

The Political Forum

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

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WHAT HAPPENS IF . . . ?

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Every four years about this time, economic policy becomes hyper-political. That is to say, the decision-making process becomes very near term oriented, and positions on the issues become more rigid because of heightened partisanship.

This is not necessarily bad. From the hot forge of politics can sometimes come a well-tempered policy. But it can get a bit scary, especially at times like these when partisanship becomes an open challenge rather than an unspoken condition.

President Reagan has thrown down the gauntlet with vigor. He has told Democratic leaders in Congress that he will accept no tax increases before the election and maybe not afterwards. He has said that he will veto any appropriations he considers inappropriate, and that the Democrats will have to take full blame for any shortfall in necessary military spending.

0 The political advantage of this strategy is that it clearly differentiates President Reagan's policies from those of the Democrats. If his program works, he can take full credit. . .

0 The danger is that if the economy derails before the election, Reagan will be hard pressed to enlist Democratic support to save it.

This state of affairs worries many GOP legislators, who wonder whether it might not be more prudent to compromise a little. Lose a battle or two to the Democrats, they counsel, who will then have to shoulder at least some of the blame if the plan fails.

Concern about an economic failure is by no means the majority view among the GOP. But some members *are* worried that the combination of huge deficits and high interest rates might cause the recovery to fizzle before the election.

What happens then, they ask? The answers are not comforting.

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The most common reply from sources close to the administration is that there is no contingency plan for such an event. The President is confident that the economy is rolling along just fine and will be doing even better in November 1984.

But, what happens if it is not?

It is obvious that the fiscal policy tool is blunt, to say the least. Stimulating the economy out of the doldrums with fiscal policy when deficits are in the \$200-billion area is hardly an option.

Of course, the President could try to cut a deal with Congress for an out-year tax increase intended to put the financial markets at ease about the long-term status of the deficits. But there is no certainty that this would work, even if the Democrats would play ball. And as one administration source said, things would have to get to a real crisis point before the President would change his mind on tax increases.

Administration spokesmen seem much more confident about the tool of monetary policy. This does not appear to be because of any secret understanding between the President and Fed Chairman Paul Volcker. Instead, it reflects an apparent view within the White House that no matter how much money Volcker has to pump into the system, he will not allow interest rates to rise so high as to cause a major international monetary crisis to develop.

Whether this is true or not remains to be seen. In any case, it is a decidedly passive tool as far as the administration is concerned.

So, the answer to "What happens if . . . ?" appears to be that the Republicans muddle through, with increasingly short presidential coattails. It's quite a gamble, and the stakes are high.

Perhaps the most disquieting thing to come up in economic conversations around Washington -- whether with Democrats or Republicans -- is the growing belief that perhaps a little inflation would solve our problems.

0 The international monetary situation would ease considerably, we are told, if the Mexicans could just pay us back with cheaper pesos. .

0 The trade deficit would also be aided significantly by a cheaper, devalued dollar, we are told -- and Americans could go back to work making goods for export to our newly solvent LDC friends.

0 Certainly, some members of Congress are saying, the federal deficit would benefit from a little inflation. They recall the good old days, when inflation-spurred receipts kept just ahead of politically popular indexed entitlements.

0 Finally, what about the voters everywhere who are said to be tired of seeing their housing values stagnate and the rate of increase in the rents on their investment properties slow to a crawl.

In fairness, no such talk has emanated from the White House. For the time being, political

strategists there seem intent on making President Reagan's victory over inflation a centerpiece of his reelection campaign.

But, it's a long time until the election, and it's going to be an interesting year.

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FOURTH ARTICLE – GREG SMITH, A LITTLE BIT OF UNPLEASANTNESS

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DR. EDWARD YARDENI – BOND STRIKE

MICHAEL WEISBERG – BLOOD, CALIFORNIA, AND QUALITY

JOSEPH A. FESHBACK – PATIENCE IS A VIRTUE THIS MARKET WILL REWARD