,” Ann Coulter, *Human Events*, May 26, 2003.

GOD BLESS THE CHILD THAT HAS HIS OWN. Fiscal deficits were a big topic for me after I opened the Washington Research office of what was then Prudential-Bache almost 20 years ago. In fact, the deficit problem was the principal topic of the first piece I wrote for Prudential, dated July 13, 1983 and entitled “Hype and Rhetoric on the Potomac.” In it I quoted an unnamed source at OMB (my old friend, the late Edwin Dale) as saying that the “net result”

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of all the budget and tax negotiations that were going on at that time would be “\$200 billion deficits as far as the eye can see.” (Clients can find the piece at: www.thepoliticalforum.com.)

I don't know that I was the first to use this phrase of Ed's, which later became widely popular, but I certainly was *among* the first, as Ed had told me the prior week over lunch at the old *Maison Blanche* restaurant near the White House, that he had just coined it.

In any case, I beat the deficit horse in story after story for the next several years, as did my colleague in those days, Pete Davis, who used to publish monthly deficit tallies from the Treasury Department. Thanks to Pete's work and his excellent contacts on Capitol Hill, my highly pessimistic forecasts on the deficit were very good throughout this period. I also correctly noted that Congress would do nothing on the spending side to stop the red ink, and I offered the insight, which remains true today, that the Republicans were, collectively, just as “fiscally irresponsible” as the Democrats.

On the other hand, my observations as to what the likely consequences of these deficits would be on the future of the U.S. economy were awful. Like many other observers, I argued that they would eventually lead to sky high interest rates, runaway inflation, recession, and, while I can't find the actual quotes to back this up, I probably said they would also cause an epidemic of eczema, hemorrhoids, and halitosis.

I suppose I could maintain even now that these predictions have not yet been proven wrong, on the theory that there is still time for disaster to strike. But I won't do that. I was wrong and that's the bottom line. Like many observers, I didn't see that the “solution” to the deficit problem of that particular period, was economic growth. And I didn't see that this panacea was right around the corner, pushed along by the Reagan tax cuts, the end of the Cold War, and a revolution in technological innovation.

To my credit, I gave up moaning about the potential destructive impact of the deficits quite some time before they had ceased being a blight on the Washington landscape. Like little Jackie Paper, I moved on to other toys and left the deficit dragon to its own devices, and lo, before you could say Honah-Lee, it slipped into its cave, like Puff, and disappeared.

I can't trace my turnabout on this issue with precision, but the impetus for the change certainly had to do with the exuberant optimism of my two senior colleagues at Prudential, Greg Smith and Ed Yardeni, who were early in recognizing that very good times, both for the economy and the financial markets, were right around the corner, and that the deficits were a minor problem at worst and possibly even a short term good thing.

I bring all of this up this week because suddenly I find my self confronted virtually every day with scare stories about the evils of federal deficits similar to those that I penned in the mid-1980s. One of the latest and best examples was a piece from a May 28 article in the *Financial Times* entitled “US Faces Future of Chronic Deficits.”

According to the *Times*, the Bush administration “shelved” a recent study, paid for by the Treasury Department, which foresees “federal budget deficits totaling at least \$44.2 trillion in current U.S. dollars.” The article doesn't provide the time frame assumed in this projection, but

it notes that the study's authors estimate that "closing the gap would require the equivalent of an immediate and permanent 66 per cent across-the-board income tax increase."

It further states that the study's analysis of future deficits "dwarfs previous estimates of the financial challenge facing Washington," adding that the pending deficits are "roughly equivalent to 10 times the publicly held national debt, four years of US economic output or more than 94 percent of all US household assets."

I have no doubt that report has the trend generally correct, i.e., that large fiscal deficits loom ahead in America's future. But I do doubt that the estimates contained in this report will turn out to be accurate. I don't say this because I question either the integrity or the skills of the authors, but because there are so many variables involved in the process that it is hard to believe that any study could get it exactly right.

Accurate long-term projections of economic growth are virtually impossible to make, for example, and yet, as we saw in the 1990s, the health of the economy has much more to do with the size and direction of fiscal deficits than does tax policy. And in keeping with this observation, it seems to me also that deficits of the size projected by this report would prompt reactions by the public, the government, and the financial markets, which would alter the projected course in unexpected ways, for better or for worse.

On the other hand, I know that, just as in the mid-1980s, there is virtually no chance of getting any help whatsoever in the form of spending restraint, either from the White House or from Washington's intrepid legislators, and this applies to both Democrats and Republicans. In fact, as we saw during the Clinton years, improvement in the deficit picture inevitably brings with it big new spending plans by members of both parties.

I have written about this phenomenon many times over the past two decades. I put it this way in a piece I wrote almost a year ago in the July 22, 2002 issue of this newsletter, entitled "Guns and Butter: A Lethal Mix for Republicans:"

I have also watched as Congress began debating whether to spend six thousand zillion, catrillion, boozillion dollars on a free drug plan for seniors, as the Democrats want to do, or just five thousand zillion, catrillion, boozillion as the Republicans want to do.

And I have watched as Washington has spent endless hours arguing over which already-giant, bloated bureaucracy should get the biggest share of the cazillions of new borrowed dollars that will be "needed" to "fight the war on terrorism;" and endless more hours arguing over who should control the purse strings on this money; and precious few hours on whether any of this will actually make any of us safer.

And it has once again occurred to me that while the whole bunch of them are damn fools, the "compassionate," big government Republicans are most especially so.

President Bush told Americans after September 11 that this war "will not be without costs" and "will require sacrifices." Then he ended up asking for just one sacrifice, that being that American taxpayers agree to another orgy of "compassionate" government

spending. Woooo! Guns and butter both! Slather it on! And everyone wonders why the markets are going to hell, while I wonder if Bush didn't miss the opportunity of a lifetime to give several million bureaucrats a generous severance allowance, and put some sanity back into the government.

So, what's up with all of this? Should I panic? Is the end near? Should I buy gold, put it in waterproof, lead boxes and sink them in my bass pond, like the Nazis supposedly did in Lake Geneva? More importantly, should I drag out all my old doom and gloom pieces from the mid-1980s and rerun them as "From the Archives" features?

Frankly, I don't know what to think. But I believe I'll follow the lesson I learned the last time around and watch the markets and the market watchers, instead of going off half cocked on my own. More specifically, I think I'll keep a close eye on my old friend Ed Yardeni's "Bond Vigilantes." When they start driving up interest rates like gangbusters, I'll begin to worry.

In the meantime, my advice to investors and friends alike, most especially the younger ones, is to try not to be holding the bag when the U.S. government eventually devalues itself out of all the debt it is accumulating. Let the Europeans have that honor. And finally, save your money, don't count on Social Security for your retirement needs, and remember the words of the song written by the late great Billie Holiday after her mother turned her down for a small loan, "God Bless the Child that Has His Own."

THE COMING WAR WITH IRAN. So, after a two month respite, the United States is back at war, or, at the very least, will be back at war soon. And this time, the target is Iran.

No, I am not talking here about a "hot" war, the kind that Bush launched against Saddamite Iraq. There will be no-large scale bombing in this war, no mad scramble to Tehran, no embedded journalists, indeed, no guns at all. This war will be different, much different. Indeed, it is possible, and maybe even likely, that when this is all over, military historians will look back on the recent conflict in Iraq as the final war of the twentieth century, and the one against Iran as the first war of the twenty-first.

Before I discuss this new 21st century type of war, let me note that this war has been coming for a very long time. Indeed, it has been a quarter-century in the making. Four presidents prior to the current George Bush have attempted to avoid this conflict, and all any of them have done is to delay the inevitable. And now it's here. It can't be avoided any longer.

This past week, there have been several reports on the recent spate of Iranian treachery that has forced the Bush crowd to begin discussing its options for dealing with the Islamic Republic. The best, earliest, and most comprehensive of these was penned by former Reagan advisor and Iran expert Michael Ledeen for *National Review Online*, in an article dated May 27. The gist of the article is that U.S. intelligence has traced the source of the recent terrorist attack in Saudi Arabia to Al Qaeda operatives currently sheltered by the regime in Iran. He put it thusly:

The operation in Riyadh was planned in Iran by al Qaeda leaders, notably Said bin Laden (Osama's son) and Mohammed Shoghi, whose *nom de guerre* is Abu Khalid Sayef al Adel (which means "the sword of justice"). Three days before the Riyadh

attacks, 17 al Qaeda members were quietly moved to the Sistan and Baluchistan areas at the Pakistan border, hoping to conceal the Iranian connection, but it was uncovered anyway.

This discovery confirms what folks like Ledeen, as well as Mark and I, have been saying for some time now, namely that Iran is both harboring the murderers of American citizens and, recent declarations of détente notwithstanding, is itself still an active participant in the slaughter of “infidels.” This, coupled with increasingly incontrovertible evidence that the Iranians are, through a combination of bribery and coercion, doing their very best to inflame the Shi’ite masses in freshly “liberated” Iraq, makes it unsurprising that this second cog in the axis of evil has suddenly become the object of much consternation within the Bush administration.

Indeed, many of the aforementioned media reports, led by a May 26 *Washington Post* piece, suggest the new intelligence information on Iran has caused the administration to consider reevaluating completely its policy on Iran, and to contemplate severing all diplomatic ties (such as they are) with the Islamic Republic. Though administration sources have denied it, many of the reports indicated that the National Security Council was to have met last Thursday to formalize such plans.

Not surprisingly, many of the stories also suggested that Secretary of Defense Donald Rumsfeld (undoubtedly the unwitting stooge of legendary “neocon” provocateur and Deputy Secretary of Defense Paul Wolfowitz) is the administration figure pushing an acutely more aggressive policy on Iran.

A recent *Financial Times* story, typical of the genre, said the following: “Don Rumsfeld is spearheading efforts to make ‘regime change’ in Iran the official policy goal of the Bush administration.” Of course, all of these stories also begrudgingly concede that Rumsfeld has not actually suggested invading Iran, and that even if the policy of regime change in Iran is adopted, again in the words of *FT*, it “would not necessarily involve military action.”

The problem is that, with a one or two notable exceptions, none of these reports attempts even the most rudimentary explanation of how exactly Team Bush intends to pursue regime change without “military action.” The only piece I saw that even addressed a possible course of action was an ABC News report that indicated that in lieu of direct military engagement, the Bush administration would opt to fight a proxy war, funding the Iranian opposition group the *Mujahedeen e Khalq* (MEK) in its efforts to turn the revolutionary tables on the mullahs. And while such a proxy war may, indeed, be part of the strategy, we doubt that’s all there is to the administration’s plans.

Nearly five years ago, back in the fall of 1998, Mark and I wrote a piece titled “Some Thoughts on Terrorism,” in which we presented a blueprint of what such a war might look like. And while we have no way to know what Bush White House will do, or perhaps is already doing, in Iran, we would suggest that much of what we detailed in that piece will be part of the plan. We wrote:

In the less emotional environment of day-to-day tactical anti-terrorist warfare, the U.S. response [to terrorism] is likely to revolve around highly aggressive covert actions against the military, economic, social and political infrastructures of nations that are

known, from intelligence gathering efforts, to be supporting, either directly or indirectly, anti-American terrorism.

These will include such things as crippling attacks of sabotage on critical infrastructures, such as water supply; electrical grids; communication networks, including telephone, radio and television services; all manner and sorts of computer networks; industrial production facilities, particularly oil and gas drilling operations; and critically needed imports, particularly those related to oil and gas operations, and agricultural production. The severity of damage could range from a total breakdown of electrical power to the incapacitation of a nation's commercial airline by a computer "failure" that destroyed all reservations.

Various other types of economic warfare will also be employed, including counterfeiting; constant transactional disruptions, which make routine international trade difficult or impossible; and the spreading of rumors that cause massive swings in the value of a nation's currency.

In addition, actions aimed at discrediting the influence of political leaders will be employed, such as the counterfeiting of "confidential" documents linking them to salacious or illegal acts, and support for insurgency operations both at home and abroad.

As we also noted in the same piece, terrorism is more than simply a political act, but is, in fact, "a type of warfare." "Indeed," we noted, "it will undoubtedly be the battlefield of choice for U.S. enemies in the 21st century, given America's clear superiority in all aspects of conventional conflict."

By the same measure, the type of aggressive covert activity detailed above is likely to constitute the "battlefield of choice" in the 21st century for the United States, and similarly positioned countries, including Israel and Great Britain. No matter how strong and militarily superior the United States is, it is neither practical nor feasible for it to invade, conquer, and occupy, even temporarily, all of the nations that harbor, support, and fund terrorists.

Even if the United States had the troops in place to maintain order in Iraq while conducting an invasion of Iran, imagine how difficult it would be for President Bush to make the case, either at home or on the global stage, for such an incursion, particularly as the principal justification for the last one remains largely unproven. At this point in time, a full-scale invasion of Iran is nigh on impossible, no matter how deserving of such a fate the regime might be.

And on that point, one should make no mistake about it, the mullahs are more than deserving. First, of course, is the new intelligence confirming Iranian sanction and shelter of Al Qaeda. Then, there are the many new and credible reports that the Iranian regime is quite likely far, far closer to the development and testing of nuclear weapons than had previously been thought. And that's just scratching the surface.

Consider the following, which comes from the U.S. State Department's "Patterns of Global Terrorism, 2001" (the last year available). Keep in mind as you read it that this is *the State*

Department, not the Defense Department or the NSC. These guys are supposed to be the doves of the administration.

Iran remained the most active state sponsor of terrorism in 2001 [emphasis added]. Iran's Islamic Revolutionary Guard Corps (IRGC) and Ministry of Intelligence and Security (MOIS) continued to be involved in the planning and support of terrorist acts and supported a variety of groups that use terrorism to pursue their goals. Although some within Iran would like to end this support, hardliners who hold the reins of power continue to thwart any efforts to moderate these policies. Since the outbreak of the *intifadah*, support has intensified for Palestinian groups that use violence against Israel.

During 2001, Iran sought a high-profile role in encouraging anti-Israeli activity by way of increasing its support for anti-Israeli terrorist groups. Supreme Leader Khamenei continued to refer to Israel as a "cancerous tumor" that must be removed. Matching this rhetoric with action, Iran continued to provide Lebanese Hizballah and the Palestinian rejectionist groups—notably HAMAS, the Palestine Islamic Jihad, and the PFLP-GC—with varying amounts of funding, safe haven, training, and weapons. It also encouraged Hizballah and the rejectionist Palestinian groups to coordinate their planning and to escalate their activities.

And so, what we have in Iran is a regime that is equally, if not more deserving of replacement than was that of the late Saddam Hussein. Yet, there are military and public relations concerns that make traditional invasion and deposition unworkable. But rather than back off its threat to those who support and harbor terrorists, I fully expect the Bush administration to adapt to the situation and undertake a different approach to dispatching one's enemies.

While this approach will utilize some tried and true methodology, (e.g. providing funding and logistical support for opposition groups), it will also almost certainly employ aggressive covert acts that have been routinely studied by Pentagon war planners over the years, and, one can assume, used every once in while in the past in various third world countries in faraway places, like maybe Latin America.

Welcome to the twenty-first century, Ayatollah.

THE TIMES IT IS A CHANGIN'. I have watched with interest as the wide-eyed public has learned that the *New York Times* ain't all that it is cracked up to be, and the only thing that I find surprising about the story is that anyone is surprised.

Now I will admit that I have enjoyed a special vantage point from which to observe the slowly evolving, but highly visible crackup at the *Times*, that being that I never read the thing. But I was for almost two years a regular reader of www.smartertimes.com, which offered a short, daily critique of one or more of the *Times*' stories on that particular day, and which made it apparent, to anyone who was interested, that the *Times*, as far as general news coverage is concerned, was in the process of crashing.

I won't take up space by running any examples here, but I would suggest to anyone who questions the truth of what I am saying to just skim through the archives of this now abandoned website, at http://www.smartertimes.com/archive_index.html.

Given the many alternative sources of news that are available to the general public today, I am not sure that this story makes any difference to anyone whose livelihood is not directly connected to the *Times*. Nevertheless, I think it is worth noting that this is not so much a story about the death of a "great" newspaper, as it is the latest blow to the long-term prospects for liberalism in America.

In this day in age of plebiscitary democracy, ideologies such as liberalism cannot survive and grow without friendly, large, and influential media outlets to continuously hype their "progressive" message to the masses. As the social philosopher Georges Sorel noted in his classic study on socialism, "Reflexions Sur La Violence," the most effective strategy that the left has employed since its founding in the early part of the 19th century has been its ability to create what he called the "social myths," described by Max Eastman as ideas that are not valid, but which are "necessary to set the masses in motion."

The *New York Times* and the also-failing network news shows have arguably been the most effective trumpet in America for these myths, most especially during the past several decades. But the *Times*, at least, appears now to have been hoisted on its own petard of destructive liberal nonsense. And our guess is that the networks won't be far behind.

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