Republicans and the Populist Temptation

By Donald L. Luskin

The best stock market rally in 74 years may have ended on Jan. 19, the same day Republican Scott Brown won the Massachusetts U.S. Senate seat held by Democrats for 57 years. We don’t know yet whether the alarming move down in stocks since then is simply a correction or something more serious. But the coincidence of these two history-making events raises troubling questions -- especially since a Republican resurgence, on the face of it, would seem to be good for business and good for stocks.

From the beginning of this historic rally of 73% over the 316 days since last March’s market bottom, politics has been an important theme. That horrific bottom was reached after Democrats in Congress rammed through a $787 billion stimulus bill so quickly that no senator or representative could have possibly read all 1,073 pages of it. That hastily concocted porkfest should not be credited with turning stocks around. Rather, it should be blamed for the more than 18% loss that stocks suffered in the 24 days from the date of its enactment to the day of the March bottom.

The haste with which the stimulus bill was enacted made it seem certain that the cap-and-trade energy tax, unionization “card check,” mortgage “cramdown” and health insurance nationalization would become law as soon as votes could be taken. It wasn’t only the antigrowth implications of these initiatives that had investors terrified in March. It was the sheer recklessness with which they were being stuffed through the legislative pipeline under the Rahm Emanuel doctrine of never letting a good crisis go to waste. The crippling uncertainty of it all was making that good crisis worse.

Since then the historic stock market rally has tracked the demise, one by one, of all these initiatives, because investors could see that a political environment that had been far out of equilibrium was quickly finding its balance. Republicans stayed unified in their opposition, while in every case key Democrats lost their nerve. Since the stimulus, precisely nothing has been accomplished by the Obama administration or the Democratic Congress. The good crisis went to waste, and stocks soared.

Seemingly, the election of Scott Brown in Massachusetts should only be a continuation of that beneficent trend back toward political balance. At a stroke, it denied the Democrats their filibuster-proof Senate majority -- and opened up the real possibility of the Republicans taking control of one or both houses of Congress in November. Perhaps in 2011 a dream team, the same party configuration that proved so fruitful in the 1990s: Democratic president and GOP Congress.

So why did stocks collapse the moment the vote was tallied in Massachusetts?
It’s because the immediate reaction to the Brown election -- in both parties -- has been a dangerous lurch toward antibusiness populism. The Obama administration’s strategy has been to latch onto something that both parties can agree on: lynching Wall Street.

Just 24 hours after Mr. Brown’s upset win, the White House let it be known that a radical plan to break up the largest banks, and to limit their size, was about to be announced. The next day the plan was revealed, and christened “the Volcker rule.” What better way to lure Republicans onto a populist, antibank bandwagon than to associate it with the legendary Reagan-era figure?

Days later came the ordeal of Ben Bernanke’s confirmation for a second term as Fed chair. Surely there are principled reasons for denying his confirmation, as there would be for any Fed chairman (they all have a way of being far from perfect). But it hardly seems possible that senators facing tough re-election challenges this year -- such as John McCain (R., Ariz.) and Barbara Boxer (D., Calif.) -- would just happen to discover those principled reasons in the hours immediately following the Brown election in Massachusetts.

More likely, they seem to have interpreted the fact that Mr. Brown wore a barn-jacket and drove a beat-up truck as indicating a voter preference for least-common-denominator populism. It’s the low road to be sure, but desperate people do desperate things. And it might work. A recent NBC/Wall Street Journal poll showed that Americans with college degrees, and with more than $50,000 invested, supported Mr. Bernanke’s confirmation. But those with only a high-school education, and with no money invested -- the classic populist audience -- opposed Mr. Bernanke’s confirmation.

These developments have been profoundly destabilizing for stocks not because some version of the “Volcker rule” would necessarily destroy America’s financial system, or because Ben Bernanke is utterly irreplaceable at the Fed. The crux of it is that it reveals a political process so dangerously narcissistic that it would use core institutions of the nation’s economy as pawns in its own power struggles.

It’s so dangerous because it potentially involves both parties, just when the Brown victory in Massachusetts holds out the hope of benign gridlock.

Don’t think that Republicans can’t be sucked in when an anti-Wall Street lynch mob gets its blood up. Recall that Sarbanes-Oxley, the devastating antigrowth response in 2002 to the Enron and WorldCom scandals, was passed with virtually unanimous support by Republicans in Congress, and signed by a Republican president. Recall that last year 85 House Republicans voted for a 90% tax on bonuses for any employee of any bank that took more than $5 billion in TARP money.

Investors got some good news last Friday. Stocks resisted following through on Thursday’s sharp plunge after it was announced that the Senate Banking Committee’s Democratic Chairman Chris Dodd and Republican ranking member Richard Shelby have reached an impasse on bank re- regulation. That’s a nice downpayment on what investors need a lot more of now: proof that the GOP won’t join Democrats in an anti-Wall Street race to the populist bottom.

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