

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

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May 4, 1993

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June 25, 1993

Gerry A -
Notes from JJ
San Antonio

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
- M1

FISCAL POLICY

Old view (Conventional Wisdom until about 1980.)

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

New view

- **deficits depressing**
- **raise real interest rates**
- **fuel inflation fears (+ \therefore 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"

Perspective on fiscal problem: 1969, 1979, 1989, 1999

- **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 %

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)