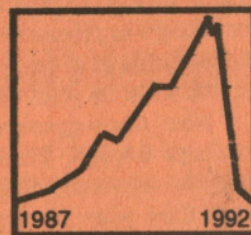


# ECONOMIC INTELLIGENCE



C I T

EI/31 MARCH 1992

## BUSH: A PYRRHIC VICTORY

GEORGE BUSH will be re-elected as President of the USA, an outcome with considerable economic implications for the world economy. More importantly, however, EI is now prepared to alert readers to a momentous shift in geo-politics, the outcome of which will be a change of epochal proportions. Here, we look at the prospects for the November elections; on page 2, we turn to the economic implications; and on page 3, we explain why the U.S. is on the precipice of a fundamental change that far exceeds the traditional switch of political allegiance.

First, readers are reminded that EI based its successful prediction of the 1992 economic trauma on trends in the land market. We examined the empirical evidence for the hypothesis

(which originated in the USA) that land-values operate in 18-year cycles. The hypothesis, it turned out, was powerful in explaining trends (particularly the all-important turning points) in other sectors of the market economy. And on the basis of historical evidence, 1992 was "bound" to be the trough of the latest cycle. Since we published the prediction four years ago, there was no 20/20 hindsight vision here!

Now consider the political cycles. American historians have for a long time drawn attention to 36-year cycles in the fortunes of Republicans and Democrats; the latest scholar to explore these cycles is Arthur M. Schlesinger.\* The data is assembled in the table, which reveals a crucial relationship. We find that an earthshaking shift in American politics always followed - by three years - every second major economic recession. The only exception was the five-year gap between the first recession and Andrew Jackson's moral victory over the landowning Whig aristocracy in 1824 (Jackson was founder of the modern Democrat Party).

Each of the succeeding political earthquakes took place

three years after the preceding recession, and represent rollcalls in the American history book: 1860 (election of Abe Lincoln, the first Republican president, ushering in a period of close party competition), 1896 (Democrats retreated to the South, Republicans gained the national majority), 1932 (Roosevelt terminated Republic dominance and launched the New Deal). What does all this tell us about the fortunes of George Bush and his challengers?

If the cyclical rhythms had continued, the first postwar change would have been in 1968. But as with the economic cycle (the Nazi threat boosted spending on munitions, which prevented the serious recession that was due in the late 1930s),

the Second World War was a sufficiently powerful event to disrupt the political cycle. No-one claims that these trends are mechanistic. Judgment has to be exercised in dating the origins of the postwar economic and political cycles.

EI accepts the consensus view of historians that 1955 saw the normalisation of the economy. Two 18-year land-value cycles brings us to the recession of 1991. Add three years to that, and we are tantalised by the prospect of political upheaval in the following presidential election - 1995.

Now cross-check this with the political cycle. When did it start? Add 36 years to

Roosevelt's victory in 1932, and we leap to 1968 - the year Nixon snatched victory from the Democrats (JFK having been assassinated in 1963). Convenient, because Nixon was the first of the rightwing Republicans. That date suggests the continued dominance of the Republicans into the millenium. Such a conclusion, however, is inconsistent with the economic cycle. Can we make the two cycles concurrent without bending the facts of history?

Schlesinger offers us the solution. He stresses the importance of the generational cycle on political motivation. He examines the postwar baby boom, and concludes that 1957 divided the Roosevelt/Truman generations from the Kennedy/Johnson generation. "The baby-boomers thus consist of two

### U. S. ECONOMIC & POLITICAL CYCLES

Land value peak	Building cycle peak	Economic recession	Political upheaval
-	-	-	1788
1818	-	1819	1824
1836	1836	1837	-
1854	1856	1857	1860
1872	1871	1873	-
1890	1892	1893	1896
-	1916	1918	-
1925	1927	1929	1932

### POSTWAR CYCLE BEGINS IN 1955

1972	1973	1974	-
1989	1990	1991/2	1996*

\*Economic Intelligence prediction

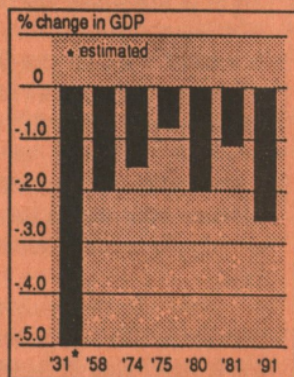
\* *The Cycles of American History*, Boston: Houghton Mifflin, 1986. The economic data in the table is drawn from Fred Harrison, *The Power in the Land* (1983), London: Shephard-Walwyn, p.65; available in the USA from Robert Schalkenbach Foundation, New York.

distinct generations, with 1957 as (roughly) the dividing line; the older generation attuned to democratic purpose, the younger to private interest." If 1957 did see the onset of a new political cycle, an additional 36 years takes us to 1993.

Now, that suggests that Bush ought to scrape through. But what about the mood of the voters? Historically, it has taken three years for the impact of the second major land-induced recession to sink deep enough into the collective consciousness to activate sufficient grassroots dissatisfaction of the kind that generates a change in political destiny. What does that mean for this year's presidential election? With people still shell-shocked by the current economic collapse, it will take them the best part of the next administration to recover and whip the politicians into doing their bidding; in other words, it will take another defeat at the hands of Bush to force the Democrats to formulate the policies that will give the next political cycle its distinctive character.

So EI concludes that Bush will make it back to the White House. Bad news for the millions who are today without work, but at least this enables the smart people to prepare a medium term plan to maximise the returns on their investments: they can now make best-guess assumptions about the economic strategy of a re-elected President Bush.

### BRITAIN'S SLUMPS



OFFICIAL figures released by the Central Statistical Office have now confirmed EI's forecast - originally published four years ago - that Britain would be in a depression in 1992. City of London financial analysts are now admitting publicly that it is now misleading to call the downturn a recession. Britain last year suffered the biggest single year slump in output since the Great Depression of the 1930s.

# BANKRUPT BY ANY OTHER NAME

IT WAS the rhetoric of a war leader, but the president's ammunition, delivered in his State of the Union speech, was a damp squib. With the US economy careering into the worst slump since the Great Depression, George Bush could do no more than deliver what *Business Week* characterised as a "grab bag" of policies.

If ever there was an occasion for setting a new course, this was it. Instead, President Bush's main vote-catcher was to allow the average family to retain an extra \$350 in their pay cheques - five bucks a week, the price of a couple of hamburgers.

But even that sop is actually an illusion, for as *The Wall Street Journal* noted: "The total tax bite will ultimately be the same; that amount will be made up at tax time next year, when refunds will be smaller or taxes due will increase."

With a federal budget deficit aiming for \$352 billion, and climbing, the real message from Washington is the bankruptcy in ideas. Quite simply, no-one knows what to do about the malaise that is afflicting the American economy. Which is why the president's prescriptions - wrapped in the language of Desert Storm - are ones of retreat.

Literally. For his plan to revive the economy is a series of measures that reverse the Tax Reform Act (1986). That act helped to reduce taxes and increase the budget deficit, but in doing so created some problems for the citizens. Take the need to help citizens to provide themselves with decent shelter. The 1986 Act succeeded in raising, rather than lowering, the marginal, after-tax cost of homeownership for a family of three earning \$40,000 by over 8%. As for the rented sector, the changes were such that any investor public spirited enough to provide accommodation for others to occupy had to raise rents by between 15-20% to maintain the same rate of return on their investment.

Something needed to be changed, and the president - a high-seas angler - thought it appropriate, in these times of high unemployment, to propose the repeal of the luxury tax on expensive boats.

"Gimmicks" was how the President's Housing Secretary, Jack Kemp, characterised the package - until, after phone

calls from the White House, he dutifully backed down.

Most of the focus was on the president's heartfelt desire to cut the capital gains tax, from 28% to 15.4% for assets held for three years or more. The idea is to encourage investment, but (a) would it? and (b) who gains? The best deals in town today are in land. Valuable sites are being sold for knock-down prices, and they can be withheld from use (which would do nothing to create new jobs) and at low cost (which provides no incentive to invest in wealth-creating activities on it). So the plan to cut the capital gains tax provides the most incentives to the least enterprising - hardly an imaginative strategy for lifting a wounded economy out of the sickbed. And the Treasury effectively admits this, for it predicts that - instead of encouraging new investment - the cut in capital gains tax would encourage people to sell assets, to take advantage of the lower rate. A second effect: by 1997, the Treasury would be losing \$200m revenue, thereby increasing the budget deficit.

As for who gains - the congressional Joint Committee on Taxation calculates

### BUDGET DEFICIT

Federal budget deficit at the end of each fiscal year.



Source: Congressional Budget Office

that nearly 70% of the benefit would go to those who make over \$100,000 a year. If you earn over \$200,000 a year, you save an average of \$18,000 as a result of lower capital-gains rates; while those earning under \$50,000 would save \$300.

It appears safe to assume that anyone looking for leadership in the economy will wait in vein. As *The Wall Street Journal* editorialised on February 6: "So it goes in Washington, where tax policy has no tangible relation to what actually goes on in the real economy."

Sit tight for a drawn-out fight for survival.