

BRIDGING THE DIVIDE

THE ECONOMIC AND FISCAL CHALLENGES
FACING THE NEXT U.S. PRESIDENT



REUTERS BREAKINGVIEWS

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Front cover photograph: Republican presidential nominee and former Massachusetts Governor Mitt Romney and U.S. President Barack Obama smile at the end of their first U.S. presidential debate in Denver on Oct. 3, 2012. REUTERS/Brian Snyder

PREFACE

America is divided. That at least is the message from the two parties in the run up to presidential and congressional elections on Nov. 6. Polls are neck-and-neck with the election just three weeks away. History suggests economic measures are among the best predictors of elections, and that social issues, gaffes and debate performances matter a lot less. And for whichever candidate wins, task number one will be the economy.

Bridging the divide – the title of this e-book – will require bipartisan compromise that hasn't been much in evidence in Washington of late. Starting with the idea of doing no harm, the occupant of the White House come January 2013 will, above all, need to focus on employment. But he will be constrained by a federal budget that's under pressure.

That means either Barack Obama or Mitt Romney will have to act fast to appoint an economic top team with an understanding of the labor market, budgeting, and getting things done in Congress, among other skills. The first section of this e-book contains Breakingviews articles on the U.S. economy, jobs and the people who might end up in charge under each candidate's leadership. Our interactive Economic Dream Team Machine allows readers to see how their own selections shape up.

Next is a collection of views produced by our columnists during the long campaign for the presidency, shedding light on the characters involved and the issues raised, from Occupy Wall Street's protests about inequality to federal budgeting via taxes and Romney's private equity background. Though surges from other Republican candidates seemingly changed the game at times, we tipped the eventual winner of the party's nomination early on.

Finally, we touch on a few of the other finance and economy-related challenges that will be in the next U.S. president's Oval Office in-box – among them tax, continuing bank reform, housing finance, and the cost of military activity overseas.

The Democratic and Republican policy platforms, while different in theory and emphasis, probably won't end up being so far apart in reality. That's especially the case if Obama is re-elected and has to work with a Republican House of Representatives, or the GOP challenger, Romney, wins and faces a Democratic Senate. But with the candidates in the final, high-tension stretch of their race, grounded insight may be hard to come by – except in this e-book! Happy reading.

Richard Beales
October 16, 2012

IT'S STILL THE ECONOMY, STUPID

O's odds

By Richard Beales

Bill Clinton's campaign advisers are still right: For Barack Obama, it really is the economy, stupid. One respectable forecasting model puts the U.S. president with a hair over half the two-party vote on Nov. 6, 2012. A Breakingviews calculator shows how even slight changes in the economic growth rate before then could tip the result dramatically.

Among the best economic indicators for American elections are measures of personal income. The unemployment rate, which fell sharply in November but at 8.6 percent is still worryingly high for a sitting president, is a favorite of pundits – but it's not well correlated to election votes. The rate of change of unemployment may be better, but that's probably already reflected in income growth.

Ray Fair of Yale University has developed a model that predicts the vote share reasonably well when tested on the 24 presidential elections since 1916. Its main inputs are the real growth rate of per capita GDP in an election year and inflation throughout the ending presidential term. Fair has a third input to incorporate the "feelgood factor" of short periods during the term when growth is particularly robust.

The Breakingviews calculator is based on Fair's model, but simplifies it and turns the result into a probability of winning. Assuming 2.5 percent annual GDP growth from the last quarter of 2011 until the election and inflation running just under 2 percent, Obama's share of the two-party vote comes out at 50.3 percent. (This ignores the potential distortions of an independent candidate, and of the electoral college that actually chooses the president.) That slim-looking margin converts into a probability of winning of about 54 percent.

For more evidence that things are on a knife-edge 10 months out, consider figures from Intrade. On Wednesday, the prediction market gave Obama a 52 percent chance of re-election. His approval rating – around 45 percent as of Jan. 2, according to Gallup – seems to bode less well. It is early to read too much into that, and Obama's approval has lately edged upward, but he will be in trouble if it stays too far below 50 percent.

Breakingviews has built a "swing factor" into the calculator to incorporate users' own adjustments. But the economy is the key. For instance, if growth hits 3 percent, the Democrat Obama's probability of winning veers to 70 percent or so. Conversely, weaker growth than hoped could easily put a Republican opponent – let's call him Mitt Romney given his Iowa win – in the White House.

January 4, 2012

Will Obama get re-elected in 2012?

This calculator shows how likely it is that President Barack Obama will win a second term in U.S. elections in November 2012.

GDP growth in year to Q3 2012



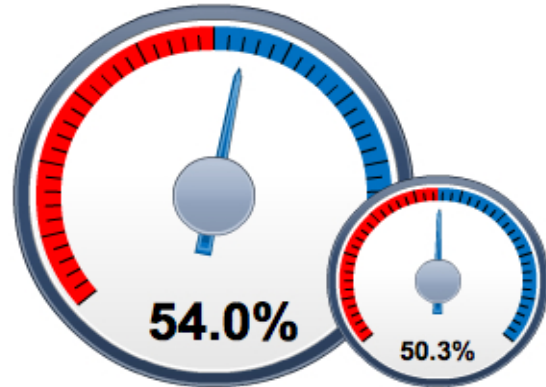
Inflation in year to Q3 2012



Swing factor - shift in two-party vote to/away from Obama



Probability of Obama winning 2012 election



Forecast vote share



Reset original values

How it works

View story

View full calculator

Source: BreakingViews, adapted from Ray Fair, Yale University
Reuters graphic/Vincent Flasseur, Richard Beales
04/01/2012



REUTERS BREAKINGVIEWS

Try the interactive Breakingviews election calculator: <http://link.reuters.com/tyf85s>

Jobs math

By Daniel Indiviglio and Richard Beales

There's still a long slog ahead for the unemployed in America. Jobs growth has started picking up. But even at a rate of 250,000 a month, a hair above January's figure, full employment may not be reached until 2020. A new Breakingviews calculator shows how a faster or slower rate of job creation changes that picture.

The important headline variable is the jobs growth reported in the U.S. monthly employment report – the stronger, the better. But a few other factors also matter when looking ahead. One is population growth, and another is how quickly the labor participation rate increases toward a more typical level. That's the percentage of the population defined as either working or looking for work.

Since the recent recession began, millions of workers have become discouraged and temporarily given up on finding a job. The labor participation rate has declined from 66.4 percent in 2007 to 63.7 percent in January. Suppose participation recovers to that 2007 level by January 2020. This trend coupled with population growth at the average rate seen between 2003 and January this year would call for almost 200,000 new jobs a month just to hold the unemployment rate – 8.3 percent as of January – steady.

Then there's the question of what level of joblessness reflects, essentially, full employment, since there will always be people between jobs. The calculator allows this input, as well as the other key ones, to be changed, but starts out assuming that 5 percent unemployment is the target.

With these assumptions, full employment would only be reached again in America in early 2020. If the monthly job creation rate jumped to 300,000, that date would be brought forward nearly four years.

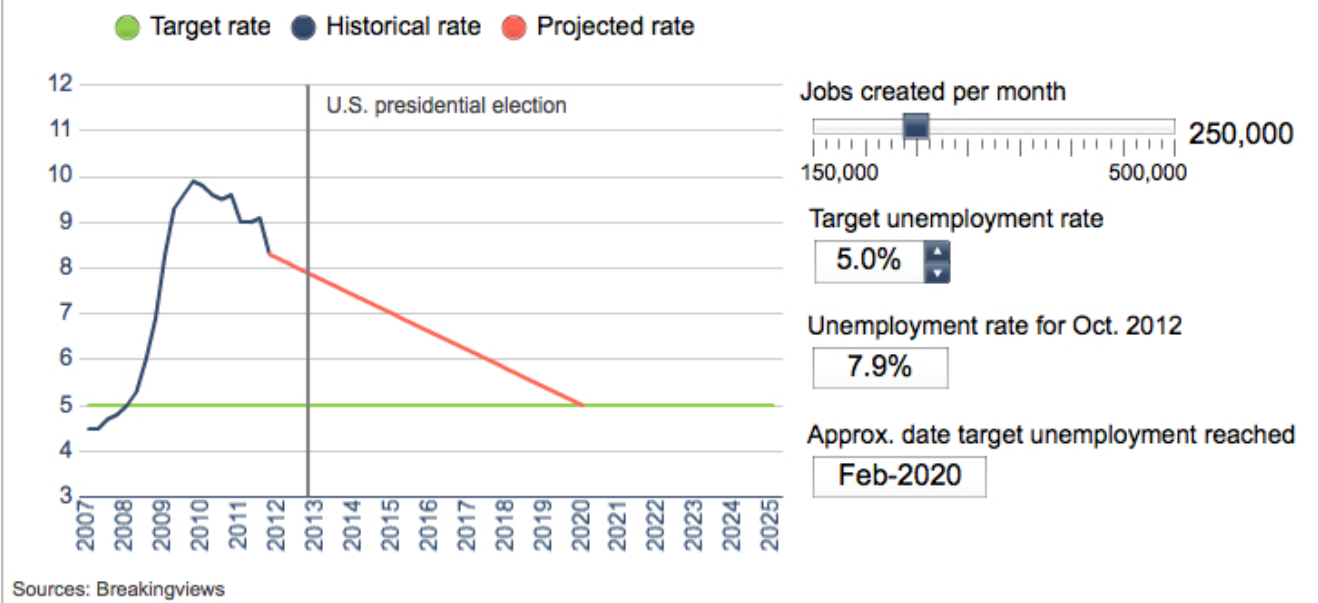
With November's presidential election never far from the news, the calculator also shows how the unemployment rate might look just beforehand. The actual data for October will be released just a few days before the election, making that employment report the last major economic indicator that may affect President Barack Obama's re-election chances.

With the base assumptions already outlined, unemployment could dip just below the 8 percent mark in October. For that to happen, Obama needs an economic shock-free spring and summer. But whether he or someone else occupies the White House in 2013, job creation looks set to remain near the top of the agenda.

February 8, 2012

How long will America's jobs recovery take?

Meantime, how will unemployment look for November's elections?



Reset original values

How it works

View full calculator

View story

Reuters graphic/Vincent Flasseur, Scott Barber, Daniel Indiviglio, Richard Beales
07/02/2012



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Try the interactive Breakingviews U.S. jobs calculator: <http://link.reuters.com/cag56s>

Dream Team Machine

By Rob Cox and Daniel Indiviglio

Mitt Romney says the first day of his presidency would be exceptionally busy. The former Massachusetts governor has promised to overturn two of his predecessor's landmark legislative achievements, the Affordable Healthcare Act and the Dodd-Frank financial reform bill; he would approve the Keystone energy pipeline from Canada, introduce sweeping tax cuts and brand China a currency manipulator.

President Barack Obama cannot promise instant action, but he is equally ambitious. In his second term, he says he will impose the "Buffett rule" to ensure the rich pay more tax, cut tax rates for middle class families, stop the "war on women," prevent a rollback of environmental protection, reform immigration laws and, not to be outdone by his Republican challenger, crack down on China.

But here's one thing neither camp will actually say out loud: they won't have the luxury of choosing their first big legislative priority. In all likelihood, it will be dictated to them. Election pledges will take a backseat to the so-called "fiscal cliff." Some \$450 billion of tax increases and about \$1 trillion of

spending cuts kick in come January 2013. If the post-Nov. 6 election session of Congress does anything, it is likely to delay the start date, throwing the issue right into the lap of the new president.

“Whether it’s done now or in the lame-duck session, Congress is going to have to extend it, say 100 days or so, at least enough time to get it done,” says Larry Fink, chief executive of BlackRock, the fund manager overseeing \$12 trillion of assets, who is also one of Wall Street’s most influential Democrats. “And it’s going to be the big priority for whoever gets to be president,” he told Breakingviews over the summer.

So the first challenge for the next administration will be to find a way to reduce government and entitlement spending and reform the tax code. The task is Herculean, thanks to gridlock on Capitol Hill. But a president who manages to bring the parties together will be in a better position to fulfill his other campaign pledges. Moreover, putting the United States on a stable long-term financial trajectory, and taking the prospect of a European-style debt crisis off the table, is the stuff from which legacies are made.

The president, whether he is on his final term with a solid mandate from the electorate or is a technocratic leader with a budget wonk as vice president, must build up an economic dream team. Nothing less will convince a polarized legislature, where House members and a third of the Senate have been newly elected, of the need to sacrifice.

The trick is to combine number-crunching whizzbangery with reach-across-the-aisle legislative prowess. To that end, the Breakingviews Economic Dream Team Machine allows anyone to choose a Delta Force of suitable people to run the U.S. Department of Treasury, the White House National Economic Council and the Federal Reserve, along with a “wildcard” position, which could be the leader of, say, the White House Office of Management and Budget, chief of staff or even a Budget Czar.

“A dream team would combine academic and policy experience with people from industry who understand the cycles of business,” Jon Huntsman, the former Utah governor who served as Obama’s ambassador to China and challenged Romney for the Republican nomination, said in an interview. “The most important thing we can do right off the bat is a big deal on taxes and spending because our national security depends on our fiscal stability.”

Of course, the United States has other economic challenges. At home, the 8.1 percent unemployment rate is much too high. Internationally, the country should seek out a better equilibrium with a new Chinese leadership, expand and strengthen global trade pacts and implement financial reforms in ways that ensure stability for the global banking system without disadvantaging American capital markets. But while those issues are important, they will be tackled more easily once the budget uncertainty is removed.

As the Economic Dream Team Machine shows, both sides have many potential corporate executives, veteran politicians and government officials from whom to choose. But neither candidate needs to rely solely on his own party. In fact, it would be wise for whoever wins the election in November to choose a bridge-builder from the other side of the aisle. Either candidate could, for instance, try to lure New York Mayor Michael Bloomberg to take on the role of Budget Czar or some other temporary economic position. Similarly, Romney could tap Democrat Erskine Bowles, co-chair of the National

Commission on Fiscal Responsibility and Reform, the group created two years ago by the president to look at fiscal matters, to encourage bipartisanship.

Either way, the Treasury secretary is the key position. In the role since Obama took office, Timothy Geithner has been involved – like his predecessor Henry Paulson – in everything from budget talks to cooling the financial crisis to new regulation to challenges in Europe and China.

Another critical post is the director of the National Economic Council, a White House function created in 1993 by President Bill Clinton to coordinate economic policymaking. Under Obama, Larry Summers and then Gene Sperling held the position as the U.S. leader's closest adviser on all things economic. The ideal candidate for either job would be a strong dealmaker to tango with Congress. No matter who wins the White House, neither party will have unchecked control, and negotiation is inevitable.

In addition, the next president will have the opportunity in 2014 to renominate Ben Bernanke as chairman of the Federal Reserve. Obama has shown support for the incumbent Republican, first appointed by President George W. Bush, while Romney has said he would seek to replace Bernanke. Though the Fed chief would not be involved in hammering out fiscal and budgetary policy, monetary affairs play an unquestionable role in the economy and the position offers a bully pulpit for influencing legislative policy.

Other key economic White House jobs could include the director of the OMB; chairman of the President's Council of Economic Advisers, effectively a brain trust of economists; the Commerce Secretary and, potentially, the president's own chief of staff.

Part II: Who should get the jobs?

Democratic team

Given Obama's current standing in the polls, it makes sense to start with the Democrats. At Treasury, Geithner has said he will not stick around. Among current West Wing employees, Chief of Staff Jacob Lew tops the list. Obama clearly trusts Lew, having promoted him from running State Department operations to OMB director and then to the highest-ranking executive office post. His budget and deal-making chops, plus brief tenure at Citigroup, give him a multifaceted background suitable to the job.

To neutralize accusations Obama has insufficiently reached out to the private sector, Wall Street holds some plausible picks, including BlackRock's Fink; Roger Altman, the founder of investment bank Evercore; and Blackstone President Tony James. Though the financial industry remains controversial, all three men have emerged from the crisis with their reputations intact and are seen as capable of receiving congressional confirmation.

Bloomberg LP Chief Executive Daniel Doctoroff, who served as deputy mayor of New York City under Bloomberg, would offer "all the benefits of Bloomberg without Mike Bloomberg," according to one former Treasury staffer. Other plausible candidates are Honeywell chief David Cote, who served on the president's deficit and job creation commissions, and Google Chairman Eric Schmidt. More inspired would be Facebook Chief Operating Officer Sheryl Sandberg, who is close to Geithner and served as chief of staff to Larry Summers when he ran the Treasury under Clinton. However, the

social network's terrifically botched initial public offering – and some \$130 million of unvested stock awards – could keep her in Silicon Valley a while longer.

The drawback shared by most of these potential Democratic business candidates to run the Treasury would be a lack of legislative experience, if the president envisions one of them leading his efforts to strike a grand budget, tax and entitlement compromise through Congress. That could make them more suitable for other economic leadership roles.

The best Treasury candidate, though, would be Bowles, who is already working with members of Congress to craft legislation that would delay the start of the fiscal cliff and set the framework for a larger bipartisan compromise. He calls it his "Cialis plan." "When the time is right, we'll be ready," he told Breakingviews. Talk of enmity between Bowles and Obama over the handling of the National Commission on Fiscal Responsibility and Reform's proposals could be an obstacle, but not an insurmountable one.

With Bowles, Warner or Lew at Treasury, an Obama 2.0 economic team would need rounding out with business and international experience, of which the administration – despite criticisms it has given the cold shoulder to business – has a surprisingly ample number of potential candidates. To win them over, however, the president would need to assure them of greater influence than previous executives who have made the jump, such as former JPMorgan banker William Daley. The former chief of staff clashed with some of the president's inner circle of advisers.

Republican team

Romney has already made budget issues and entitlement reform a centerpiece of his campaign by picking House budget committee chair Paul Ryan as his running mate. Ryan's experience on the Hill might give his administration a leg up in working with Congress on a big fiscal deal, though the Wisconsin representative's draconian budgetary approach has won him little comity across the aisle.

Either way, with Ryan on the ticket Romney is more likely to choose a Treasury secretary versed in other priorities like financial stability and job creation. That's something he will find more readily in the corporate world than in government or academia, even though the tenures of industry chieftains John Snow and Paul O'Neill under Bush were widely considered to have been lackluster. "An understanding of the private sector is important," said former Hewlett-Packard CEO Carly Fiorina, who has been advising the Romney campaign on economic matters. "I think an academic is not the right résumé."

Apart from Fiorina herself, Samuel Palmisano, who recently stepped down as IBM chairman, might fit the bill. So would New York Deputy Mayor Bob Steel, who is also a former Wachovia CEO and Goldman Sachs partner. Two of Silicon Valley's most prominent Republicans, HP boss Meg Whitman and Cisco Chairman John Chambers, have said they're not inclined to take administration jobs, though both have spoken publicly about the need for fiscal reform. "If we don't deal with the fiscal cliff and don't deal with predictability on taxes for both citizens and business, with the rest of the world in a struggling state, this is really bad for us," Chambers told Reuters last week.

Though not wholly a product of Corporate America, former Fed Governor Kevin Warsh would perhaps make the best all-around candidate for the job. Warsh was one of the chief firefighters during the 2008 financial crisis, alongside Geithner, Bernanke and Paulson, earning him respect from members of his own party, Democrats and the capital markets. The former Morgan Stanley banker is also close

to Ryan, who taught him to shoot handguns. But Warsh tells friends he is enjoying private life, teaching at Stanford, giving speeches and helping billionaire Stanley Druckenmiller manage his considerable fortune.

Economic Dream Team Machine

Can you build a team that will fix the American economy? Reuters Breakingviews editors have evaluated candidates for key economic positions in an Obama or Romney presidency and graded them in five categories with scores ranging from as low as one to as high as five depending on prior experience. Click on prospective candidates to learn more about them and see their scores and then drag and drop them onto the positions you want them to fill. As you make selections, each presidential candidate's team total points are tallied through a sum of their scores in the five subject areas. When all the jobs are filled you'll see a total score for each candidate's team to see how they match up. [About](#) | [Read full article](#)

Team Obama

60

Budgeting Finance Markets Job Creation Legislative International

Team Romney

60

DEMOCRATS

- Roger Altman
- Max Baucus
- Xavier Becerra
- Jared Bernstein
- Michael Bloomberg
- Erskine Bowles
- Lael Brainard
- Hillary Clinton
- Kent Conrad
- David

Presidential Nominee

Barack Obama

Treasury Secretary

Erskine Bowles

National Economic Council Director

Lael Brainard

Federal Reserve Chair

Richard Fisher

Wildcard

Michael Bloomberg

REPUBLICANS

- Jeffrey Immelt
- David Koch
- Mike Leavitt
- Chris Liddell
- Greg Mankiw
- David McCormick
- David Nason
- Samuel Palmisano
- Rob Portman

Mitt Romney

Glenn Hubbard

Greg Mankiw

Sheila Bair

Michael Bloomberg

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Try the interactive Breakingviews Economic Dream Team Machine: <http://link.reuters.com/kaz33t>

David McCormick, who served as undersecretary for international affairs under Paulson, might be a sleeper candidate for a Romney economic squadron. The West Point graduate and Gulf War veteran is currently co-CEO of Bridgewater Associates, the massive Connecticut hedge fund led by cultish founder Ray Dalio. McCormick has served as president of a public company, Ariba; worked as a McKinsey consultant and been the CEO of a Wall Street trading venture.

Corporate bias aside, there would undoubtedly be a place for academics and experienced government officials on a Team Romney. After all, his top economic adviser is Columbia Business School Dean Glenn Hubbard, who has worked at Treasury and chaired Bush's Council of Economic Advisers. Though he lacks the legislative nous key to bargaining a sweeping fiscal deal, he has devoted much of his work to budgetary issues. Similarly, former World Bank boss Robert Zoellick has international gravitas and finance experience, but is considered by some Republicans to be difficult to work with.

Rob Portman, who made Romney's vice presidential short list, would bridge the parliamentary gap. The Ohio senator is a former congressman, was director of OMB and served as U.S. trade representative. Still, some combination of corporate experience with Zoellick or Hubbard at Treasury or the NEC – and with Ryan leading the charge on the Hill – might offset the shortcomings of any individual candidates.

The other academic in the frame for an important role following a Romney victory would be John Taylor, the Stanford economist who developed the eponymous rule on how central banks should set monetary policy in response to changes in inflation, output and employment. Though Taylor served as undersecretary of the Treasury for international affairs under Bush, and as an economic adviser to George H.W. Bush, Gerald Ford and Jimmy Carter, he is considered more likely to accept a job as Bernanke's replacement.

October 2, 2012

THE LONG CAMPAIGN

Elephant stampede

By James Pethokoukis

The Federal Reserve economic forecast is bleak. It predicts high unemployment will plague the rest of President Barack Obama's four-year term. The assessment provides the strongest reason yet for any Republican who ever dreamed of occupying the Oval Office to launch a campaign in 2011 to be the party's candidate to challenge Obama in November the following year. And many will. But the president remains a formidable opponent.

The midpoint of the November 2010 economic outlook from Fed policymakers has unemployment ending 2012 at around 8 percent. Even if Obama's trillion-dollar stimulus spared millions of jobs, Republican candidates will surely remind voters that the president's economic advisers promised to keep unemployment from ever hitting that lofty level.

Obama's team likes to compare its political plight to that of President Ronald Reagan. Unemployment was 8 percent or higher for half of the Republican's first term, the last time the country experienced a recession anywhere near as bad as this latest one. And Reagan still won by a landslide. But the economy was racing and the jobless rate tumbling when he faced voters in 1984. Another White House incumbent who looked a guaranteed loser was Harry Truman in 1948. But blistering 7 percent GDP in the first half of that year helped Truman pull off the biggest upset in U.S. presidential election history.

Obama probably won't have such wind at his back. An overhang of debt and housing problems should keep GDP growth moderate. Some at the Fed also reckon that even if growth picks up sharply, workers still won't have appropriate abilities for available positions.

Perhaps with that in mind, a herd of Republicans are sure they have just the right skills for Obama's job. The frontrunner, whether measured by polling, financial or betting market performance, is Mitt Romney, the former Massachusetts governor and head of private equity firm Bain Capital. But he will need to contend with a group of rivals that may include Sarah Palin, Minnesota Governor Tim Pawlenty and Senator John Thune of South Dakota. By late spring, the crowded field will be set.

GOP contenders shouldn't get cocky, however. By 2012, Obama could have unexpected economic improvements to boast about. And the president's own finances should be sound even if America's aren't. He could raise \$2 billion for a second run – and sitting U.S. presidents rarely lose. What's more, midterm election beatings seem to have little bearing on re-election odds. For now, those too are working in Obama's favor, suggesting a better than even chance at four more years.

December 29, 2010

Big government walkover?

By Martin Hutchinson

The Keynesian consensus may win by default in the United States' 2012 election. With New Jersey Governor Chris Christie out, former Massachusetts Governor Mitt Romney looks more likely to win the GOP nomination. He professes a wish to change policy, but his history shows him susceptible to the big-government consensus. The Tea Party's Austrian hard-money views could fade from view in the election.

Romney's best-funded and most credible rival is Texas Governor Rick Perry. But Perry's poll ratings have stumbled amid a handful of presidential debate missteps that will be difficult to recover from. Of the other candidates, pizza magnate Herman Cain lacks political experience; Texas Representative Ron Paul has an economic platform and devoted following but is too off the mainstream to win; Representative Michele Bachmann is underfunded and prone to gaffes and former Speaker Newt Gingrich is unpopular with independents.

Surprises are of course possible. But as of today, there are fewer obstacles in Romney's path to the Republican nomination, though with his private equity past and riches he may be vulnerable to a populist Obama campaign thereafter.

Romney has presented a 59-point economic plan promising change from current policies. Some of it owes more to populism than to consensus economic policy, such as its promise to impose unilateral tariffs on Chinese goods. Nevertheless his proposed spending cuts are vague and he has notably not endorsed Representative Paul Ryan's Medicare reform plan. He has pledged not to re-appoint Fed Chairman Ben Bernanke, but his opposition to Bernanke's loose-money policies seems half-hearted.

Additionally, Romney's track record hews to the Keynesian consensus still guiding policy in Washington. His Massachusetts healthcare plan was a model for President Obama's. Romney approved increasing inflation-adjusted spending in the Bay State by 3.8 percent. His father was also a big-spending governor of Michigan in the 1960s.

In 2010's congressional elections, the Tea Party's economic program of small government and hard money prevailed. In 2012's presidential election, don't be surprised to see Keynesians getting a bit of a walkover.

October 5, 2011

Weak Tea

By Edward Hadas and Christopher Swann

Occupy Wall Street has the elements of a serious political uprising. Like any number of crusades before it, this one began as a series of ragtag protests. The campaign also is zeroing in on a single theme: America's richest 1 percent, or conversely, the other 99 percent. Yet it's still hard to see Occupy fully catching on.

The Tea Party represents an unlikely role model. Like that conservative movement, Occupy began as an incoherent, populist expression of anger partly catalyzed by social media. It took a concerted effort to rally the troops around an intelligible agenda of low taxes and small government.

The Occupy protesters, who brandish an array of contradictory banners, are also becoming more focused. Their message of growing inequality should pack a powerful punch. The richest 1 percent of U.S. earners more than doubled their share of national income to 17 percent in 2007 from 1979, according to a new report from the Congressional Budget Office.



A supporter of U.S. President Barack Obama wears a 99 percent shirt while speaking at a campaign event at Natural Habitat Park Field on the St. Petersburg College Seminole Campus in Florida on Sept. 8, 2012. REUTERS/Larry Downing

Yet it looks doubtful the campaign will recreate the Tea Party's political stir. True, even President Barack Obama said he understands the "frustrations" expressed by the Occupy protesters. But his sympathies, like those of other lawmakers, come only in the vaguest terms. Even becoming an influential fringe of the Democratic Party will be a struggle.

Class warfare repels Americans. Economic envy seems almost unpatriotic in the land of opportunity. Most Americans believe they or their children will climb the economic ladder, even though sociological studies suggest Europeans have a better chance. The privileged are increasingly segregated from the rest of society. The lack of personal contact may keep indignation away.

What's more, U.S. elections demand that both major parties call on the top 1 percent with regularity to finance their campaigns. The small-government brigade, whose austerity policies tend to accentuate social inequality, present a case that better suits U.S. political culture. The Tea Party message already has reshaped Congress and influenced several Republican presidential candidates. Occupy Wall Street may tug at Democratic hearts if it becomes more respectable. But its own version of Rick Perry or Michele Bachmann seems unlikely to emerge.

October 31, 2011

Resigned to failure

Agnes T. Crane

Global investors have given American lawmakers plenty of slack to rein in long-term deficits before they enter crisis mode. Instead, the so-called “super committee” charged with the task failed to make any progress. That’s not shocking: there was even a Plan B in place. The problem is that lawmakers never faced any real urgency to get a deal done.

Seniors are not about to lose their social security benefits and companies like General Electric aren’t pulling up their stakes in Fairfield, Connecticut because the tax code is too complicated. Entitlements and taxes are powerful talking points, but they’re not life-threatening to the U.S. fiscal position – at least not yet. Most importantly, the bond vigilantes – the traditional enforcers of fiscal discipline on sovereign states – are too busy in Europe to inflict any pain across the Atlantic.

In fact, Europe’s woes have reinforced a well-worn pattern of investors running into U.S. government bonds at the first sign of trouble. Not even the loss of America’s AAA rating last summer has changed that. Uncle Sam can now borrow funds at around 1.95 percent for 10 years, down 60 basis points from August, when the government’s half-measures cost the nation its AAA rating. The dollar, on a trade-weighted basis, is up 5 percent.

Yet this most-favored status casts doubt on whether the \$1.2 trillion of automatic cuts will even be implemented on schedule. As long as the U.S. dollar is the world’s reserve currency and its debt markets are the most liquid in the world, legislators have much more freedom to avoid long-term fiscal problems that come packed with short-term political pain.

But assuming the world will always be so accommodative to sovereign dysfunction makes for a much bigger adjustment when the country does own up to its fiscal imbalances. Such shifts can happen with lightning speed. The euro zone has been brought to its knees because investors decided in July that Italy, once considered to be roughly on par with Germany, is a bad credit. Financial markets have given the United States an opportunity to avert crisis. Unfortunately, so far, its leaders are squandering it.

November 21, 2011

Taxing positions

By Daniel Indiviglio

The U.S. Republican presidential primaries kick off on Tuesday in Iowa. The contenders want to set themselves apart. But they don’t differ much on taxes. The front-runners would all cut them, reducing government revenue. But that undercuts another supposed shared goal: deficit reduction.

Four of the hopefuls currently appear to have a shot, namely Newt Gingrich, Mitt Romney, Ron Paul and Rick Perry. On tax policy, these candidates have made strikingly similar promises. While all prefer a flat tax, they would all extend the tax cuts dating from George W. Bush’s presidency, eliminate most capital gains taxes, kill the estate tax, and reduce corporate tax rates to between 15 percent and 25 percent.

Cutting taxes would encourage economic activity and hiring, and boost growth. That in turn would increase taxable earnings. It's highly unlikely, however, that this would fully offset the government's lost revenue from lower tax rates – at least to begin with. And some of the cuts the candidates want could directly result in higher deficits and additional national debt.



Republican presidential candidates (L-R) former U.S. Senator Rick Santorum, U.S. Representative Ron Paul, Texas Governor Rick Perry, former Massachusetts Governor Mitt Romney, businessman Herman Cain, former U.S. House Speaker Newt Gingrich, U.S. Representative Michele Bachmann, and former Utah Governor Jon Huntsman stand at attention during the singing of the national anthem during the CNN GOP National Security debate in Washington, Nov. 22, 2011. REUTERS/Jim Bourg

The estate tax is an example. It has been gradually limited over the past decade, now excluding estates up to \$5 million. The U.S. economy hasn't flourished as a consequence – and in the case of a tax that is a burden only after death, it's hard to argue why it should. Yet cutting the tax shrinks the government's revenue. It brought in more than \$20 billion annually during the decade to 2009. The GOP front-runners would do away with what's left of this revenue.

Even small reductions in revenue add up. And avoiding fatter deficits means finding at least equal spending cuts. The recent fight over extending reduced payroll taxes showed how hard it is for Congress to slice even a measly \$35 billion off spending. Rather than modestly reduce meaty entitlements or the defense budget, it fudged the issue by forcing Fannie Mae and Freddie Mac's mortgage guarantee fees higher for the next decade.

If a GOP candidate wins the White House in November, tax cuts may seem easy. But getting even party colleagues in Congress to slash spending so as to avoid rising deficits will be a much tougher challenge.

December 29, 2011

Bain of existence

By Jeffrey Goldfarb

Private equity is caught in the crossfire. Rivals for the Republican nomination for the U.S. presidency are leading a full-blown assault on front-runner Mitt Romney's track record at Bain Capital. The attacks won't stop Romney, but the collateral damage could hurt the buyout industry.

Only two months ago, KKR kingpin Henry Kravis warned his fellow buyout barons to beware the barrage. If Romney becomes the nominee, "they're going to describe us all as asset strippers," he said. But "they" were supposed to be the Democrats. Not even Kravis anticipated friendly fire.

Romney, to an extent, invited the onslaught. To burnish his economic credentials, he put forward an unsupportable claim about job creation during his time at Bain. But that doesn't justify the absurd spectacle that has unfolded. Newt Gingrich, who once advised private equity firm Forstmann Little, claimed that Bain "looted" companies. Jon Huntsman, whose family's publicly listed chemical business agreed to an ultimately unsuccessful \$6.5 billion leveraged buyout in 2007, jumped on the bandwagon. So did Texas governor Rick Perry, even though his state's teachers – whose retirement fund board he appoints – have invested in Bain funds.

Moreover, the GOP en masse has helped thwart repeated efforts to make buyout firms pay a fairer tax rate on a big chunk of their profits. And while Republicans in Congress took less money related to private equity than Democrats between January 2007 and June 2011, they still pocketed some \$6.5 million, according to research firm MapLight.

The rhetoric is unlikely to derail Romney's chances of taking on President Barack Obama in November's election. The populist anti-private equity message from GOPers could, however, have staying power. For one, it gives fresh fodder to the Occupy crowd. It also will make it harder for Republicans to defend the industry when debates such as the one over taxing carried interest are rejoined in Congress.

Private equity is battle-tested. It survived, if somewhat weakened, a crusade from British labor unions and legislators a few years ago. Buyout barons are also still licking their wounds four years after the financial crisis began. They may relish having one of their own in the White House. But their industry could get badly scarred along the way.

January 10, 2012

Laissez-faire economics

By Daniel Indiviglio

After the August debt ceiling fight, U.S. President Barack Obama said he would focus on generating jobs. But recent White House initiatives look more vote-grabbing than jobs-creating. Politics, and an opposition party that seems determined to just say no, make meaningful action tough. Still, a hands-off approach could backfire if voters don't feel more warmth of recovery by November.

Congressional gridlock has Obama understandably frustrated. His ambitious political agenda was halted after Republicans triumphed in the 2009 midterm elections. But rather than compromise and give a little to the GOP to pursue additional stimulus for effective job creation measures, he has focused on programs that sound like music to voters' ears but which may be ineffective in sparking large-scale growth.

Take the "Summer Jobs+" program announced last week. Through a public-private partnership, the initiative hopes to usher in 180,000 jobs for teenagers. Their employment levels plummeted due not only to the recession but also to recent minimum wage increases. Meanwhile, adult unemployment remains above 8 percent, according to government estimates. That's clearly a bigger problem.

Similarly, the president's sidestepping of Congress to appoint a new consumer watchdog chief and three labor board members also suggests greater concern for election politics than economic stimulus. Other, arguably more important, nominees for regulators like the Federal Deposit Insurance Corp and Federal Reserve will likely now be blocked by Republicans. The move also may doom any hopes for an extension of the payroll tax cut and long-term unemployment benefits through 2012.

True, these decisions didn't come out of the blue. They were clearly part of his executive-order driven stimulus measures from last fall. Others included student loan relief and mortgage refinancing for underwater homeowners. But these will have little economic impact this year, amounting to less than \$4 billion in stimulus. These, too, touch on issues that are distinctly populist in flavor and important to some voters.

Taken as a whole, the White House's prescriptions for the economy, at least until the election, appear heavier on placebos than potency. Of course, if the unemployment rate continues to fall, as it did in December, and business picks up, the plan may work. But if growth slows before November, the weak economy could swamp the popular rhetoric.

January 10, 2012

Carry nation

By Daniel Indiviglio

The following is an imagined speech that Mitt Romney could deliver to handle attacks on his private equity background and low personal tax rate while simultaneously appealing to moderate U.S. voters to help his run for the White House.

Today, I have released my 2011 tax return for my opponents to scrutinize. This disclosure marks a perfect opportunity to explain a big portion of my tax policy and why it's better than the president's.

Some on the left will criticize the 15 percent rate I have paid, due in large part to retirement earnings from my time working in private equity. They'll say it's unfair that investment managers can sometimes qualify to pay the relatively low capital gains tax rate on their compensation through a loophole called "carried interest." To those critics, I say: I agree.

This area of tax policy, like many others, demands reform. When investment managers are paid based on the return earned on capital invested by clients, rather than themselves, then that compensation should be taxed as regular income. This would raise my tax rate much closer to the top income bracket of 35 percent.

Eliminating the carried interest exemption won't have any detrimental effects on economic growth. Careers in private equity will still be plenty attractive. Best of all, it won't in the least deter Americans from investing in jobs or good ideas.

A more important pillar of my position on taxes relates to other forms of capital gains. Low rates on such income do encourage investment. That's why I would leave the current rates in place for wealthier Americans. But I would eliminate the tax entirely for everybody else.

This wrinkle makes my policy more appealing than President Obama's. He wants to raise your taxes broadly in a misguided attempt to grow our government. Instead, it will inhibit businesses big and small from investing in new machinery and hiring more employees.

Allowing the middle class to keep more of their investment income will have the opposite effect. And eliminating the carried interest exemption would raise taxes on only those privileged enough to have created enormous wealth by investing in this great country of ours.

January 19, 2012

Pragmesidential

By Antony Currie

Mitt Romney may be unsure which hat to wear when it comes to General Motors. In a Detroit News article this week, the Republican presidential candidate exhorted President Barack Obama's administration to offload Uncle Sam's holding in the automaker, which reported fourth-quarter earnings on Thursday. That may be Political Romney's take, but selling now would leave taxpayers with a hefty loss. That's a hit Private Equity Romney would surely avoid.

Romney is right that governments should try not to hold long-term positions in private companies. So if the U.S. government were to sell its 32 percent of the Detroit automaker immediately, that would superficially satisfy Romney's belief in free-market capitalism.

But at Wednesday's closing share price, doing so would leave taxpayers shouldering a \$14 billion loss on their GM investment – almost a third of what Presidents George W. Bush and Barack Obama poured in to keep the company on the road. Not only would crystallizing that loss offend Romney

with his private equity background. It's also a sure bet that Romney the presidential candidate would have pounced on it as evidence of Obama's fiscal irresponsibility.

Of course, it's not quite the same as a private equity investment – price shouldn't trump everything else. The U.S. government invested in GM, Chrysler and hundreds of banks to keep them afloat, not to make a profit. Even so, it isn't hard for the government to explain why it's OK that it still holds a significant stake 15 months after GM went public.

Executive pay aside, officials have not interfered with the automaker's business; the fact that its investment has largely been a non-issue for months speaks to that. And the Treasury has proved adept at getting out of other bailout positions relatively quickly and at a profit – just the kind of responsible approach Romney advocates. That should give non-partisans comfort that the GM stake is receiving the same treatment.

There's also a reasonable case that GM's market value will rise over the next year or more as it continues working on its turnaround, especially in its loss-making European operations. If Romney finds himself in the Oval Office next year and he's able to sell the GM stake at a profit, both his political and private equity personas will find it hard to resist taking the credit.

February 16, 2012



A General Motors dealership displays a sign indicating it is still in business in Santa Monica, California on June 1, 2009. REUTERS/Lucy Nicholson

Dynamic dreaming

By Daniel Indiviglio

The Republican Party's U.S. presidential hopefuls are relying on faith for more than just the religious vote – it's key to their economic plans. Romtorumgrich are promising to cut taxes and simultaneously shrink the deficit. Economists criticize their math, which doesn't add up. The candidates say critics don't use "dynamic scoring" to account for the stronger growth that would result from lower taxes. Neither should voters.

Rick Santorum and Newt Gingrich, runners up to Mitt Romney after the Super Tuesday primaries, want deep tax cuts and a balanced budget. Yet the nonpartisan Committee for a Responsible Federal Budget says the deficit would swell under either's vision. Its intermediate budget-cutting scenario shows Santorum's and Gingrich's plans would inflate the deficit by \$4.5 trillion and \$7 trillion, respectively, over nine years.

Romney's proposals don't do much better. His income tax cuts and Alternative Minimum Tax repeal would boost the deficit by \$3 trillion over a decade, according to the nonpartisan Tax Policy Center. Pile on reductions to capital gains, estate and corporate taxes and the number balloons to Gingrichian levels.

The candidates dispute these independent estimates, saying they only consider a static scenario where growth remains constant with or without their tax cuts. The three instead rely on what is known as dynamic scoring, which considers the impact fiscal policy changes would have on economic behavior. Their models assume reduced tax rates will pump up overall growth and, with it, government tax receipts.

While that may be the case, the trillion-dollar question centers on magnitude. There is no economic consensus on the precise impact tax cuts have on growth, which is why most economists agree that dynamic scoring won't pump up tax revenue the way the candidates hope. Romney economic adviser Greg Mankiw himself published a 2005 study that showed tax cuts don't pay for themselves dollar for dollar.

For argument's sake, though, take the rosy assumption that Santorum's tax cuts could pay for half their cost. He would still need to shave \$3 trillion in spending over nine years to achieve a balanced budget. The chances of that happening are remote, as the failure of Congress last year to agree on \$1.2 trillion in cuts during the debt ceiling debate shows. But then again, with a little faith anything is possible – at least that's what the three GOP candidates seem to want voters to believe.

March 7, 2012

Mystery continent

By Martin Hutchinson

Europe is mostly unrecognizable from the U.S. Republican rhetoric. Presidential hopefuls Mitt Romney, Rick Santorum and Newt Gingrich, who face off again in Tuesday's trio of primaries, often accuse Barack Obama of leading America to "European-style socialism." The monolithic pejorative

works to a point but conveniently overlooks the many economic achievements throughout the continent. On this matter, voters shouldn't take the candidates seriously, and the candidates might do well to consider Europe more so.

Certain features of the continent's political economy are of course anathema to U.S. conservatives. For example, U.S. public spending of 42 percent of GDP last year was still lower than all but four of the 27 EU members. And while the mostly state-run healthcare systems in Europe are cheaper than in the United States, ones like Britain's NHS limit available treatments and involve long waiting times for many procedures. The EU bureaucracy also has a tendency to micromanage in a way that would make Republicans run screaming.

But the nominee wannabes either artfully or ignorantly miss the desirable aspects of Europe's many and varied economies. Imagine the jubilation if the United States could attain the 4.3 percent growth experienced by Poland last year. Romney and Santorum surely would swap jobs pictures with the Netherlands, where the unemployment rate was 6 percent in February. And for austerity-minded Republicans, euro zone fiscal discipline as a whole is better than in the United States. The euro zone's 2012 budget deficit is projected by the European Commission to be 3.4 percent of GDP, compared to the Economist's consensus U.S. forecast of 7.8 percent.

What's more, a big slug of the GOP agenda seems to be something of a blueprint from Berlin. With a healthy current account surplus, inflation at around 2 percent, unemployment under 7 percent, a budget deficit of just 1.5 percent and a savings rate over 11 percent, Germany offers much to admire.

With America still trying to find its economic way, U.S. presidential candidates ideally should seek ideas anywhere they can find them. The political expediency of making Europe a bad word doesn't help.

April 3, 2012

Gunning again

By Robert Cyran

The gun bubble has reloaded on fears of a second term for President Barack Obama. His election in 2008 triggered massive growth in firearms sales. Buyers apparently expected the first Democratic White House in eight years to push for stricter gun control laws. That never happened, sending weapon sales tumbling – until now. The prospect of Obama's re-election is boosting sales, and shares of gunsmiths, once again.

Candidate Obama's victory nearly four years ago set off the first "run for guns." Anxiety about economic Armageddon also added to demand for the ultimate counter-cyclical asset. Federal firearm and ammunition excise tax receipts rose 45 percent in fiscal 2009, the biggest increase ever, according to government statistics. Gun-maker Smith & Wesson's backlog jumped from \$20 million in Oct. 2008 to \$268 million in April 2009.

The boom misfired. The Obama administration didn't press for gun legislation of any significance. Meantime, the financial crisis abated and the economy improved, leaving fewer people concerned about stockpiling weapons. Smith & Wesson's firearms backlog fell to \$32 million in October 2010, and the stock lost half its value.

Gun owners and investors are once again betting on post-election restrictions. Whether the president's leaving gun owners alone is a guide to future policy or "part of a massive Obama conspiracy to deceive voters and hide his true intentions to destroy the Second Amendment – during his second term!", as National Rifle Association executive Wayne LaPierre claimed recently in a speech, remains to be seen. Gun buyers aren't waiting.



*A sticker is seen at the Rocky Mountain Guns and Ammo store in Parker, Colorado on July 24, 2012.
REUTERS/Shannon Stapleton*

Sturm, Ruger recently announced it couldn't keep up with demand. The maker of weapons such as the Hawkeye Predator varmint rifle had received more than 1 million orders in the first quarter. Smith & Wesson had a nearly \$200 million backlog at the end of January. That's more than 2.5 times larger than it was a year earlier.

No wonder gun stocks are on a tear. Since the start of the year Sturm, Ruger's stock is up 55 percent; Smith & Wesson's has risen 91 percent and hunting superstore Cabela's has surged by 53 percent. The run could continue to November, and perhaps beyond. It may be that a second Obama term will seek to curb the sale of firearms. But history – rather than conspiracy theory – suggests this is just another gun bubble in the making.

April 3, 2012

Saving VP Ryan

By Rob Cox

It's the budget, not the economy, stupid. That variation of the 1992 slogan that propelled Bill Clinton into the Oval Office may now apply to Mitt Romney's candidacy. The Republican presidential wannabe's choice of conservative House budget chief Paul Ryan as his running mate has the power to transform a heretofore mealy campaign into something substantive: a referendum on fixing the American balance sheet.

It's pathetic that it has taken the nomination of a 42-year-old Wisconsinite from Congress to give Romney's candidacy much appeal, even to his base, beyond the simple fact that he is not Barack Obama. But at a time when debt crises threaten the sovereignty of developed nations and the U.S. fiscal picture is about as bleak as it has been outside of wartime, righting the country's finances is the stuff of long-term legacy creation.

Despite his relative youth, Ryan has spent 13 years in the House, neutralizing arguments that he's unprepared for the post. Though that includes the Bush era, when Congress was at its most profligate, Ryan has since distinguished himself as a proponent of fiscal probity. His recent counter-proposal to the White House's budget was a serious attempt to propose constructive fixes to vexing long-term economic problems.

Elements of Ryan's plan, particularly deep cuts to entitlement and Medicare spending, offer the Democrats a distinct target. But that's a necessary debate for the country to engage in. For Romney, too, it's a better issue to campaign on than a half-hearted defense of the GOP's more recent obstructive record in Congress.

Moreover, whatever either candidate says on the stump, tangling with America's finances will be the chief legislative task of the new president. Congress will not find a solution to the so-called "fiscal cliff" of some \$450 billion of tax increases and \$1.2 trillion of spending cuts that take effect from 2013. In all likelihood, a lame-duck legislature will extend the implementation of these into the first half.

That requires a leader capable of shaping a grand compromise to knotty fiscal predicaments, one that takes a European-style crisis off the table. It is going to require shared sacrifice, including meaningful spending cuts and a fairer tax code. Done right, a long-term budget deal creates confidence, lifts economic growth and puts the unemployed back to work. Ryan may not have all the right answers, but his arrival on Romney's ticket at least gets the conversation started.

August 11, 2012

Captain Austerity

By Rob Cox

There's only one delegate at the Republican National Convention actively trying to keep a low profile: Captain Austerity. He certainly wasn't visible at the Florida Aquarium, where the booze industry threw a party Monday night replete with mermaids in a shark tank and giant tequila bars carved in

ice. He's also totally absent from the official addresses delivered by politicians on the podium. Yet make no mistake, he's lurking everywhere at the Republican shindig.

While Captain Austerity – who is a household name in Europe – is not playing on primetime television or throwing back Patron shots at parties financed by lobbyists, he's discernible between the lines of speeches, and he peppers private conversations taking place across Tampa.



Republican presidential nominee Mitt Romney looks at vice presidential nominee Paul Ryan as they pose with members of their staff during a walk through before the last day of the Republican National Convention in Tampa, Florida on August 30, 2012. REUTERS/Adrees Latif

Sometimes known by the nickname, “Sacrifice,” as New Jersey Governor Chris Christie called him twice in his keynote address Tuesday night, Captain Austerity is a shape-shifter. To the party rank-and-file, he takes the form of a machete poised in the hands of a mighty leader to hack away at layers of fat built up by the federal government over the past decade by a procession of profligate politicians on both sides of the aisle. He delivers the promise made Wednesday by VP-hopeful Paul Ryan “to stop spending money we don’t have.”

But the Grand Old Party’s presidential candidate Mitt Romney sees something of a mini-monument, which he describes with the alliterative mouthful, “Smaller, simpler, smarter government.” In this

guise, Captain Austerity's shadowy form begins to take some of the contours all-too familiar to the government-shrinking British and Greeks.

He has a distinctive face – actually, many faces: Romney is promising the disappearance of one in 10 of the country's 2.1 million federal government workers, saving \$4 billion. He has legs: 41 of them, actually, coinciding with the number of money-losing Amtrak rail routes. By privatizing Amtrak Romney hopes to save \$1.6 billion.

And he has a voice: by cutting subsidies for, among other programs, The National Endowments for the Arts and Humanities and Corporation for Public Broadcasting, Romney would pocket another \$600 million for taxpayers. Captain Austerity even appears to have private parts. Eliminating Title X family planning funding, which includes programs benefitting Planned Parenthood, Romney scrapes another \$300 million in unborn expenses.

But Captain Austerity appears in yet other guises. To hard-money conservatives in Tampa such as John Taylor, a Stanford professor whom many at the convention want to see running the central bank, Captain Austerity appears less as a superhero than a plumber with a mechanical tool kit to slim down the Federal Reserve's bloated balance sheet, end quantitative easing and reverse the negative sign on real interest rates.

Though none of the American politicians gunning for the White House or the hundreds of congressmen craving a second term invoke Captain Austerity's name directly, they have their surrogates from across the ocean to speak the unspeakable. That includes a dozen parliamentarians from the UK, where two years of eating spinach have yet to nourish a more muscular, prosperous country.

Indeed, if any experiment may guide the GOP's aversion to public displays of affection for Captain Austerity – if not Romney's towards his spouse – it is the British one. A preference for continued tax relief to start, and belt-tightening to follow, distinguishes it from Prime Minister David Cameron's approach. But the objective of cleaning up the national balance sheet before investors, like, say, the People's Republic of China, get surly is similar.

Douglas Holtz-Eakin, who four years ago guided Senator John McCain on economic matters in his run for the presidency, says his party is recognizing "that our social safety net is falling under its own financial weight; that Medicare, Medicaid and Social Security have to be reformed. There will be benefits greater than seniors receive today but less than are projected." That, dear readers, is Captain Austerity skulking in the semantic shadows.

August 30, 2012

Jobs blues – and reds

By Martin Hutchinson

Thirty months after the U.S. jobs nadir, employment has risen by 3.1 percent, according to Friday's report for August. That's roughly in line with the post-recession record of the last two-and-a-half presidents – but far short of Ronald Reagan's 9.8 percent jobs increase. The picture for August alone was also mixed: President Barack Obama, his Republican presidential rival Mitt Romney, and the Federal Reserve can all take something from it.

The increase in total employment in the 30 months following recessions was 3.8 percent under George W. Bush starting in 2003, and 3.4 percent under George H.W. Bush and Bill Clinton from 1991 to 1993 – though Clinton’s economy exhibited more robust job growth later in the cycle. On this comparison, it’s hard to argue Obama’s record on job creation is noticeably weak. Republicans willing to reach back 30 years, however, can point to much stronger numbers under Reagan.

As for August, the net new jobs figure of 96,000 was distinctly under par – fodder for the Romney camp. Yet the unemployment rate, measured by a different survey, declined to 8.1 percent. Another 0.2 percentage point drop would take the rate below 8 percent, surely a psychological threshold that Obama’s team would play up.

Beyond the headline numbers, the report underlined the sluggish nature of America’s economic recovery. The manufacturing sector lost 15,000 jobs, while overall new jobs figures for both June and July were revised lower. And the decline in the unemployment rate was mostly the result of reduced participation in the workforce. The ratio of total employment to population in August was only 0.1 percentage point above its December 2009 nadir. On this metric, Obama’s record looks poor. Thirty months after the previous three recessions, that metric had improved much more strongly, by at least one percentage point.

In any event, both presidential candidates will get talking points from the new data. The Fed, which meets next week, also gets a new input for its analysis. The U.S. central bank has indicated that it is leaning toward another round of so-called quantitative easing – essentially, bond purchases that amount to printing money. The lackluster report on Friday won’t discourage Fed Chairman Ben Bernanke from pushing ahead – and sooner rather than later.

September 7, 2012

Flee market

By Daniel Indiviglio and Jeffrey Goldfarb

Mr. Market would have felt unwelcome in Charlotte and Tampa over the last couple of weeks. The political jamborees hosted in the two southeastern U.S. cities offered stark differences in tone that mirror the different options Americans face in November’s elections. Eat the fiscal spinach served up by Mitt Romney and the Republicans, or gorge on the pro-worker red meat dangled by Barack Obama and the Democrats. Voters may be tempted by one or the other, but investors will probably turn their noses up at both.

A broad cross-section of America showed up for the Democratic convention, which wrapped up proceedings on Thursday night with President Obama formally accepting the nomination to run again. The party’s diversity was obvious throughout Time Warner Cable Arena, even without organizers jack-hammering the point home on stage. And yet while union bosses, mayors, auto workers, abortion rights activists, firefighters, equal pay advocates and celebrities like Scarlett Johansson got their say, there was little room for Mr. Market.

He would have winced anyway at the repeated brags by Vice President Joe Biden and many others about the president’s deal to save General Motors and “more than 1 million American jobs,” which

required upending the automaker's capital structure and trampling on bondholder rights. He would have balked, too, at all the unqualified praise for Obama's healthcare law, aggressive environmental enforcement and financial regulation.

The lack of attention to Uncle Sam's biggest long-term challenge also would have alienated Mr. Market. How to reduce the nation's debt load, which surpassed the \$16 trillion mark during the Democratic convention, got scant mention during the three-day event and only brief lip service in the keynote speeches of former President Bill Clinton and Obama, whose \$3 trillion of proposed deficit cuts over the decade starting in 2013 would all come from collecting more taxes.

Delegates from across the country liked the idea of raising taxes on the rich to balance America's accounts, a populist and impractical notion that could stifle investment and growth if applied excessively. "Desperate Housewives" star Eva Longoria summed up the sentiment on the final day of the Democratic convention. "Eva Longoria who worked at Wendy's flipping burgers – she needed a tax break," Longoria said. "But the Eva Longoria who works on movie sets does not." Wall Street was much less in evidence than Hollywood. The only banker who made a meaningful splash was Robert Rubin, the former Treasury secretary and Citigroup bigwig, who fell in a pool at the Ritz-Carlton.

The GOP convention started out all wet, too, with a hurricane washing out the first day. Once the Republicans started, though, they delivered a tsunami of "We built that!" rallying cries, derisively riffing on an Obama syntax gaffe which, taken out of context, suggested the government was responsible for business success. Mr. Market might have shared the disdain of everyone in the (publicly funded) convention hall for this twisted version of what the president said – but he wouldn't have approved of the political rhetoric that obscured the reality of the issues that concern him.

The Grand Old Party's answer to budget deficits and the debt seems to be as one-sided on the cost-cutting front as the Democrats' response is on the tax front. Yet even though this essentially means austerity, that word was notably absent from proceedings on the stage. And the Romney approach is also unrealistic. To keep current tax rates constant and reach the Republican nominee's goal of reducing federal spending to 18 percent of GDP in a decade would require slashing over \$6 trillion of expenditure over the period, or some 14 percent of all projected outlays. And that would come from entitlements and domestic programs, without touching defense.

That assumes this is the plan – something hard to discern since Romney hasn't laid out many clear policies or details. Mr. Market probably isn't impressed with the results of austerity in Europe. And the combination of the political difficulty of achieving it in the United States with Romney's general vagueness creates just the kind of uncertainty investors detest.

The two parties' unrealistic extremes may have left Mr. Market scratching his head. More than usual, he may even relish the prospect of legislative gridlock. Stocks often do well when Congress is at an impasse, partly because it blocks new legislation or at least keeps it middle-of-the-road. But stubbornly high U.S. unemployment – still above 8 percent in Friday's jobs report – along with the need for big fiscal decisions at the end of this year and known longer-term problems that need fixes make gridlock less attractive.

If neither convention gave Mr. Market much to cheer, at least both parties' focus on the political meant they did little to no market harm. The S&P 500 Index hit a four-year high on Thursday, and the Nasdaq reached its highest level since 2000 – both largely reflecting new European Central

Bank help for euro zone countries, something even U.S. presidents can't pretend to control. After November, though, the politicians will have to get real again, and Mr. Market will have to get to grips with their choices.

September 7, 2012



U.S. President Barack Obama waves with Vice President Joe Biden after Obama accepted the 2012 U.S. Democratic presidential nomination during the final session of Democratic National Convention in Charlotte, North Carolina on Sept. 6, 2012. REUTERS/Jim Young

Fed politics

By Daniel Indiviglio

Try as they might, U.S. monetary policymakers meeting on Thursday won't be able to sidestep politics. Investors widely expect a big announcement from Chairman Ben Bernanke's committee. Anything less could sink stocks. At the margins, staying the course might ding President Barack Obama's hopes for the economy gaining a bit more steam before November's election. On the other hand, an aggressive dose of stimulus juice could infuriate Republicans and jeopardize the Federal Reserve's independence.

No action would shock markets. Recent monetary policy communication has suggested an unusually clear readiness by the central bank to pump more money into the financial system, given anemic employment growth. Last month's jobs report came in worse than even modest expectations.

Consequently, economists overwhelmingly predict both a third round of bond purchases and revised language suggesting interest rates will remain very low into 2015. The expectation of a significant Fed move may be part of the reason the S&P 500 Index soared 4.5 percent since the August meeting. Inaction could erase much of that gain, and its attendant wealth effect.

That wouldn't be great news for Obama. By the same token, if the Fed commits to showering the market with money and stocks continue to rally, that in turn may marginally improve sentiment and the president's chances with swing voters looking for signs of life in the bleak economy. In a close election, even a tiny nudge could make a difference.

Although Fed officials will probably act based on economic statistics alone, the symbolism of a big move so close to an election won't be lost on Obama's opponents. Republicans already critical of the central bank and vowing to replace Bernanke when his term expires at the end of next year will see it as a form of favoritism if they believe the Fed's jolt boosts the president's votes.

While the central bank has eased near presidential contests before, this time is different. Vocal GOP calls for reform, including a full audit and possibly stripping the Fed's employment mandate, will only grow louder with further stimulus. Republicans aren't likely to forget such perceived betrayal by central bankers – and may seek retribution should they eventually regain power in Washington.

September 12, 2012

Political numerology

By Daniel Indiviglio

The first presidential debate showcased the numerology of the U.S. election. A quintet of very large figures came up repeatedly as the two candidates squared off for 90 minutes on Wednesday night. How voters score them could influence the electoral math. All told, Mitt Romney's sums seem to be in slightly better order than Barack Obama's.

\$5 trillion of tax cuts

Obama began the proceedings by deriding Romney's tax plan as fiscally irresponsible. He noted an estimate by the Tax Policy Center that shows his challenger's proposal to cut marginal income tax rates by 20 percent would boost U.S. deficits by \$5 trillion over 10 years. The president said it's just math, but it isn't that simple.

Romney would also reduce the amount of allowable deductions. He says if he can't make the numbers work to shield the middle class from higher taxes, then he'll rethink the rate cuts. That's suspiciously convenient. More importantly, fighting bloated budgets without raising tax revenue isn't realistic.

Point: Obama

\$4 trillion in deficit reduction

This has become the magic number of deficit cutting over 10 years for Washington to show serious dedication to fiscal reform. Obama's Simpson-Bowles Fiscal Commission targeted the figure. The president didn't embrace the plan, however, and none of his alternative budgets passed in four years. Romney hasn't produced details about how he would achieve the \$4 trillion either.

Point: None

\$716 billion of retiree health benefits

The Republican complained that the president's reforms slash \$716 billion from Medicare retiree health benefits. Obama countered that the savings are created by no longer overpaying insurance companies and doctors. Romney's rejoinder resonated: some providers and hospitals will shun Medicare at lower reimbursement rates.

Point: Romney

\$90 billion for green energy

Obama asked if Romney would eliminate \$2.8 billion of tax credits for Big Oil. They'd be on the table, he replied, while slashing deductions to simplify the code. Romney also pointed out that the president's 2009 stimulus provided \$90 billion of breaks for green energy, in the process lumping electric car maker Tesla with bankrupt solar company Solyndra. That will hurt Romney's credibility in Silicon Valley. The figure also conflates loan guarantees and spending. About one-third isn't strictly green, either, such as funds for electric grid modernization.

Point: One each

700,000 jobs

Romney asserted that the president's healthcare plan would kill 700,000 jobs. The figure originates from a study conducted by the nonpartisan Congressional Budget Office saying the president's law would reduce labor by one-half of 1 percent. Obamacare may have its virtues, but the employment effect comes from a credible source.

Point: Romney

Perhaps the most important numbers connected to debates are subsequent polling results. On that score, Romney came out ahead, too. After his performance, Romney is now viewed positively by 51 percent of voters, his first net positive during the race, according to a Reuters/Ipsos poll released on Thursday. The one set of numbers may well have influenced the other. But with 33 days left till the election, it's not clear whether the final math will work for Romney.

October 4, 2012

THE WINNER'S OTHER CURSES

Snowed in

By Daniel Indiviglio

The U.S. capital endured snowmageddon last winter, but Snowemageddon could prove worse. Maine Senator Olympia Snowe's retirement messes up the math for a Republican Capitol Hill coup. Though the private sector often thrives on gridlock, the prospect of the behavior of the last two years persisting in Washington may change that sentiment.

Legislative congestion, in theory at least, means fewer new rules, which translates into less political risk to factor into investment decisions. Deutsche Bank found that the S&P 500 historically returns more in the six months after a midterm election, when the sitting president's party typically loses congressional seats and therefore makes it harder to push through proposals that can hurt businesses, than it does in corresponding non-election periods.



A worker uses a snow blower to clear walkways at the U.S. Capitol in Washington on Dec. 19, 2009. REUTERS/Jonathan Ernst

Snowe's decision increases the likelihood of more congressional bottlenecks. Republicans need four more Senate seats for a majority – exactly the number of net openings up for grabs that were won by Democrats in the last election by fewer than 15 points. But Snowe's seat had been considered safe.

She is well-liked by her constituents, but because she's a moderate Republican, Maine citizens could vote in a Democrat to take her place.

Even if the GOP manages a 51-seat majority, that's far from the 60 needed to avoid filibuster, the procedural tactic used to block legislation. The chances that Republicans win that many seats are slim but with an expected Republican House majority, gridlock should be assured – regardless of who is president.

That's bad news for the private sector. Washington logjams of late have created, not reduced, market risk. The 2011 debt ceiling debacle is the clearest example. The episode rattled investors globally. It's a debate that will be back. Inevitable fights over tax cuts could create still more problems.

Meanwhile, some businesses are clamoring for Republicans to roll back regulations imposed by the Obama administration, including Dodd-Frank and the president's healthcare law. Political impasse will make full repeals unlikely and compromise all around after 2012 isn't looking as though it'll be any easier to achieve.

February 29, 2012

Going local

By Daniel Indiviglio and Christopher Swann

Mitt Romney has a reputation for business friendliness. One tax idea from the Republican U.S. presidential hopeful fits that bill, but also seems sensible for most everyone else. If he wins the election, he wants Congress to tax companies only on their U.S. income.

One immediate benefit would be a kind of stimulus. American companies are holding \$1.4 trillion offshore, JPMorgan estimates, largely to avoid tax under the current global regime. Even if only about a third of those funds flowed back, company dividends and stock buybacks could surge by \$350 billion, the bank calculates, increasing investing returns. Meanwhile new investment could boost GDP by \$140 billion and create up to 1.3 million new jobs, the U.S. Chamber of Commerce reckons.

There's a more durable rationale as well. The existing U.S. tax regime is becoming an international outlier and may disadvantage American multinationals compared with foreign rivals who pay only one layer of tax in each jurisdiction. Policies taxing companies' overseas earnings were recently ditched by Japan and Britain. Now, about three-quarters of rich nations only go after profits made within their borders, according to a review of data from the nonpartisan Tax Foundation.

Moreover, it wouldn't cost Uncle Sam much tax revenue – just \$13 billion a year, according to the Treasury. The number is small because tax is collected only if companies move the money they've made elsewhere to the United States. Global, cash-rich companies like Apple simply hoard the money overseas.

Of course, America could repeat the 2004 tax holiday that removed the burden temporarily. But ad hoc amnesties make tax planning tough. And the fact that a special exception was sanctioned once, never mind a possible second time, suggests the underlying rules need a rethink.

The idea even has a shot of making it through Congress. It's no surprise that Republicans love it, or that President Barack Obama doesn't – even though his Export Council favors a territorial tax system, as did the Bowles-Simpson fiscal commission he established. But some key Democrats do seem receptive. After all, a modest change, in revenue terms, should mean big bucks flowing into the United States from abroad. It could be a relatively easy, early win for Romney – but he has to get to the White House first.

July 18, 2012

No child's play

By Daniel Indiviglio

The Dodd-Frank Act is hitting the terrible twos. That's when children often start displaying defiant behavior – and the landmark U.S. financial regulation is likely to pose similar challenges. Its third year will be chock-full of important rules being finalized. That will get its opponents squirming and reinvigorate their plots for infanticide. But smothering the boisterous toddler won't be easy politically or logistically.

One part of Dodd-Frank is already getting sassy ahead of Saturday's official second birthday. This week, the Consumer Financial Protection Bureau took its first enforcement action, hitting Capital One with a \$210 million penalty for allegedly tricking its customers. As parents know, such success can quickly lead to more of the same.

Two is when infants often begin to run – and Dodd-Frank's derivatives rules will pick up pace now that regulators have defined what a swap is. In October alone, 11 separate derivatives provisions will be finalized. Swap dealers will face new registration, record-keeping and reporting requirements.

It's also the age when kids get more curious. That will be the job of the Federal Deposit Insurance Corp when dissecting the living wills giant financial institutions recently submitted. It must determine whether these plans are workable. If not, it can force asset sales.

Social skills and cooperation become more important, too. With the details of the Volcker Rule to limit proprietary trading still being debated, the five regulators involved in hashing it out must find a way to work together in the coming year.

Republicans will be quick to note Dodd-Frank's growing pains. They're already clamoring to repeal the law. But even if their candidate wins the presidency, they're highly unlikely to secure the 60 votes needed in the Senate to drown much of the legislation.

In any event, banks may come to prefer that the law – or most of it – remain intact. They have already been rejigging their systems and regulatory structures ahead of the final rules; changing the process again could be more costly than continued compliance. Perhaps that's the silver lining: as Dodd-Frank matures, much of the uncertainty they have been complaining about will disappear.

July 20, 2012

Frantastic

By Agnes T. Crane and Daniel Indiviglio

The U.S. Treasury has put Congress on the spot over the future of housing finance. On Friday Team Geithner unveiled some bold moves to speed up winding down Fannie Mae and Freddie Mac. Now it's up to the nation's lawmakers to figure out what will replace the troublesome twins.

Treasury is ending the onerous 10 percent annual dividend the two mortgage agencies have to pay on the \$188 billion they borrowed from taxpayers. That payout had created a bizarre feedback loop which forced them, until recently, to borrow even more money from the Treasury to pay their annual tithe.

Instead, the companies will hand over all their profit to Uncle Sam. At present, that means extra cash for the nation's coffers: both earned more than what they owed for the dividend in the second quarter but kept the extra. The new agreement also removes the temptation for the two lenders to use any unreturned profit to grow their business or overpay their staff.

Treasury has also ordered the agencies to shrink their \$1.3 trillion investment portfolios by 15 percent annually, up from 10 percent. That means they should hit the \$250 billion target by 2018, four years early. Freddie already slimmed its portfolio at the new rate over the past year.

This still leaves the dilemma of how to reform the dysfunctional U.S. housing finance system. The Obama administration put forth some suggestions over a year ago, but lawmakers have done little since. Even the most crucial of questions remains unanswered: should the government guarantee home loans at all?

It must be tempting to do nothing: Fannie's and Freddie's earnings go straight into the general fund for a cash-strapped Congress to spend. But just letting the agencies shrink is not an answer. They account for more than 60 percent of all home loans made in the past few years. Banks do not have the balance-sheet capacity to fill the gap and investors prefer buying federally guaranteed mortgages.

Saying goodbye to potential revenue is never easy. It is especially difficult in the middle of a budget war. But keeping the Franken-Frannie monster alive is no solution.

August 17, 2012

Presidential priorities

By Daniel Indiviglio

As President Barack Obama begins his re-election campaign in earnest, he can only show voters a middling report card. Despite good marks for stabilizing the banks, he barely passes on debt and jobs. All told, his performance since 2009 warrants a C-minus grade. Obama needs to show he can do better in fiscal math, improve on business basics and play well with Republicans.

The former Illinois senator, who is due to headline the Democratic National Convention in Charlotte this week, can be graded a bit on the curve. He took office at a terrible time. In the first four months of 2009 alone, the U.S. private sector shed 3.2 million jobs and the financial industry was only just beginning to calm.

The banking sector stabilization is arguably the president's chief economic accomplishment. And by his administration's aggressively supporting, regulating and stress-testing financial institutions, they endured. The success has come at a cost, though. Despite Herculean financial reform efforts, the rules have been slow to come and there's no certainty future bailouts won't still occur.

Obama's stimulus package also helped keep the unemployment situation from getting out of control. Though the jobless rate has ticked down from its 10 percent peak, virtually all of the improvement came from Americans exiting the labor market. What's more, July's 8.3 percent rate remains where it started 2012.

The president also did poorly on his MBA coursework. Businesses complain that Obama's healthcare law creates higher costs and regulatory uncertainty. He didn't push hard for new trade deals to boost exports. Excessive borrowing and a breakdown in negotiations over the debt ceiling last year caused a downgrade to U.S. debt. And Obama didn't seem to do his homework when he opted not to embrace the proposals of his own Simpson-Bowles deficit-cutting commission.

Fortunately for him, he usually aces public speaking. When he takes the stage on Thursday, he'll be under pressure to make a persuasive case about how to deliver a better grade in the next four years. A clear plan for job creation, restoring confidence to chief executives and a commitment to finding common ground and compromise with the GOP, particularly on taxes, would be a start. Extra credit could be earned for reconsidering Simpson-Bowles. Failure may leave Obama joining the nearly 13 million Americans looking for work.

September 5, 2012

Seconds out, round one

By Daniel Indiviglio and Antony Currie

President Barack Obama and his Republican opponent Mitt Romney finally face off in their first presidential debate on Wednesday evening. With domestic policy as the theme, the two are likely to be challenged to outline their policies for fixing the economy. Breakingviews concocts the nine answers we'd like to hear – ones that could win either candidate the White House in November.

It's time to stop pretending that only cutting costs or raising taxes will get us out of this mess.

This would be music to the ears of all but the most partisan of voters. To date, none of the policies Obama or Romney are espousing do the trick. Mitt Romney wants to cut costs, and while his recent proposal to limit annual tax deductions to \$17,000 sounds promising, he's likely to offset that by lowering tax rates. Obama's proposed tax hikes on the wealthy would raise \$2.1 trillion over a decade, but on its own would at best cover half of the reduction needed.

Let's adopt the Simpson-Bowles plan to balance the budget.

This would reinforce the first point. The commission, set up by Obama, proposed reducing the deficit by \$4 trillion over a decade with a combination of tax hikes and spending cuts. It's not perfect, but it's the closest thing to bipartisan cooperation on the table.

Waiting until we're falling over the edge of the fiscal cliff is an option we should be ashamed of even considering.

More stirring leadership stuff. Recent history suggests the two parties are so polarized that they will only come together to form a plan after the mutually assured destruction of falling off the fiscal cliff, having debt-ceiling limits and cost cuts imposed and sequestration. Boldly rejecting that would be a boon.

Fostering cooperation on the budget would be one of the biggest things any president could do to improve the jobs market.

In reality the president's ability to create more jobs is limited. But cutting costs, as Romney suggests, is likely to have a big multiplying impact that risks sending the unemployment rate higher. Raising taxes, as Obama suggests, might not have as big a negative impact, but would still undermine jobs growth. That said, some austerity will help prosperity longer term.

The tax code needs simplifying. In fact, let's rip it up and create a new one with no more than a fifth of the exemptions!

Tax preparers would hate this. Everyone else would love it.

Healthcare should, over time, be a matter for individuals, not companies.

Some analysts calculate that Obama's healthcare law will slow the rise in costs – but it probably isn't enough. Romney wants to keep the pre-Obama system mostly in place, but provide for more competition among insurers. But there's not much hope either approach will prevent medical costs spiraling upward. Giving individuals control over healthcare insurance and more direct exposure to its costs – perhaps by abolishing subsidies for employer-based insurance – could be a more radical way of tackling the fundamental problem.

Let's reform the Fed.

No, not scrap – sorry, Ron Paul. But the Fed's dual mandate looks unsustainable. Ultra-low interest rates are hurting the middle class in general and savers in particular and there's little evidence that continued measures will create many jobs. Either the Fed's actions need to be more strictly limited by Congress or its mandate to seek full employment should be eliminated entirely.

Fannie and Freddie need to be abolished.

Neither side has made much progress on solving what role the government should play in financing mortgages. Fannie Mae and Freddie Mac have been a failure, costing taxpayers almost \$190 billion to keep afloat. Yet they still prop up the mortgage market. Treasury's options for changing this lie dormant. The regulatory structure to provide the backbone for any significant return of private capital is stuck in committee.

Not all education is currently worth the costs.

Student loans have ballooned by 150 percent since 2005. Washington is part of this problem as it subsidizes the entire market. The federal government needs to spend less – and so do students. Making loans a bit more expensive is one answer, but no one wants to rob people of the education they deserve. The federal government might need to do other things, like cutting grants to institutions that allow tuition fees to rise faster than inflation.

October 3, 2012

Big sticks cost money

By Martin Hutchinson

Mitt Romney's foreign policy doesn't match his thrifty approach to other spending. The U.S. Republican presidential candidate's speech on Monday suggests a George W. Bush-like interventionist streak, another step away from the party's pre-World War Two isolationism. That could lead to more Middle East conflict and defense spending. It's also just as risky as President Barack Obama's stance.

Before 1939, GOP foreign policy was insular, partly on cost grounds and partly following President George Washington's admonition to "have as little political connection (with foreign nations) as possible." After 1945, there was bipartisan agreement on a more activist foreign policy. Romney recalled that period, claiming that the current Middle East situation "would be familiar to George Marshall."

With the Cold War dwindling in significance after the fragmentation of the Soviet Union, George W. Bush ran for election in 2000 promising a "modest" foreign policy. But following the attacks on Sept. 11, 2001, he reversed course and sent the military into Iraq and Afghanistan. Romney appears to support the Bush approach. He claimed there is a "longing" in the Middle East for American leadership and promised complete alignment with Israel, stronger support for Syria's opposition and tighter sanctions on Iran.

Interventionist policies are, however, expensive. The Iraq and Afghanistan wars have so far cost around \$1.4 trillion, according to the National Priorities Project. That's only 14 percent of the \$10 trillion increase in U.S. debt since 2001, but towards the high end of politically feasible spending cuts over the next decade. In addition, Romney wants to increase defense expenditures, putting more pressure on other areas if, as he says, he wants to cut America's deficit and debt.

It's also far from obvious that Romney's policies would improve U.S. security. As the last decade has shown, Uncle Sam can deter major attacks, but may not be strong enough to prevent them altogether. Conversely, increasing U.S. activity in the Middle East - for instance drone attacks - risks alienating those affected, as seems to be happening in Pakistan. That in turn could destabilize existing regimes that, while unpleasant, are often replaced by worse ones or chaos.

Romney's desire for a bigger role for the U.S. government in other nations' affairs could easily negate the benefits of his relatively austere, small-government policies at home.

October 9, 2012

Get used to it

By Edward Hadas

Whoever wins the U.S. presidential election will preside over a relative decline in the country's global economic position. He should, but probably will not, accept the inevitable.

There was a time when almost everything about the American economy set the world standard. In 1960, the United States was the world's largest market. It had by far the most developed infrastructure, easily the best educational system and undoubtedly the most business-friendly government. It was the source of most innovations, from safe highways and comfortable suburban houses to computers and advanced pharmaceuticals.

Those days are long gone. The creation of the European Union has left the U.S. market in second place. Overall, the infrastructure in Europe and Japan is at least as advanced. The United States is still the global leader in many areas of industry, education and government, but it has fallen behind in some, and the gaps have narrowed in all.

The automobile industry provides a good example of the trend. Researchers Joyce Dargay, Dermot Gately and Martin Sommer point out that in 1960 the United States had 411 vehicles for every 1000 people, while Sweden, then the European leader, had 175, only 43 percent as much. By 2002, the U.S. ratio had almost doubled to 812, but the ratio in the current European leader, Italy, had increased much faster – to 656 or 81 percent of the U.S. level. In Japan the ratio moved from 19 to 599. Almost inevitably, in the interim the United States lost its clear pre-eminence in automotive design and manufacturing.

The principal cause of the end of American economic predominance is the sincerest form of flattery: imitation. Other countries have learned from the American teacher, and copying proved easier than creation. Some of the students learned so much that they are now teachers. The catch-up was only hastened by American economic weaknesses, most notably insufficient investment in infrastructure, a persistent trade deficit in manufactured goods and financial mismanagement.

None of these problems as well as the painfully slow recovery from the 2009 recession is likely to have much effect on the basic pattern in the next presidential term or for many terms thereafter: the U.S. economy will continue to advance, but much of the rest of the world will advance faster. The largest relative losses will no longer be to Western Europe and Japan, which are basically in the same economic position as the United States. They are rich and slowly getting richer despite financial, social and demographic weaknesses. However, about 80 percent of the world's population live in countries which have a long way to go to catch up to global standards. Some may languish, but others will move fast enough along the path towards prosperity to ensure that America's lead narrows.

What should the next president do?

He should recognise reality. The truth may be painful, but it is better to know. An American president will be better at promoting American interests if he does not assume he has the right to set the global agenda on trade, finance or technology. Recognition will also make him better at calibrating

military and diplomatic ambitions to economic reality. The president might just be more motivated to address domestic economic weaknesses if he has no notions of inevitable national superiority.

After he admits the hard truth, he should relax. Not only is there nothing much to be done, but the relative decline of the United States is basically a good thing. More extensive prosperity is good and lesser global economic inequality is even better. Americans who believe in the nation's manifest destiny to teach the world the right way to live can be pleased that one part of the American dream, the tremendous economic enterprise, is becoming more of a global reality.

Finally, he should act responsibly. Although the American economic era is slowly ending, the country has a disproportionate residual importance. Its currency is the global reserve and its research universities remain the world's best. In many parts of the globe, America is considered almost as much the archetypical land of opportunity as it was a few decades ago. A president who wishes to conserve as much of the country's position as possible would do his best to nurture these legacies. For example, he would try to reverse the current fiscal and monetary policies, which might have been designed to make the dollar untrustworthy.

Unfortunately, neither candidate shows much sign of taking my advice. At least in public, they vie to show more confidence in American greatness. Such boosterism may be an electoral necessity, but it is poor preparation for dealing with the challenge. In the 19th century, France suffered from refusing to recognise that the Napoleonic conquests marked the peak of the nation's influence. The UK repeated the mistake in the 20th century. The United States looks all too likely to do the same.

October 10, 2012

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A volunteer adjusts a sign at the America Presidential Experience exhibit during the Democratic National Convention in Charlotte, North Carolina on Sept. 4, 2012. REUTERS/Adrees Latif