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ECONOMIC NEWS UPDATE

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One of the anomalies I have mentioned several times is the gap between the American economy's performance, and the public's perception of the quality of President Bush's economic management. The first thing to keep in mind is that the US economy is a huge, sprawling, diversified beast, driven in the long run by the entrepreneurial energy and the hard work of individuals. There is no room in the White House that contains a series of dials and buttons that the president can use to control the economy's performance.

That said, economic policy decisions taken by the president can affect the rate of economic growth, the inflation rate and other variables, within limits. Lyndon Johnson set the stage for an inflationary spurt by trying to wring both guns and butter from the economy, without raising taxes to pay for the war in Viet Nam. Jimmy Carter came close to wrecking the economy with a set of programs that created that least desirable of conditions, stagflation – high inflation and negative growth. In the long-run, such policies prove self-

correcting, as voters turn out the rascals who, left in office, would have brought the nation to ruin, and install proponents of corrective policies, as they did when they chose Ronald Reagan, who unleashed Paul Volcker and the Federal Reserve Board to wring inflation out of the system while Reagan took the flack for the recession that was needed to cool the economy.

So what of George W. Bush? There is little doubt that he deserves credit for helping to reverse the recession that greeted him as he moved into the White House. The tax cuts worked out for him by his then-adviser, Larry Lindsey, helped to stimulate growth, and turn the negative job figures of the early Bush years into large positives. Data compiled me by Xiuyue Zhu, a colleague at the Hudson Institute, show just how Bush's three major tax cuts worked their magic.

In the years before the tax cuts made themselves fully felt, the economy grew at the puny rates of 0.8% and 1.6%, respectively. Then, things picked up – to 2.7% in 2003, 4.2% in 2004, 3.5% in 2005, and a torrid 5.6%% in the

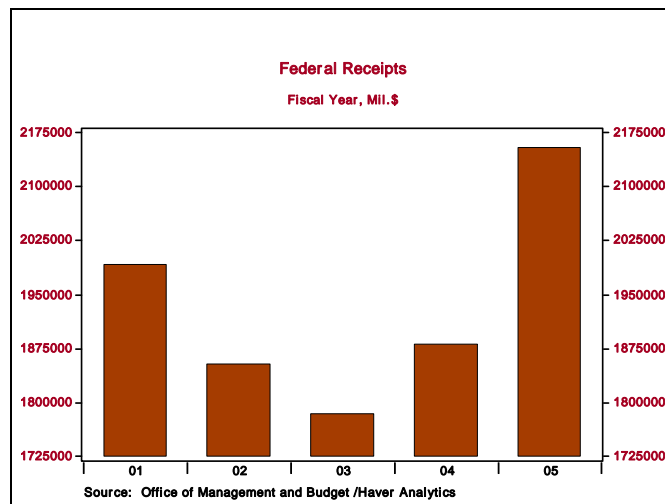
first quarter of this year, before cooling to an estimated 3% in the second quarter.

Accelerated growth did not immediately affect the jobs market. From the time Bush took office until the hemorrhaging finally stopped in the Autumn of 2003, some 2.7 million jobs were lost. But as consumers found themselves with more money to spend, and business confidence rose as the taxes on corporate dividends and profits fell, the jobs market picked up. Between August 2003 and the end of last month, over 5.4 million new jobs have been created. That drove down the unemployment rate from its June 2003 peak of 6.3% to its current level of 4.6%.

The tax cuts also proved to be partially self-financing. Treasury receipts, which initially fell, recovered sharply, as strong corporate profits and

last year's record by 11%, and reducing the projected budget deficit for this fiscal year to 2.3% of GDP. Such "good news is no accident," says the president.

True. But neither is some of the bad news. For which he deserves some credit. In a booming economy, when the budget should be in surplus, Bush continues to preside over substantial deficits. The reason: he has never used his veto to reduce what he calls "the wasteful spending" of a wildly profligate congress, and has himself pushed expensive prescription drug and other programs through congress. Nor has he attempted the major overhaul that is required if the Medicare and Medicaid programs are not to reduce the nation to penury in years to come. He concedes that by 2007 the spurt in tax receipts will abate, and knows that outlays are headed up as we fund the war on terror



taxes on the capital gains of high earners increased Treasury revenues. Harvard's Martin Feldstein guesses that the supply-side effects of tax cuts produce one-third of the revenue otherwise lost.

The latest reports from the Office of Management and Budget show that the incoming flood of cash is topping

(now costing an estimated \$300 million per day), and the costs associated with the ageing of the baby boomer generation. The President could not help noticing the latter problem: he recently reached his 60th birthday, and will join the ranks of retirees only a few short years from now.

Still, the rapid growth in the economy, the reduced tax burden, the healthy jobs market, and a business community that is benefiting from what Jim Awad, of the eponymous asset management company, described to a television audience as “Lots of profits, lots of cash, lots of deals”, should be producing the “feelgood factor” to which all politicians aspire.

No one is quite sure why the President’s party cannot count on such a factor in the upcoming November congressional elections. It might be that house prices are cooling, or that gasoline prices aren’t. Or that interest rates, although still low, are rising, dampening growth.

Or that various groups feel unconnected to the generally robust economic performance. The elderly worry about rising drug costs. Middle income folks feel they have not shared fully in the economy’s growth, which has favored high earners, including CEOs, whose widely publicized compensation is not always related to the performance of their companies. Such corporate practices as backdating pensions, and convening meetings immediately after the 9/11 attack to award executives more options when stock prices were depressed, exacerbate feelings that the system is excluding many from its rising wealth generation.

But most of all, there is an unsettling sense that things are out of control, and not only in Iraq. Arab terrorists, backed by Iran, have declared a two-front war on Israel. Globalization is seen as a threat to the jobs by workers who see work moving to China, a potential adversary that is piling up billions of our IOUs. Some 11 million illegal immigrants are in the country, and thousands more sneak in every week.

Putin tells the President that his repression of dissent in Russia is none of America’s business, North Korea tests long-range missiles in a program the President describes lamely as “unacceptable,” al Qaeda seems to be regaining control of Afghanistan, and Iran cocks a snook at an impotent US.

Not likely to produce a contented electorate, even if it is a prosperous one.



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