intellectuals assumed. Wendriner and company were not as introspective and troubled as the literati. "Herr" Wendriner, even "Herr Kommerzienrat" Wendriner, simply did not read those monographs produced by the Frankfurt School of Sociology or by Marxians, Freudians, and Adlerians that have received so much publicity since. Who is to say that Wendriner missed much?

What of those super-assimilated German Jews, denounced as *Kaiserjuden*, "Imperial Jews," men proud of their reserve officers' commission, German patriots to the core? They have likewise had a bad press: they had neither foresight nor common sense nor a true feeling of ethnic identity; surely, they must have realized what was coming.

I myself do not think much of such criticisms, many of them made with the benefit of hindsight. Germany's road need not necessarily have led into the Third Reich. The assimilated German Jew, the *Yekke* in Israeli parlance, did, however, have problems of a special kind. Heine, in one of his poems, made fun of those Prussians who walked so stiffly as if they had swallowed the corporal's cane with which they had once been beaten. Heine might with equal justice have written about the assimilated German Jews. They had internalized the values of that enlightened and reformist German bureaucracy that had emancipated them toward the end of the eighteenth and the beginning of the nineteenth century. They were a remarkable lot, committed to the *Rechtsstaat*, hard-working, conscientious, enterprising, and patriotic. *Kristallnacht* was the end for them all. □

THE BUSINESS OF AMERICA

THE DEBT PRESIDENCY

by Irwin M. Stelzer

Debt. That's the word President-elect Bush is likely to hear most often in his meetings with his economic advisers before he is sworn in on January 20. He will hear it in discussions of Third World problems, corporate restructurings, and America's budget deficit.

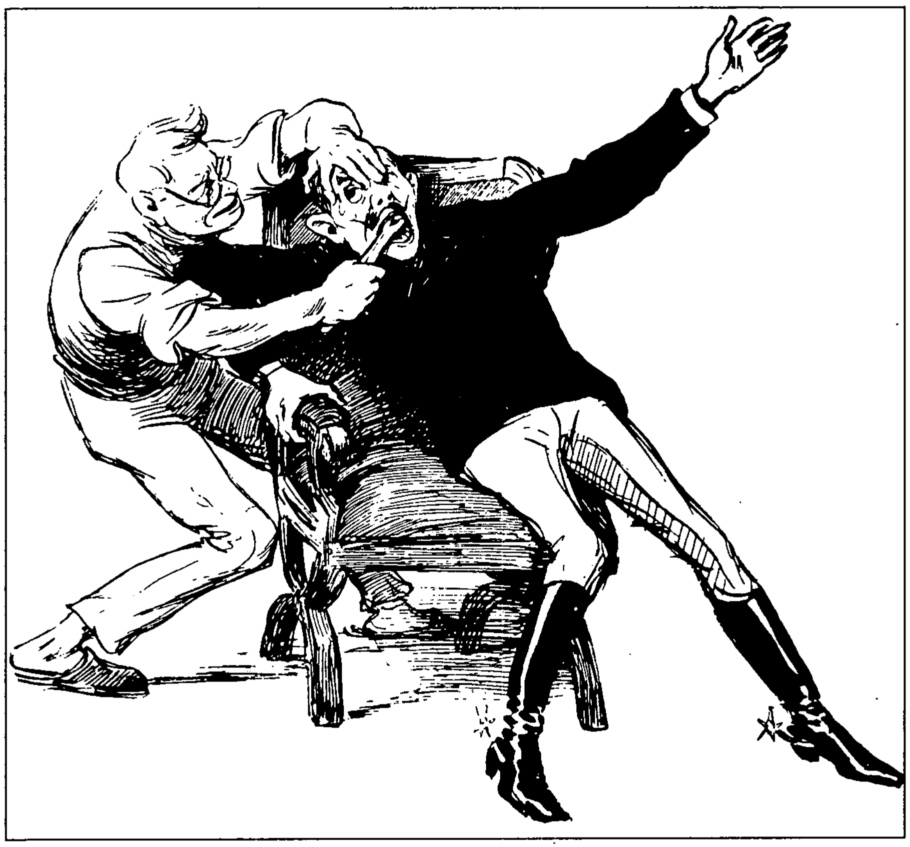
Third World Debt

Secretary of State-designate James Baker is no stranger to Third World debt. As Ronald Reagan's Secretary of the Treasury he devised the so-called Baker plan, offering debtors new loans and easier terms in return for promises to bring public spending under control, reduce the size of the public sector (i.e. privatization), and adopt a host of other free-market reforms.

Baker will undoubtedly urge Bush to continue pushing this plan. Given his eminence as the next Secretary of State and as the President-elect's closest adviser, Baker should prevail, at least for a while. But three problems lurk not far beneath the surface.

The first is that debtor countries are increasingly reluctant to adopt the economic reforms that Baker sees as the necessary predicate to new bank loans. Mexico, the recent recipient of a new $3.5 billion U.S. government loan (Reagan cares more about the impact of low oil prices in Mexico than in the U.S., charged the Independent Petroleum Association of America), is about to swear in a president who faces a powerful left-wing opposition calling for repudiation of past debts. Argentina, only recently arrived in the democratic camp after years of misrule by a military junta, is witnessing the resurgence of Peronism; the leader of that movement, Carlos Menem, also wants to renege on his country's debts. And Venezuela is about to elect as its new president a self-styled populist whose claim to fame is that, when last in office, he nationalized the country's oil industry. No instinctive privatizer, Carlos Andres Perez has been telling American bankers, in a series of private meetings (one was arranged for him in Boston by his admirers, the Kennedys), that his resource-rich country simply cannot afford to meet its existing obligations.

A second problem for the Baker plan is an emerging consensus among liberal academics and Democratic congressmen that some form of debt forgiveness, rather than a new payment stretch-out, is required. This group, led by Senator Bill Bradley (already considered a leading prospect for the Democratic presidential nomination in 1992), argues that debt forgiveness is necessary to prevent social upheaval in debtor countries, and to enable them to buy more American goods.



A third problem facing Baker is that bank lenders are not enthusiastic about making new loans to debtor countries. For one thing, they no longer believe these countries' promises to get their economic houses in order. For another, they no longer accept the notion that foreign governments are safe risks because they never default. The banks now know better—Brazil and Peru for a long time suspended interest payments—and even in the absence of defaults, loans to foreign governments often can be sold only at substantial discounts (up to 80 percent) from face value.

Corporate Debt

Perhaps an even more important factor in the banks' reluctance to make new loans to debtor countries is the emergence of a more profitable alternative: the financing of leveraged buyouts. George Bush will be under pressure from the business establishment and from Congress to restrict bank participation in such deals, and to take other steps to reduce the number of takeovers. There is already talk at Wall Street luncheon tables that Senator Bob Dole has expressed a willingness to consider merger-discouraging changes in the tax laws, such as ending the deductibility of interest paid for money borrowed to finance takeovers.

These proposals reflect two underlying ideas. The first, and one worth careful consideration, is that the deductibility of interest payments makes debt excessively attractive in financing Amer-

Irwin M. Stelzer is director of the Energy and Environmental Policy Center of the John F. Kennedy School, Harvard University, and an American correspondent for the London Sunday Times.

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ica's corporations. A company borrowing money at 11 percent has an after-tax cost of about 7.26 percent; it would have to pay investors twice as much to get them to part with equity capital. So an argument can be made (I won't bore everyone with the counter-arguments) that eliminating the tax-deductible feature of debt would remove the artificial incentive corporate managers now have to rely on debt financing. The second idea, if it can be called that, is that America's corpocrats see hostile takeovers as a threat to their perquisite-laden life-styles, and ultimately to their jobs. Since many such takeovers are financed by heavy borrowing, America's corpocracy would like to see that borrowing become more expensive.

Bush's natural inclination will be to ignore business leaders' requests to rein in these deals. After all, the ratio of debt to equity in American corporations (75 percent) is still well below the 106 percent level reached in the 1974 bear market, and shares of highly leveraged companies continue to out-perform the averages. But he will have to give weight to Federal Reserve Board Chairman Alan Greenspan's recently expressed concerns.

In October Greenspan sent a letter to Senator William Proxmire (retiring chairman of the Senate Banking Committee) informing him that "the Federal Reserve Board . . . has cautioned banks . . . that they should . . . examine the prospects for LBO loans under a range of economic and financial circumstances." His concern appears to be that a recession might reduce borrowers' cash flow to such a point that, like Third World debtors before them, they will be unable to meet their interest payments, perhaps threatening the solvency of some banks. One banker says that "three or four banks . . . have over 50 percent of their LBO paper in retail companies," which he rates "the most risky because they're cash flow sensitive, with not a lot of assets behind the debt."

One must always respect Greenspan's judgment—he was, after all, decisive and, more important, right in moving to expand credit in the face of the October 1987 stock market debacle. But close examination of the available data suggests that he will ultimately decide that the words of caution he has already spoken are sufficient for two reasons. First, the markets are already taking corrective measures: lenders are demanding stiffer terms, and some have closed their books on these loans altogether. Second, banks are not really over-exposed. A major investment bank, working with data from the Federal Reserve Board and the *American Banker*, has provided some interesting numbers, in return for a promise of anonymity. In 1987, 9.1 percent of all commercial bank loans went to LBO borrowers. This means that, *on average*, the banks have not allowed LBO loans to become too prominent in their portfolios. Of course, some individual banks may be over-exposed to LBO loans, just as some Texas banks—but not the banking system as a whole—were brought to ruin by an over-weighting of energy loans in their portfolios.

Here is where we may get some idea of Bush's policy preferences. If he is the pragmatist that some conservatives fear him to be, he may decide to intervene to avoid the possibility that a few banks may run into trouble. He will, after all, have at his elbow Jim Baker, who specializes in trying to manage currency markets, and also Secretary of the Treasury Nicholas Brady, who thinks stock markets should be closed if they rise or fall too much. Not exactly a committed band of free marketeers.

But if Bush indeed has a visceral feeling in favor of letting entrepreneurs take risks in pursuit of profit, and bear the consequences of any bad judgments, he will let the LBO game run its course. If the banks think the returns warrant the risks associated with these merger deals, they should be left free to make the necessary capital available (subject, of course, to such restrictions as the Federal Reserve Board may impose to ensure the banking system's solvency).

National Debt

Finally, the President-elect will have to contend with nervous international bankers and finance ministers. U.K. Chancellor Nigel Lawson, sitting atop a growing budget surplus, has already renewed his unsolicited warnings to America that its continuing budget deficit could eventually cause a run on the dollar, and force it to raise interest rates to recession-producing levels. Like the Democrats, and some Doleful Republicans, international finance ministers would like Bush to raise taxes. Morgan Stanley's Byron Wien recently visited European money managers and noted "a consistently expressed suspicion that the economic problems facing the United States will grow worse over the next year . . ." Foreign investors, he reports, fear the consequences of "the long period of overspending by U.S. consumers and the federal government . . ." Some cut in spending and increase in taxes—almost all Europeans with whom I meet favor higher gasoline taxes in the U.S. on the misery-loves-company theory—is, in this view, clearly required.

Bush has asked us to read his lips. But this is easier than reading his mind, wherein thoughts about some compromise with Congress may be lurking—witness the chummy meetings the President-elect has held with House Speaker Jim Wright. After all, the world's money men have already fired a shot across the Bush bow: they sold the dollar down immediately after his election. And, by initially refusing to intervene, the Japanese central bank let it be known that it could not be counted on, indefinitely, to support the dollar in the absence of some move by the new administration to stanch the flow of red ink.

Everyone agrees that what is needed is a bipartisan, *credible* long-term plan for reducing the budget deficit. The problem is that such a plan has no independent existence: it is not a magic formula, waiting to be discovered. Rather, a deficit reduction plan, if one could be found, would reflect a consensus on how the nation's resources should be allocated between defense and social programs, and between current consumption and saving. Ronald Reagan and Jim Wright didn't disagree about bookkeeping: they disagreed about whether resources should be spent on the Strategic Defense Initiative and the Nicaraguan contras, on the one hand, or middle-income entitlements and bailing out Texas savings and loan associations, on the other.

Clearly, no consensus on deficit reduction exists. In its absence, Bush's proposed (and, so far, suitably vague) "flexible freeze" may provide the only available route through the budget thicket. If all recipients of federal largesse more or less continue to get what they have been getting (with perhaps a bit, too small to notice, shaved off in real terms), and if the economy keeps growing at a real annual rate of anything like 3 percent, the increase in government revenues should begin to whittle away the deficit. Such gradual reduction of the deficit should encourage foreign investors to continue to lend the U.S. the money it needs to finance the deficit, on reasonable terms.

There are, of course, several problems with this scenario. For one thing, it assumes that Congress is prepared to keep social spending more or less constant in real terms. With Bush himself calling for an expanded war on drugs, stepped-up help for AIDS sufferers, a so-called day-care program, and greater environmental protection, the upward trend in social spending is likely to continue. All this, while a multibillion dollar savings and loan time bomb is ticking in the closet. So, if Bush holds the line on taxes—which is far from certain—military spending will have to bear the brunt of any deficit-reduction program.

Remember: like Dukakis, Bush called for greater "burden sharing" during the campaign. This means that Europe and Japan will be asked to increase their defense expenditures so that we may reduce ours. But, with Europe enthralled by Gorbachev's "reforms"—the Germans are rushing in with credits to finance their new-found friends, Berlin Wall or no Berlin Wall—our allies are unlikely to increase the portion of their GNPs devoted to defense. This will give us an excuse to cut back our overseas commitments: in the interests of balancing our budget we may increase the imbalance of military power in the world.

In short, when Bush confronts the three debts—Third World, corporate, and national—he will be confronting most of the important issues of his presidency. Third World debt will force him to choose between those who would improve the lot of debtor nations by forgiving past loans, and those who feel that genuine economic salvation requires replacement of statist with free-market economies. Corporate debt will force him to choose between greater regulation of entrepreneurial risk-taking, and a hands-off policy that may produce a few spectacular bankruptcies. And national debt will force him to decide on his priorities—on how to allocate the nation's limited resources among competing claimants. So we should soon know more about our new President's basic philosophy—if, indeed, he has one. □

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EMINENTOES

EXPERIENCED CONSERVATIVES FOR BUSH

by Edwin Feulner

To specify criteria on who should play which roles in the new administration would be presumptuous and unfair. But it's clear that by calling on the best and brightest that contemporary conservatism has to offer, George Bush has a golden opportunity to broaden and deepen the conservative intellectual revolution that has been the wellspring for record-long economic expansion, restoring U.S. military strength, and turning Communist advances of the seventies into the democratic advances of the eighties.

Will the President-elect dance with the conservatives who brought him to the Inaugural Ball? Some conservatives are understandably uneasy, and for reasons that go beyond their well-known fear that they could be ignored in favor of Nixon-Ford-style Republicans. Since the New Deal, Washington has been the headquarters of the world's biggest welfare state—not exactly a natural stomping ground for champions of limited government and free markets. Most conservatives are disdainful of the federal bureaucracy, congressional inquisitions, and (by their standards) low salaries. To them, serving in the federal government is a pain justified only by the very ideological commitment that antagonizes the establishment.

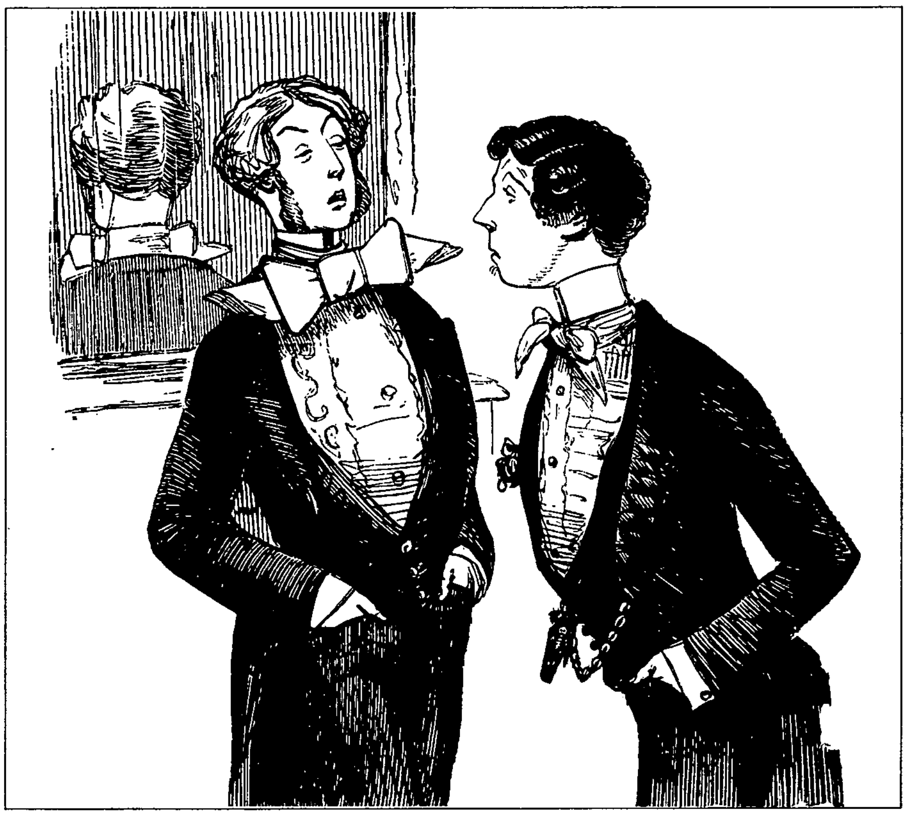
Nonetheless, the last eight years have shown that conservatives can not only analyze policy but change it. The Reagan era has bred a new generation of *competent* ideologues, and the depth and breadth of the conservative revolution will depend on whether their influence rises during the Bush years. In picking Dan Quayle, at 41 one of the Senate's staunchest conservatives, Bush said he was "reaching out to a new generation." If that attitude governs the rest of his appointments, he will have a chance to translate the ideological revolution of the seventies and eighties into the policy revolution of the nineties. Certainly a major stride in that direction was the selection of another hard-charging champion of conservatism, 49-year-old John Sununu, as chief of staff.

For Bush, there *is* a new generation to reach out to. In the last fifteen years, conservatives have generated virtually all the new ideas to be found in the political arenas of both America and Europe. If there has been anything comparable coming from the left since the New Left was laughed into oblivion in the mid-seventies, it has escaped my attention. The left has done little over the last twenty years but reduce Hubert Humphrey's politics of joy to the politics of gloom. Radical-chic relics have fled to redoubts in the media, the universities, popular culture, and the federal government. The time is ripe for George Bush to empower a generation of young to middle-age conservatives in Washington.

To be sure, some of my conservative brethren sometimes act as if presidential appointments should resemble the ordination of priests, with tainted "pragmatists" purged from the ranks of the pure. That may be apt, say, for political science departments bent on knowing which Marxist profs have been orthodox enough to deserve tenure, but it's suicidal nonsense in Washington.

The selection of James Baker as Secretary of State, for example, has made some conservatives nervous. The State Department, true enough, has been the chief roadblock to implementing Reagan's foreign policy. You advance in the Foreign Service not by rocking boats or offending foreign governments, but by charmingly accommodating the status quo, which is why the White House, not the State Department, must control foreign policy, with the President relying on a strong national security adviser.

But that's hardly an argument against Baker. As White House chief of staff and Secretary of the Treasury under Ronald Reagan, and of course the architect of Bush's bracingly conservative presidential campaign, Baker has shown he is well equipped to make State more responsive to the will of the President—and hence the electorate.



Shortly before the election Baker told the National Press Club that among the distinctions the campaign clarified was that Bush "is more comfortable with the notion of using American military force—when absolutely required—to defend American interests. And he is less willing to cede American leadership in world affairs to multinational institutions." There are better things to lose sleep over than the fear that Jim Baker will return us to the peace-through-niceness hooey of the seventies, however wedded to that hooey State itself remains.

Baker could do a lot to calm the concerns of conservatives by appointing a few rising young conservatives to key positions. Phillip Hughes, for example, is a former assistant to Vice President Bush, a member of the National Security Council staff, and deputy assistant secretary of state for politico-military affairs. Now an assistant secretary of commerce, he is a natural to fill one of the key assistant secretary positions at State.

If Bush means what he said about going ahead with Reagan's Strategic Defense Initiative, he must save it from the budgeteers at the Pentagon who worry that strategic defenses will draw money away from their preferred weapons. It is time to put SDI in the hands of a highly qualified civilian who is dedicated to its success. Ambassador Henry Cooper comes to mind. A scientist and former deputy assistant secretary of the Air Force, Cooper is now U.S. ambassador to the Defense and Space Talks in Geneva and knows better than anyone else how important SDI is in getting Moscow to negotiate on our terms rather than theirs.

People such as John Lehman, the former secretary of the Navy whose yeoman efforts restored America's sea power; Richard Perle, the former assistant secretary of defense whose "zero option" concept makes him, in effect, the grandfather of the treaty on intermediate-range nuclear forces the Reagan Administration signed with the Soviet Union; and Assistant Secretary of State Elliott Abrams, whose elo-

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Edwin Feulner is president of the Heritage Foundation.

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