

The Driving Forces

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The good news is that we had a presidential election that actually ended on Election Day (or reasonable facsimile thereof). The bad news is that "Landslide W" is claiming a mandate for a variety of social and economic programs. I'm not sure if November 2 made any difference for the economy in the short run, but it did put into motion some forces that will shape this economy over the next decade or two.

Let me explain. This economy is settling into a pattern of positive but weak GDP growth and positive but weak employment growth. Home sales will be down by about 7 percent, and consumer durable spending will increase, but only mildly. The numbers for 2005 will be worse than those of 2004 but will, in all probability, not come close to resembling a relapse.

It's the longer run that gives one pause, however, and the legacy of the two terms of George Bush will come down to his ability to address and solve the challenges that face this economy for the next twenty years.

1. The Boomer Wave. The baby boomers start becoming eligible for Social Security in 2008, and Medicare in 2011. Right now, it looks like they will overwhelm the system, unless something is done. The President's proposal to allow for private investment accounts is in reality a tax cut, since Social Security is a pay-as-you-go system in which current workers' taxes pay for retirees' benefits. Thus, private accounts reduce the funding of current retirees, cut taxes on workers and trade off future benefits for future retirees. This intensifies the near term problem and may or may not cure the longer term one. And this does not even begin to touch Medicare.
2. The Deficit. For the fiscal year ended September 30, 2004, the Federal government was in the red by over \$400 billion. Moreover, forecasts suggest that this deficit will continue at only slightly lower levels for the next five or six years. As with any debtor, increasing amounts of debt for the United States will cause creditors to ask for higher interest payments. This will happen and these rates will flow through to the entire economy, if the deficit cannot be held down or eliminated. It seems ironic that such a conservative president is such an irresponsible money manager.
3. The Other Deficit. We have maintained a persistent trade deficit with the rest of the world. In one sense, this reflects the generally better economic times that we have had relative to the rest of the world. This deficit is improving, in part because of the weakness of the dollar. The real issue here is that to make up the deficit, we take on our major trading partners as creditors. It then becomes much more difficult to carry out trade policy,

international monetary policy and even global political strategy with nations like China when we owe them so much money.

4. The Emergence of China and Europe. As the massive Chinese economy grows and as the Euro bloc solidifies, we are being slowly pushed off the gold medal platform and down to silver and bronze. The long run health of the American economy requires that we maintain our world economic leadership. This requires a serious and coherent economic policy toward both the East and the West.

Any or all of these challenges could spell either trouble or opportunity for this country. What is not at issue is that they will shape the economy in which we and our children will live. It's curious to me how little (in some cases, none) attention or discussion these challenges were given during the recent campaign. Yet, as far as our long term welfare is concerned, they out rank war service, or tax cuts, or same-sex marriage or any of the other issues that assumed center stage last fall. Let us hope that the second Bush term will result in some solutions to the real challenges that we face.