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POLITICAL PULSE

Buried Alive?

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Social Security reform is tied to the Bush growth agenda -- and both are still in play.

The media is declaring the death of **President Bush's Social Security** reform initiative, but the resiliency of the stock market over the last week in the face of this seemingly bad news --and with bond yields rising at the same time -- suggest to us both that stocks are undervalued and that the reform initiative is still very much alive. Conversations with **White House** sources confirm that reform is anything but dead. In terms of visible efforts, the President plans to spend twelve days out of the next thirty on the road stumping for Social Security reform with personal accounts. Behind the scenes, the true heart of the process will continue: private conversations with a dozen **Democrats** whom the White House believes are candidates for supporting the president in some form of reform. The White House never expected a lightning victory, anyway. As one source told us, "Under the best of circumstances, we wouldn't be seeing a vote before September or October."

The fate of Social Security reform with personal accounts is important to markets for two key reasons. First, if the initiative *succeeds*, the advent of personal accounts would expand the natural clientele for long-term equity ownership and thus catalyze an important upward revaluation. Second, if the initiative *fails*, it will break George Bush's winning streak, thus significantly lowering the chances for more pro-growth policy over the coming four years. The White House is intensely aware of the latter, and is attempting to use it as a whip to bring balky **Republicans** into line behind an initiative about which they are naturally cautious. One White House source told us, "For anyone who spilled blood to get this president re-elected, for whatever reason, you have to support him on this or it's all over."

Of course the Democrats are aware of it too -- thus the ferocity and solidarity of their opposition. That's why the White House believes the single most critical next step is to "turn" even a single Democrat, in the hopes of breaking that solidarity. *That*, in turn, is why the White House has been so annoyingly vague about the details of its reform proposal, and so open to dangerous anti-growth measures such as lifting the payroll tax wage cap, which wouldn't even importantly improve the system's solvency (see "Pyrrhic Victory?" February 23, 2005). As one White House source told us, the targeted Democrats "know raising the cap doesn't do anything. But if they sign onto a Republican ideology, they fear for themselves in that." So keeping the terms of debate open is essential in the short term. Longer term, the same source urged us not to worry: "[The president] is a guy who has cut taxes four times in four years. His natural inclination is to *cut* taxes." We hope he's right.

Whatever the ultimate fate of the Social Security reform initiative, for the moment the important thing is that the White House at the very least be seen as still trying. If the initiative is indeed fated to die, then better its death be deferred until after **Congress** votes on this year's budget, in which the 2003 tax cuts on dividends and capital gains can potentially be made permanent. If

Social Security reform dies first, the tax cuts may well die with it. In that sense it's a relief to hear the White House talking about a vote on Social Security in September or October at the earliest.

Bottom Line: We are in a period of risk to pro-growth policy, which is difficult for stocks. But the possibilities of very positive policy outcomes are still very much alive, which suggests significant upside. Stocks remain very undervalued, even in the face of rising interest rates, so the downside is limited.