ECONOMIC POLICIES FOR A PROSPEROUS 1990s

ECONOMICS POLICIES FOR THE 1990s

These notes were used by Jerry Jordan for speeches on the following dates:

March 5, 1993
April 13, 1993
April 15, 1993
May 4, 1993
May 10, 1993
June 25, 1993
Economic Policies for a Prosperous 1990s

Bicoastal economy—1980s vs now

Sm indirect bit of evidence—Easter Sunday N.Y. Times --- Houskeeping

Perspective
13-14 years ago
internationally & domestically
-falling apart
-"dunkirk Memorandum"
(retreat in the face of superior forces)

International—1979
Sandinistas, Angola, Iran, Afganistan

Domestic
inflation, Unemployment, interest rates,
$ forex, Stock mkt

NOW
-Cold war over
-articles and conferences:
"Policies for a One Super Power World"

Germany; Japan; French election

Cold War: 70 years, not 45 years (1917)

Contest of Ideas:
-democracy and capitalism
 vs
-dictatorship and socialism

Economic and Political victory,
NOT
Military Victory
[debate: whether or not arms race of 80s necessary; no debate about whether a strong domestic economy was necessary--it was; whether or not it was sufficient, we will never know]

Leadership in the Post-cold war world--
   Setting the right example
demonstration/imitation effect

How we won:
   -inflation
   -marginal tax rates/govt. spending
   -deregulation
   -free trade; strong $

Recent Months
   -equity market
   -bond market
   -$ forex mkt

New thinking: about what used to be called
   -"Countercyclical Stabilization Policies"
     -that is, "pump priming"

--Rejection of the "Phillips curve"
   Fed: "Hawks vs Doves"

--price stability

Role of monetary policy actions after the Gulf War

Conventional Wisdom about fiscal policies
CURRENT ISSUES

PERCEIVED NEED FOR STIMULUS

2 Views of reasons for slow recovery after Gulf War

(1) poised for rebound

- recession caused by "oil shock"; uncertainty related to war; however,

- restrictive monetary policy (M2)
  (M. F., Samuelson, Congress)

(2) 50 mile "headwinds"

- Defense
- Commercial Construction
- Corporate Debt/LBOs
- Consumer Debt
- Banks (credit crunch)
- S & Ls

Monetary policy stimulative

- S - t interest rates
- M 1
FISCAL POLICY

Old view (Conventional Wisdom until about 1980.)

- deficits expansionary (pos. deficit spending multiplier)
- Increase spending ) stimulate
- Cut taxes ) faster growth
- Both )

New view

- deficits depressing
- raise real interest rates
- fuel inflation fears (+ inflation premium in nominal i)
- government borrowing crowds out private investment

Problem:

- reducing the deficit means either cutting spending or raising taxes (or both); actions still viewed as depressing, reducing tax-base, worsening the deficit. thus, "low growth trap"

- Johnson/Nixon:
  - surtax, budget surplus 1969 (20% of GDP)
  - shift in social/political priorities for 1970s
    - cut defense; raise "Great Society"

- Carter:
  - balance budget at 20% of GDP

- 1979:
  - defense = 5% (vs. 10% in Viet Nam)
  - entitlements: 10% (vs 5 1/2% in 1960s)

- Reagan
  2 Theories:
    - Milton Friedman; spending; tax away revenue
    - Art Laffer/Jack Kemp; "self-financing tax cut"

1980 Campaign: balance budget at 19% of GDP

- while increasing defense 2% points (from 5-7)
- would have required reducing entitlements to same share of GDP as 1960; i.e., reverse the "Great Society" welfare state

- by 1989: Full Employment
  \[ E = 21.7\% \quad \text{Deficit} = 2.5\% \]
  \[ R = 19.2\% \]
- **Clinton:**
  - raise tax revenue to reduce deficit
  - lower deficit means lower i
  - lower i means faster growth
  - non-defense spending continues to rise faster than GDP (incl. $38 billion "unspecified further cuts" in FY97)

- Defense spending assumed to fall (w/o details) to level inadequate to meet payroll, military pensions, current facilities;
  - implies: - dramatic cuts in personnel/base closings
  - or, no expenditures on weapons, research and development, etc.

**INFLATION**

- currently low, but people expect it to rise
  - home mortgage refinancing
  - corp debt issuance
  - yield curve
  - consumer/business surveys
  - Blue Chip forecasts
Skepticism

- Phillips curve (Sarbanes)
- inflation good (Business Week, NY Times)
- growth causes inflation
- fiscal dominance
  (deficit)

Costs

- high real i, Investment
- high expected real tax on capital goods
- resources used for inflation hedges
- high real wages (ex-post)
- high business and consumer debt servicing burdens

Cures

FED
ADMINISTRATION
CONGRESS

3/4/93 (JLJ)