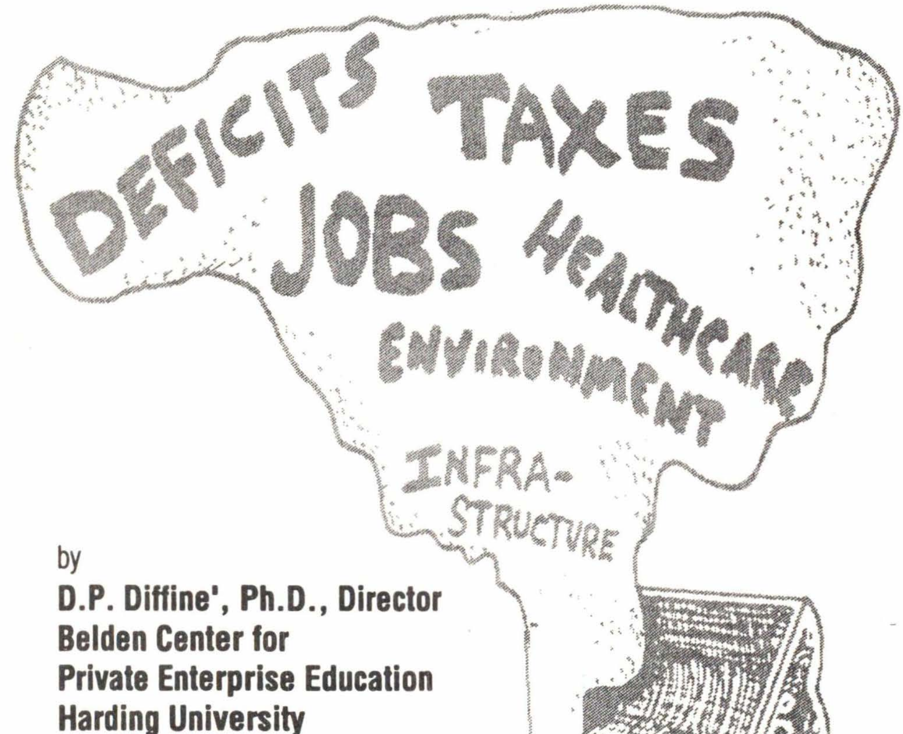
1992

Post Election Economics: The Future is Now

Don P. Diffine Ph.D.
Harding University, ddiffine@harding.edu

POST-ELECTION ECONOMICS

"The Future is Now"



by
D.P. Diffine', Ph.D., Director
Belden Center for
Private Enterprise Education
Harding University
Searcy, Arkansas

A

Commemorative Issue

of

The Entrepreneur

a quarterly journal

of the

Belden Center for
Private Enterprise Education

D. P. Diffine
Harding University
Box 2245
Searcy, Arkansas 72149-0001
(501) 279-4470

POST-ELECTION ECONOMICS

The Future Is Now

by D. P. Diffine, Ph.D., Director
Belden Center for
Private Enterprise Education
and
Senior Research Associate
American Studies Institute

Introduction

According to Greek mythology, Pandora, the first woman on earth, was given gifts by all the gods. One gift was a box which they warned her never to open. Not being able to resist her curiosity, Pandora raised the lid and all of life's troubles, sins, vices, and diseases immediately escaped. Pandora quickly closed the lid, preserving only "hope," mankind's last refuge.

We can be Arkansas-proud to be the home of the President of the United States. Frankly, as we went through the fall 1992 election season, the average American had a basic question about each of the three major candidates. Looking at Mr. Bush's ideas, some wondered how much good they would really do. Mr. Perot's proposals left others wondering how much pain they would cause. Mr. Clinton's positions caused many to ponder how much they would cost.

Beyond that, we are a people of contrasting feelings. We distrust government, and yet we expect more from it. Presidents really can't control the economy very much at all. Would we really want it any other way?

The recession has been worldwide, and we have fared better than most of our major trading partners. Ironically, and this is true for any leader, if he takes the credit for the prosperity, he must also accept the blame for the hard times. Its your basic two-edged sword: when one takes the credit for the sunshine, he must also accept the blame for the rain. In this century, and during an election year, when the economy has been doing poorly or is in decline, the party in the White House has lost control of the White House 75 percent of the time.

No Contest

We can certainly credit President Clinton for doing his homework very well on the 1988 election. Mr. Clinton is to be commended for having the great courage to launch his campaign at a time in 1991 when the Incumbent was exceedingly popular. Mr. Clinton also appealed to a broader cross section of people than did Mr. Bush. It was obvious that Mr. Clinton's campaign got a faster start and was better organized than the rather late and labored effort put forth by the Incumbent.

To many voters, it seemed that Mr. Bush had combined Reagan rhetoric and Carter economics. Many Americans knew that the Election might be over when, during the second debate, Mr. Bush said, "I know the economy is bad." Then he gestured frustratingly toward his wife in the audience and announced in past tense that *"It's too bad that Barbara wasn't running this year--She could have won the election."* There, we saw it--the handwriting on his lips. On balance, the economy wasn't bad by most indicators. More on that later.

Historically, Americans have, more often than not, opted for divided governments: a Congress from one party to serve people's specific interests and a President from another party to guard the frontiers. That has certainly been true for five of the last six presidential elections, Mr. Bush did capably preside over the end of the Cold War. He adeptly restabilized the Mid East. He also superbly brought the NAFTA Treaty to fruition. He has our profound thanks, and we wish him well.

No, George Bush is not Herbert Hoover, and this is not 1932 all over again. There are many differences. Today, federal transfer payments provide a purchasing power "floor" to keep a recession from becoming a depression. The Fed isn't "imploding" the money supply as it did 1928-1932. Interest rates have fallen dramatically.

Today, there are no three-to-five-year mortgages with balloon payments. Investors are diversified today; there is a 50 percent stock market margin requirement, not 10 percent. There is no highly prohibitive tariff today, unlike 1931. Only 20 percent of GNP is vulnerable to the business cycle today (mining and manufacturing), not 44 percent as it was in the 1930's.

Market Reaction

Institutional investors and Main Street Americans do tend to view Presidential candidates differently, and this partially explains the performance of the economy during an election year. Typically when a Republican wins, the business sector views this as a positive thing and the market surges from Election Day to Inaugural Day. Then, the investment community realizes the problems are somewhat real and won't be going away easily, so the market remains in the doldrums over the next calendar year.

Traditionally, when a Democrat wins the White House, the investment community initially reflects the attitude "that things are going into the tank"; the market then declines modestly from Election Day through Inaugural Day. By then, most people notice that the sun rises and sets with great regularity, and that our problems, by world standards, are fairly minor. If history is any indication, the Dow Jones industrial average should then go up in 1993.

In the post-war era, Democratic and Republican presidencies have performed similarly on the average. Averages are deceptive, the Republican average was pulled down as Mr. Bush unfortunately witnessed the slowest four-year period of growth during his watch. The 1980's did bring us a long period of expansion, approximately 20 million new jobs, tax cuts and then tax increases.

Throughout the past decade, federal tax revenue increased about six percent a year at the same time federal spending was growing at about eight percent a year. The deficits are a symptom of that. We are not under-taxed, we are over-spent. It is a R&D problem. By R&D we mean Republican and Democrat.

There is certainly enough blame to go around. Why else would Ross Perot have been so popular? We are a nation of people who are unwilling or unable to balance our checkbooks. The economic recovery was throttled by the fact that there is a lot of debt to be worked through the system: individual and family debt, business and corporate debt, and of course, government debt.

To The Winners

Certainly under the Clinton administration there will be some industries which will be favored through tax breaks, subsidies, and tariff protection. Included on the list would be the hi-tech and bio-tech industries.

Additional groups who would prosper are those in the environmental, recycling, and waste management business, lawyers and accountants, any groups associated with the health care industry that aggressively control costs, and businesses, foreign and domestic, engaged in work on the infrastructure--construction engineering, public works, etc.

What other sectors would benefit from a Clinton presidency and a united government? Most probable candidates would include, starting here at home, Little Rock specifically, and Arkansas, in general. The Clinton presidency will put us on the map, and Arkansas will become a greater and more selective filter for additional federal grants and traditional pork-barrel projects. Tourism, publicity, agriculture, exports, industry relocation, utilities, delta initiatives, airline service, upgraded medical and military facilities--the list is endless.

Taxing and Spending

What should we look for in the way of additional taxes? Likely candidates would be a significant reduction in the minimum of the Federal Estate Tax on all forms of wealth, a national sales tax, and increases in the gasoline tax. Increased federal spending could cause interest rates to go up, and, of course, that would cause bond prices to go down.

One big question mark on the proposal to "tax the rich" is whether such might take the form of not just taxing the income of the rich but rather taxing the wealth and assets of a great many Americans. There is an obscure proposal before Congress, that Federal Estate Tax minimums be dropped from $600,000 to $200,000 and that these estates be taxed at rates of 32 to 55 percent above that new minimum.

In the new Administration, will there be a tilt toward protectionism that could endanger the North

American Free Trade Agreement? Possibly, and that could lead to what usually comes from protectionism: inefficiency and higher costs which are the result of protection from competition. Time will tell.

Increased taxes on foreign companies, also a proposal of the new Administration, could dampen investment. Increased income tax rates could also choke off some money that would normally go into investment capital. That would result in capital flight, that is, money seeking better rates of return and industry seeking lower costs off shore.

Of course, the business sector would welcome the President keeping his promise on reducing capital gains and re-instituting the investment tax credit. Conversely the increased cost burdens to business through tougher environmental regulations, combined with less disposable income of consumers if taxes go up--these could cause sluggish growth in 1993.

Interest rates could rise as the markets anticipate growth in government spending. This would, of course, increase the cost of capital and, to the extent that businesses operate on borrowed monies, could increase the cost of producing goods and services.

One obvious lesson to business people today is to refinance external debt while interest rates are low and to position themselves to not have to rely on outside credit. Interestingly, it was reported recently that Wal-Mart was being upgraded by Moody's analysis as the company, unlike most these days, has been able to finance expansion without external borrowing.

Hopefully businesses have come out of the recession stronger by paying down debt and eliminating unproductive assets. If they will continue to do this along with pushing for new methods that simultaneously decrease costs and make them more competitive, the economy can rebound amply.

Tradeoffs

In economics we deal with tradeoffs. Increased taxes and increased costs of environmental regulations could force more companies to do the very thing that most Americans dread--move off shore to survive. That process has been going on for some time and should be part of Economics 101 for candidates of all parties.

Other economic lessons come with the perverse nature of higher taxes: (1) they leave consumers with less money to spend, save and invest--throttling back the recovery, and (2) few people really connect their subsidy as someone else's tax--sometimes known as the *"No Free Lunch"* fallacy.

The recovery will continue to be weak at first. One does not get out of the hospital and immediately go directly to play three sets of tennis. Excess capacity in the pipeline will slow down the rate of growth for at least the next year. Nationally, as consumers read about the possibility of new and different taxes, this could put a damper on consumer spending. The current unemployment rate could also be aggravated in the near term by defense related cutbacks.

The fine line that the President walks includes the fact that if he attempts too much too soon, he could short-circuit the system and be patently unsuccessful. If he attempts too little, and doesn't take advantage of the honeymoon accorded to new Presidents, a precious window of political opportunity would be lost. American presidents also tend to develop the attention span of a hummingbird after a while.

Our presidents have to keep alert to so many interest groups with foreign and domestic agendas which compete for the President's attention. Every administration also has warring factions even within its own Cabinet. This tends to chew up American presidents, age them prematurely, and frequently throw us into a cycle of one-term presidents. Think about it, only two presidents in the last half century have been afforded the luxury of a second term: Eisenhower and Reagan.

Even Mr. Reagan suffered from being tugged several directions simultaneously. For most of his career lifetime, he was a successful actor. To do that, one must please people. However, he had some deeply held conservative beliefs. There comes the dilemma: how does one please people and also hold to one's beliefs?

Our new President has had a wonderful career as an accommodator. Will he, in trying to please everyone, end up pleasing no one? Again, time will tell. The conventional wisdom is that he will have a short term stimulus package followed by a longer term deficit reduction package. Additionally, the first hundred days might see some specific and familiar legislation in the area of jobs, health, and training.

This writer has always said that economics is the only game in town. The concerns of the voting public this election year have pretty well proven that. Learning economics won't make us millionaires nor will it keep us out of the soup line. It will simply give us a better understanding of how we got there. Most in my profession would pragmatically prefer to be neither optimistic nor pessimistic, but rather correct.

Goods and Bads

In many ways America in general and Americans specifically are better off. In some other ways, both the country and Americans collectively are worse off. So, it has been neither the best of times nor the worst of times. Frankly, on several fronts, the economy is not as bad as the challengers made it out to be. Nor is it as good as we would like it to be. It's a bit like the economist who, with one foot in the oven, and the other in the freezer, announced *"On the average, things are not too bad."*

Looking around the world, don't we Americans have much to feel good about? The U.S. still enjoys the highest standard of living of any major country. Unemployment in the last recession peaked at 11 percent. That's 50 percent higher than our current rate of 7.5 percent.

What is the record as things stand today? With five percent of the world's population we create 25 percent of the world's GNP. Two percent of us grow enough food to feed 200 percent of our population. Our poverty level income exceeds the average Russian income. Our work week is 40 percent shorter than in 1900.

The Scorecard

The American economy is on a rebuilding binge that will run for the next two decades. During this era of restructuring and implementing of new ideas, we will, in both goods and services, be able to compete with any other nation in the world at a profit. In the last two decades we've grown about 60 percent in real terms on only 10 percent more energy. We've doubled vehicle fleet mileage. The equipment in homes and factories is 30 to 60 percent more efficient.

Applied science has brought renewal to our domestic economy. Information technology is changing the concept of industrial resources. Today, everywhere, we are applying hi-tech to low-tech industries. Basic low-tech industries are now smaller, leaner, stronger, and more profitable. Joint ventures are a growing trend to reduce risk, build expertise, and penetrate markets. Our trade deficit is lower now than any time in the last eight years, and it doesn't even include services--law, finance, tourism--in which Japan is a net buyer from the U.S. Most people don't know that.

Arkansas is ninth in the nation in manufacturing intensity and yet most of our industries are recession-resistant. Our number one manufacturer is proof of that--food processing. This is another well kept secret. Last year, Arkansas was in the Top Ten in the percentage of growth in output, employment, and personal income. We are ahead of 24 others states in the number of Fortune 500 companies located in Arkansas.

Fifty years ago, incomes in the South were two-fifths the national average. Today Southern incomes are four-fifths the U.S. average. Sixty-six percent of us own homes today (that's both the Arkansas average and the National average), compared to forty-four percent just fifty years ago.

Living standards have improved greatly. In the mid 1940's, one-third of the nation's homes had no running water, two-fifths had no flush toilets, three-fifths had no central heating, and four-fifths were heated by coal and wood. Don't tell us we haven't made great progress--thank you very much.

We are better off when looking at the reduced number of countries that are called Communist today. We are also better if we look at the reduced ratio of Federal employees to private sector employees. The per capita income gains of the last decade, in real dollar terms, have been healthy. The Dow Jones index has seen a massive increase the past decade. Infant mortality has dropped significantly and the life expectancy is up.

On the other hand, we have doubled the percentage of Gross Domestic Product that goes toward interest on the National debt. Federal spending has also nearly doubled in the last decade. Government deficits are two to three times larger than they were a decade ago.

Spending on health care has tripled and yet the problem has grown worse. Births out of wedlock have doubled in a decade, and the prison population has tripled in 15 years. Americans pay more total dollars in taxes of all kinds now than 12 years ago, and yet we still wonder how to get good government at a reasonable cost.

Fiscal Mandate

Yes, there is a saying going around these days in Washington, D.C. that ". . . *all the king's horses and all the king's men will never be able to cut government spending again.*" The legacy of fiscal irresponsibility is that runaway, big spending government is out of control. And it's a bipartisan problem. Neither political party seems to know what to do about it.

Even leaders with relatively clear sets of principles find it politically difficult to make those tough policy decisions that are required to turn the state of our economy around. The problems with the American economy are not the result of malicious actions by mean people.

Rather, the problems are the cumulative toll of well-intentioned folks who either have not done their homework or have not considered the long run consequences of short run, quick fix policies. The basic economic truth is that, in the long run, far from "creating new jobs," deficit spending actually throws people out of work.

By hogging the supply of credit, the government elbows private firms out of the market. Strapped for funds, businesses languish. And unemployment soars. With the federal budget well over one trillion dollars, and chronic triple digit deficits, isn't it imperative that stronger fiscal controls be exercised?

It was America's first great economist, Pelatiah Webster (1726-1795), who stated the following in an essay in opposition to the Continental currency inflation: "*An error in finances, like a leak in a ship, may be obvious in the fact, alarming in its effects, but difficult to find.*"

We in the United States seem unwilling or unable to spot the leaks and seepage leaks in our twin ships of monetary and fiscal policy. But as Webster also said: "*The first thing necessary to correcting an error is to discover it. The next thing is to confess it, and the last to avoid it.*" It's a tough job, and we have to do it. Let's get started.

Press On

The past is prologue. The future is a place we haven't been before, but that's where we are going to spend the rest of our days. And now, what began as a national blind date, has blossomed into both a courtship and a marriage of the Executive and Legislative branches for the next four years.

Hopefully, Mr. Clinton's administration will be able to adopt a budget package that is multi-year and credible enough to give the financial markets hope. I am not a prophet nor the son of a prophet. Nevertheless, if the new government doesn't get a handle on the problems and concerns of the voting public--health care, jobs, the deficit/debt dilemma--then by 1996, as Machiavelli would put it, "*What a year to have an election.*"

ABOUT THE AUTHOR

Dr. Don Diffine is currently Professor of Economics at Harding University in Searcy, Arkansas, and Director of the Belden Center for Private Enterprise Education. The Senior Research Associate of Harding's American Studies Institute, Dr. Diffine is also the Director of Economics Teams that have won First Place in national Students in Free Enterprise competitions on six occasions.

Listed in the Heritage Foundation's **Guide to Public Policy Experts**, Dr. Diffine is the author of a 200-page **Facts Book for Business and Industry** and is published frequently in the **Journal of Private Enterprise**. He currently has over 80 articles and monographs in print.

Dr. Diffine is the recipient of the Freedoms Foundation George Washington Honor Medal for his article *"All American Economics--Made in the U.S.A."* He is the editor of the ENTREPRENEUR, a journal that has received five Freedoms Foundation awards in the category of Non-profit Publications. In 1990, the National Flag Foundation presented its *"New Constellation Award"* to Dr. Diffine for his booklet, **"TO THE FLAG--Our Banner of Liberty."**

The recipient of the $7,500 Freedoms Foundation Principle Award for Excellence in Private Enterprise Education, Dr. Diffine has received nine other Freedoms Foundation awards in the categories of Economic Education, Public Affairs-Advertising, Public Address, and Published Works. He is also the faculty winner of a $1,000 First Place prize in a National Essay contest judged by Nobel Economist Milton Friedman.

In 1988, the First Annual Distinguished Scholar Award was presented to Dr. Diffine by the Association of Private Enterprise Education. He is listed in **Personalities of the South** and **Outstanding Educators of America**. The Wal-Mart Foundation has designated him as a Free Enterprise Fellow.

Dr. Diffine has provided Congressional testimony on business problems, economic impact statements, and inflation-recession dilemmas. Also an economic humorist, he is a frequent speaker for conventions, trade associations, stockholders' meetings, and chambers of commerce.

Mary Binkley
HU Box 2267