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Post-election Speculations

When the citizens of a world power elect their leaders, the generally rather obscure notion of a "global village" takes on a more palpable meaning: The repercussions of who becomes President in Washington, D.C., his convictions, his goals and programmes, are not confined to the American electorate; they affect the rest of the world. If you're sharing a bed with an elephant or sitting in the same boat as one – whichever analogy you prefer – it's a good idea to watch out for any moves your weighty partner makes.

The American voters' choice of George Bush is certainly partly attributable to their inertia. After two terms of office, they knew where they were with President Ronald Reagan and everyone appears to assume that under the Bush Presidency the previous administration's basic policy line will be left virtually intact – an impression the winning candidate has so far fostered. The Democrat Michael Dukakis was more of a dark horse.

The international climate of opinion seems to have coincided with the basic mood of the American voters, so it's hardly surprising to detect a certain sigh of relief in the reactions of the world's capitals to the outcome of the American presidential elections. Nor is it difficult to understand the desire for a degree of continuity, for known quantities, in a world of political flux and economic instability caused by imbalances. That the new incumbent actually does aim to take up where the old one left off is by no means an unrealistic proposition. How far circumstances will in fact permit him to do so is of course another matter altogether.

A policy line of the outgoing administration most likely to be pursued is the dialogue with the second world power, the USSR, the efforts towards détente and further progress in disarmament. Success here, should it be substantial enough to permit a reduction in defence expenditure, could help the new administration to attain its policy goals in the economic, monetary and financial areas.

Here, the President has a difficult balancing act to perform. He must avoid creating the impression of deviating from his predecessor's economic policy course while at the same time trying to cope with the heavy burden of the double deficit the latter has left behind in the federal budget and on current account. Whether and how he succeeds in paying this off will not only be decisive for the business outlook and growth prospects in the United States; it will also be a key determinant of economic development and employment trends in the rest of the world.

The question of whether the new President Bush will be able to lower the budget deficit in the coming years invites speculation. Modest consolidation successes have already been achieved. Following a budget deficit in the first half of the financial year 1987/88 which was well above that registered twelve months previous, the trend in the latter half improved culminating in a figure at the end of the financial year in September which only slightly exceeded the 1986/87 debit balance. A clear, contributory factor in this development of state finances has been the vigorous economic recovery. This result constitutes a consolidation in that in the previous financial year exceptional factors which took effect with the introduction of the tax reform magnified the decline in the budget deficit as compared to its peak in the financial year 1985/86. According to the latest budget forecasts, however, it is very doubtful whether the deficit in the coming financial year 1988/89 will diminish appreciably unless

additional action is taken by the new President. The remedy advocated by some, a combination of expenditure cuts as provided for in the Gramm-Rudman-Hollings Act with a sustained, high rate of growth, continued oil price restraint and a reasonably firm dollar, permitting the Federal Reserve to loosen its monetary reins, rests on very shaky ground, as demonstrated amongst other things by recent events on the foreign exchange markets.

Besides, to rely on the "lawn-mower method" of the Gramm-Rudman Act would verge on a kind of political declaration of bankruptcy. On the other hand, almost the only area in which drastic cuts in spending are still conceivable is in defence, which presupposes an easing of global political tensions, as already mentioned, and/or a shift of the defence burden onto the NATO partners.

Cuts in welfare expenditure already reached or even overstepped the tolerance threshold under Reagan. Even if Bush were planning further cuts, the even larger Democrat majority in Congress would be able to block them. On the contrary, more programmes are likely to be implemented in this area, the more so as Bush himself is sure to be reminded of his election pledges on the domestic front. After defence and welfare, interest payments now make up the third largest item in the federal budget, a clear sign of how narrow the leeway on the expenditure side has become.

Let's look at the revenue side. When campaigning, Bush declaimed: "Look at my lips. No new taxes." Irrespective of the credibility of politicians' pre-electoral promises, besides new taxes there are still old taxes, fiscal charges and other sources of revenue for the federal budget. Raising these and stopping more loopholes, i.e. broadening the tax base, could contribute to lessening the deficit. Should however the economic forecasts anticipating slower growth, also in the USA, prove correct, this more or less surreptitious way of raising revenue will be of limited scope, at least for the foreseeable future.

Uncertainty about the direction economic policy will take after the election has obviously put the dollar under pressure. If the economy slows down as predicted, however, the increase in US imports will probably decline even further, thus easing the trade balance. The recent sizable improvement in real foreign trade could therefore persist. It will have to be very substantial, though, if it is to make itself felt on current account in the near future, since a more favourable trade balance will continue to be partly offset by the adverse tendency on capital account. Ideally, the best means of ensuring continued progress in the trade balance and mitigating the adverse trend on capital account is an optimum mix entailing a reduction of the budget deficits, a restrained growth in American domestic demand and comparatively sturdy growth rates in domestic demand elsewhere, at least in the other major industrialized countries, to avoid the danger of a further drop in the dollar triggering abrupt adjustment processes and/or prompting greater protectionism. Making use of the trade legislation adopted under Reagan in such a way would certainly clash with President Bush's basic convictions, but hardly those of the Democrat majority in Congress.

Here at the latest, the other industrialized countries, especially the EC and Japan, must take up their share of the responsibility for the "global domestic economy". It is in their own interests to make sure that the elephant in the same boat doesn't have to move around too much. The growth in domestic demand, at least in Japan and the Federal Republic of Germany, is encouraging, but the latter's plan to raise excise duties next year is counterproductive as regards the interests of the world economy. It is certainly not the responsibility of the other industrialized countries to act as an economic locomotive, an almost futile undertaking anyway. It is however their business to remove the many and varied structural constraints on growth; this applies particularly to the Federal Republic of Germany and other EC countries. This responsibility also means dispensing outright with any idea of building up a "Fortress Europe". What is needed is just the opposite: it would be of great benefit to the world economy if the economic giants – the USA, the EC and Japan – went back to adhering more closely to the rules governing the free movement of goods and capital, instead of devoting so much thought and energy to setting up blocs and reaching bilateral agreements. The new US President has a key role to play here.

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