

ECONOMIC NEWS UPDATE

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This Election Matters

Politics matter. Not whether Hillary Clinton really teared up before key primaries. Not whether John McCain's famous temper will erupt, scuppering his chances of getting into the White House. And not whether Barack Obama can revive Camelot, and find a place in America's future for the ageing Kennedy clan.

Only two things will matter. The first is foreign policy. The lines are clearly drawn. McCain, with the Republican nomination locked up, would continue waging what he sees as a decades-long war against terrorism, and see it through to victory. Obama or Clinton would pull our troops out of Iraq almost immediately upon taking office, and hope that a series of conversations with the likes of Iran's president Mahmoud Ahmadinejad and the Taliban will produce peace for our time.

The fiscal and domestic policy consequences of these differences can't be overestimated. The war in Iraq is now costing something on the order of \$10 billion per month, up for \$4 billion in 2004, due to rising costs of fuel, food, protective gear and pay-offs to Sunni

fighters. McCain would hold down domestic spending to fund the war. The Democrats would divert these funds to increasing the scope and size of domestic programs.

So these differences over foreign policy have an enormous impact on domestic policy, as the Democrats' reaction last week to President Bush's final budget makes clear. This was the first ever budget to be submitted electronically -- no trees sacrificed, no tons of paper to be pulped. Good thing, since the budget was labeled by the Democrats D.O.A. -- dead on arrival. Or, as Senator Judd Gregg, the New Hampshire Republican who is the party's senior man on the Senate budget committee put it a bit more politely, the president's budget "is some bit of an academic exercise."

Bush's \$3.1 trillion budget projects a near-record deficit (\$401 billion, or a shade under the politically unpalatable 3% of GDP) for the coming fiscal year, and a surplus in 2012. But Bush has included only enough money to fund the wars in Iraq and Afghanistan from the start of the fiscal year on

October 1 until after the next president is inaugurated. The projected surplus assumes that congress will go along with cutting or eliminating some 151 domestic programs -- which it won't. It ducks the question of reforming entitlement programs, the major domestic spending items; fails to cope with the impending crisis created by the Alternative Minimum Tax (AMT), designed to nab tax-avoiding millionaires but now ensnaring middle-income families; and assumes that the Bush tax cuts will be made permanent when they expire in 2010, which they won't if a Democratic congress has its way. A realistic guide to America's future priorities the Bush budget is not.

But the reaction to it provides an indication of just how important the 2008 elections are. McCain supports extension of the Bush tax cuts, and the President's plan to rein in the growth of domestic spending, including spending on the Medicare and Medicaid programs, rather than short-change the military. He also hopes to find billions by cutting wasteful earmarks. Clinton and Obama want to allow the Bush tax cuts to expire, in effect raising taxes on the "rich", and cut defense spending.

Neither ending waste nor taxing the rich would come close to providing the money needed to plug the hole in the budget created by rising health care costs, much less to putting the social security and other entitlement programs on a sound financial basis. But the differences between the parties' prospective candidates tells us something: that a Republican president will attempt somehow to cut domestic spending and hold the line on taxes, while Clinton and Obama plan to increase domestic spending on benefits programs and on infrastructure, funding

the increase by cutting the military and raising taxes on dividends, capital gains and high earners.

The desire to shift overseas defense spending (but not aid to Africa) to domestic programs is part of long-standing goal of the Democrats and their backers. Trade unions have taken out television ads claiming that the US spending on one week of the Iraq war would buy health care for 1.7 million children, and Obama says that what we are spending to fight that war "could be going right here ... to lay broadband lines in rural communities, to put kids back to school." Clinton plans increased subsidies for college tuition, universal pre-school care, more money for New Orleans, doubling spending on research, and \$1 million for a Woodstock museum to serve that those who were at that 1969 festival, but can't remember being there.

Health care remains another important point of difference. And here we have a three-way split. McCain would attempt to bring down costs and make insurance more affordable for those not now covered by stimulating competition and cracking down on the big pharmaceutical companies that he believes overcharge patients. Obama has some as-yet-unspecified plan to make insurance more affordable for those who want it. Clinton, clinging to the approach that proved politically disastrous when she headed her husband's health-care task force, would make insurance coverage compulsory, even for youngsters who neither need nor want it, and deduct the cost from their paychecks if necessary.

Enough detail to make the broader point. This is one of the few elections that create for Americans what Ronald Reagan once called a time for

choosing. In 1932 we elected Franklin Roosevelt and put paid to the notion that government is best which governs least. In 1980 we elected Ronald Reagan, a Roosevelt Democrat turned Republican, and put paid to the conservative war against FDR's New Deal. This year we will have to choose between a man who is confident that America can -- indeed, must -- play a leading role in maintaining world order, even at the expense of domestic spending, and a man or woman who believe that America must concentrate its resources on the home front, while relying more on international institutions to keep the world's democracies safe from its enemies.

Little wonder that the current round of primaries has attracted worldwide attention. What happens in America doesn't stay in America.

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