Center for the Study of the Presidency

Issue Papers For the New Administration

#1 "Managing a Complex Global Economic Situation"

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"In my view, we face something of a global event as both U.S. and world investors begin making judgements about the U.S. and other world markets. Inter linkages between markets are nothing short of comprehensive today, and the U.S. is by no means in a secure position at this late point in the cycle. The new Administration could well face a sharp and painful adjustment in the near term and will certainly do so at some point in the next four years."

In **Report to the President-Elect 2000: Triumphs and Tragedies of the Modern Presidency**, the Center analyzed Presidential leadership through the lens of more than seventy-six case studies. These **Issue Papers** are a forward looking complimentary series of short, single-author papers that frame and briefly analyze key issues that the next President must address during the early months of his Administration. Views expressed in these papers are those of the authors.

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NOTES ON THE PRESIDENCY

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When the new President takes office in January 2001 he will face a complex global economic situation which may well provide an early test of the new Administration. The success with which this challenge is managed will have a significant influence on the ability of the new Administration to implement its declared policies. The controversial outcome of the election will probably further complicate the challenge because early gridlock now seems inevitable.

Appraising the new President's prospects for continuing our longstanding economic success goes far beyond the US in today's highly inter-dependent global economy. In my view, we face something of a global event as both US and world investors begin making judgements about the US and other world markets. Inter linkages between markets are nothing short of comprehensive today, and the US is by no means in a secure position at this late point in the cycle. The new Administration could well face a sharp and painful adjustment in the near term and will certainly do so at some point in the next four years.

The most immediate issues facing the new Administration are:

- Sustaining US growth, high productivity and low inflation.
- Maintaining stable financial markets, strong inward capital flows and a reasonably strong dollar.

- Establishing an economic/political/strategic policy team with strong domestic US and global credibility, together with organisational arrangements in the White House and among the major departments that allow the new team to focus on the truly global nature of the economic challenge.

- Create as quickly as possible a basis for US leadership of the world economy and monetary system that stands equal to the need to establish US strategic leadership in the more traditional foreign policy areas.

At this point it cannot be assumed that the US will continue to enjoy a benign economic environment. Despite years of prosperity during which we have benefited from a continuing flow of positive economic developments and strong financial market performance, there exist a number of negative economic realities. If these are appraised differently than has been the case for many months now market sentiment could change very quickly. The most obvious of these are signs of slowing US growth, record US trade and current account deficits, our low domestic savings rate, our heavy dependence on foreign capital flows, a volatile and probably still over-valued equity market. Until now investors have ignored these factors in favour of the overwhelmingly positive performance of the US economy. However, the army of global analysts are already at work reappraising US economic fundamentals, and it requires only a modest shift of emphasis to change perspectives and along with it market sentiment.

If market sentiment does change - and perhaps it already is if one observes the lack of direction and disturbing volatility in stock markets - a number of comfortable key assumptions might be quickly altered.

- The US economy may well show signs of a significant slowdown.
- Inflation may reappear.
- Interest rates may begin to rise.
- The dollar may fall sharply as foreign investors shift priorities.
- A large and sustained correction in the US stock market might occur as years of positive assumptions suddenly reverse.
- Baby boomers, who are heavily exposed to the stock market with a large part of their savings, might lose faith in the equity markets and turn in a panic to liquidity.
- Negative US market developments would probably cause major fallout for other markets around the world - particularly Europe, Japan and a wide range of emerging markets.

This list, which does not represent a prediction, but simply a series of entirely plausible developments that could easily destabilise world markets and our successful global economy, should be viewed as distinct contingencies by the new Administration; and they should have a clear idea of what actions would be taken if these possibilities became realities.

The key point here is that none of the above developments would be simply a US phenomenon. There is little real distinction today between US domestic and international economic policies, just as the repercussions of one are quickly reflected in the other. The effects of precipitous developments in one area can be transmitted virtually instantaneously to others via today's globally inter-linked financial markets. We have seen this in the various emerging market crises in recent years - all of which we have weathered tolerably well. What we have not seen is a major US market shock transmitted to the world at large.

If the new administration were to face such a development early in its life, it is fair to say that very little exists today in terms of well-established and practiced cooperation among the major industrial nations in economic, financial and monetary affairs. The G7 initiatives of the past have languished, Europe has been totally pre-occupied with establishing and managing (extremely poorly as it turns out) its single currency, US-Japan economic relations are at a low point, both the IMF and the World Bank need significant reform and stronger US leadership, and arrangements for crisis prevention and management between the major industrial nations and the dozen or so emerging market countries are practically non existent.

None of this has been particularly critical in the benign environment of recent years, but we have had enough warnings to remind us how important these issues can be when crisis strikes. It is increasingly clear today that Korea, Argentina, Brazil and perhaps Mexico and China are all experiencing adjustment problems more complex than was at first assumed by many market participants following the market shocks of 1997-1998. Access to global capital markets for emerging market countries generally at the moment continues to be poor - hence Argentina's newly announced $20bn emergency financing package.

The problems of the Euro are deep-seated and a clear reflection of the complex management and unification problems the countries of Europe face. Yet capital markets in Europe have been significantly and positively affected by the Euro, and what has been a weak currency in recent months may well tend towards strength as the fundamentals of the dollar are reassessed.

One could go on speculating about possible developments. My point in recording these thoughts is to ask the fundamental question that the various scenarios imply. How well prepared is the new Administration going to be? Unless the people who form the economic team include strong global knowledge, established relationships with key decision makers world-wide and international market experience in their ranks, we could face a long and costly learning process. If a strong and well-diversified team is assembled, has adequate thought been given to the organisation of the White House and the major departments' leadership to ensure an effective US response to our post-cold war world? Up to now this latter challenge has been a major disappointment.

And finally, will we have a game plan for US global leadership from the earliest days of this Administration? If we don't, we could well be on the receiving end of highly adverse developments, and the new President could find himself unable as a result to accomplish his primary policy goals.

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