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PRIME MINISTER

REAGANOMICS

Many Tory MPs think that Reagan is ruining the world economy. Yet with inflation very low, employment rising, growth continuing at a reasonable rate, and the US continuing to attract the money it needs to pay for its expansion, why should the President worry?

The points he and his advisers should be thinking about are:

The Federal Budget Deficit

In 1981, the Budget deficit was a little under $60 billion. It rose to $110 billion in 1982; $195 billion in 1983; and is estimated to stay between $175 billion and $210 billion between 1984 and 1986 (Simon & Coates figures). If you adjust the deficit for the state of the economic cycle, it has been steadily rising throughout his Presidency. This requires financing, and means an ever-bigger burden of debt.

The trade balance has also deteriorated markedly from around $4 billion a month in 1981 to over $10 billion a month, and still seems to be going up. This too requires financing.

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The US has probably become a net debtor country, bringing to an end many decades of American dollar exports to finance growth and investment around the world.

As the trade balance deteriorates, US manufacturing industry is being forced onto the defensive. In 1970, imported manufactures accounted for 9.3% of total manufactures. By 1984, it is estimated this figure had reached almost 23%, and it is rising sharply (Simon & Coates). As this process is under way, the pain of the manufacturing sector will become more obvious in Washington, and there will be arguments for import controls and other measures to alleviate the pressures on the US manufacturing base.

The very high interest rates which the States has had to impose are also furthering strains in the world financial system, making adjustment to the world debt crisis more difficult. Yet because there are tax breaks at home against interest payments, but not for those who have borrowed from overseas, the very high real interest rates are making adjustment that much more difficult. Nor is the adjustment process proceeding that smoothly. The 8 February Wall Street Journal pointed out that in Argentina prices rose by 25% in January alone; and in Bolivia prices are now rising at 80% a month. At this level, normal commercial relationships start to break down.

The message of all countries forced into adjustment by the IMF or the world banking crisis in recent years must surely be the same to the USA. It is better to adjust while you still have the chance to do it yourself in your own time and in your own manner.

Conclusion

Asking the President to cut his deficit because high real rates are hurting the other Western world currencies and economies is unlikely to move him. And the strong dollar and rapid US growth does bring us benefits as well as agonies - a much bigger potential market. But appealing to his own political sense on what high real rates and large deficits are doing to his own domestic manufacturing base, and to the US banking system, may bring the message home in a more direct way and encourage him to plan a little more for the longer term. Otherwise the inexorable logic of compound interest on his debts will catch up with him.

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