



## So, he wins big...then what?

Normally, we don't spend time commenting on strictly political events. In this case, however, what happens to the U.S. economy, and for that matter, perhaps the global economy, may be substantially altered by the outcome of the voting tomorrow. Despite the strong rally at the end of the month in the stock market, the news today (the ISM plunge and the whopping downturn in auto sales with GM sales being cut in half, month to month) is distinctly negative. If there is a positive on the economic front it is the closing of Libor spreads, the partial opening of the commercial paper market and some evidence that at least some (perhaps only regional) banks are making mortgages. Oh, yes, the compression of volatility on the stock exchange resulting from the recent rally and the essentially unchanged market today could be a positive, but stay tuned!

Is this enough to carry the economy no matter who wins tomorrow? We doubt it. Is this a watershed election? Yes, but not necessarily for the reasons that the political pundits have elaborated *ad nauseam*. The "talking heads" have posed the election as which candidate – which party (?)---is the true agent of change? It is hard to argue either candidate will have the latitude to be a significant agent of change, unless it is Obama. Will the change be for the better or merely amount to a retrograde movement to the regulated state? Let's probe a bit deeper. First, let's ask about McCain? Could he be an agent for change?

If, despite all the polling results, McCain should win, it is more than likely that his margin of victory will be miniscule and he will still be faced with an overwhelming Democratic majority in both houses. It might even be that he will face a veto-proof Senate. Under such circumstances, we are likely to incur something even worse than a stymied economic agenda, unless of course, McCain pulls a reverse and caves into mounting pressures from a Democrat-controlled Congress. He wouldn't be the first Republican to reverse field. For markets, this would be truly awful because of the continued uncertainty and the likelihood of true confrontation over withdrawing troops from Iraq and a step-up in the war in Afghanistan. Even the budgetary consequences of such an unlikely outcome are essentially impossible to forecast. No financial analyst has been able to get his arms around the recent McCain pitch to have the Federal Government buy-out or somehow takeover delinquent mortgages. It is not even clear that McCain could generate uniform support from his own party to do this. The press seems to forget that changing an existing mortgage causes benefits and losses. Somehow, the prevailing attitude is that McCain's plan is simply an election ploy with no serious intent behind it. In any event, a McCain victory has to mean a sharp elevation in economic uncertainty: over taxes, over the budget, over mortgages, over future bailouts, even to the appointments for the judiciary and for unfilled positions at the Federal Reserve. Is it likely that this kind of uncertainty would disappear with an Obama victory?

Strangely, we think the uncertainty that would accompany a McCain victory, would disappear at the outset if Obama wins. Sadly, it may not be an end to the massive uncertainty that now confronts financial markets. If Obama wins, we will confront a new kind of uncertainty, not a temporary respite that financial markets now sense. Why? Let's consider a few of the issues that have been left totally unclear in this campaign. No one is really sure at this moment what the Obama program might actually turn out to be. Here's my list.

Regulation, taxation, spending, recasting of social security, recasting of Medicare, foreign policy, defense appropriations, energy policy, assistance for delinquent mortgages, Treasury programs to get the credit mechanism restored, compensation for executives, environmental policy, measures to assist unionization, measures to assist education to name a few. The list is as long as you wish to make it. And, I have left out any consideration of foreign policy with regard to the 'war on terror,' Iraq, Afghanistan, Iran, Korea, China. You could add a few more items to the list, but the problems to be solved only grow. Real definition remains to be supplied. We truly have no idea what an Obama program might look like. All we hear is the "we're going to change America" That message resonates with many who are deeply distressed and plainly tired of the questionable leadership. There is also a strong undercurrent of distress that somehow "intelligence" is what is



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needed and no one questions Obama's credentials on this score. To be sure, however, this country has had quite intelligent Presidents that have failed and failed badly! That said, where else might uncertainty reside?

Take trade policy for example. Imagine a landslide sweep for the Democrats. Does that mean the U.S. is going to unilaterally abridge the NAFTA agreement? Does it mean that the free trade agreement with Colombia is destined to be defeated? What is the substantive content of the Obama rhetoric on "fair trade" as opposed to free trade? Ambiguity on trade issues should serve to remind us that we cannot rely upon campaign promises of a candidate for President. What did George Bush do to the free trade mantle normally cloaking Republican Presidents practically from his first moments in office? He caved in to a politically motivated deal during his first two years in office and handed the steel industry more protection. That was only the beginning. In short, he shifted from multilateral trade policy to a bi-lateral trade policy and in effect, killed the traditional free trade agenda of Republicans. Why? Because he thought that going into the 2002 elections he would lure votes in key steel states for Republicans. He succeeded in moving the country away from dismantling on a multilateral basis existing tariff barriers and got nothing in exchange. Then, remember the farm bill that Bush signed that raised subsidies just in time for silo-rattling upsurge in commodity prices. To those Republicans who really believe in free trade and free markets, the Bush presidency was a total repudiation. Thus, making sense of the Obama rhetoric on 'fair trade, not free trade' leading up to tomorrow is essentially impossible. Change you can believe in is not the same things as a substantive policy objective.

Obama is clearly the cleverest political warrior since Bill Clinton. Having defeated both the Clintons in the primaries, he may even exceed the former President on political cleverness. When he says "we're going to win...we are going to win this general election; we are going to change America and then we are going to change the world," ---the rhetoric that the networks carried this morning---I don't know whether to disbelieve or fear him. When it comes to ascribing the current financial calamity to a dominance of free market ideology---a rhetorical theme heard frequently these past six months---I am not sure what he truly believes. The ideology of free markets, if it ever caught on in the Bush years, was clearly honored more in the breach than in the observance. Casting our financial failure as an ideological failure seems stilted if not just plain misleading. There was no end of regulation during the Bush years, but neither was there a true devotion to free markets. What was noticeable was the absence of enforcement. There were plenty of laws on the books and plenty of power to supervise and regulate the financial sector, but that power wasn't used. It wasn't used at the SEC and it wasn't used at the Fed. The laws were there to allow that enforcement, but the will to use them was wanting. On this issue, we might at least have substantiated the mantra of "change." Or is there more?

Does a President Obama rewrite the regulatory book, or does he make clear that enforcement of existing law is to be vigorously pursued? To hear him speak on the campaign trail, one scarcely hears the charge that enforcement was lacking. On the contrary, it is that the people were sold a "free market ideology" that is faulty to its core. Does it mean that the "change" he wants is command and control? Get out the worry beads.

In the long stretch beginning in the Carter years, a great deal of our former regulatory apparatus was dismantled: in transportation, in international trade; in banking and finance, just to name a few arenas of deregulation. On balance, consumers benefited. Real purchasing power increased rather steadily. Have there been both "winners" and "losers?" Certainly! When there is substantial economic change, there is disruption of old arrangements and old positions on the economic ladder.

At various times in history, the abhorrence of inequality in outcomes has led to the suppression of innovation, of change, and of a dynamic economic environment. Winners and losers are always a part of substantial economic and political change. Are we to now witness the establishment of a command and control environment? Are we about to embark on a course of sodden mediocrity in order to pursue a more equitable distribution of outcomes? If that is the change that the Obama-ites wish to pursue, it will be sad and ironic. With China swiftly dismantling its regulatory state, are we about to witness a 180 degree turn in the U.S. that



makes regulation its wave of the future? That may be satisfactory for some. It is a P.J. O'Rourke's ultimate EAT THE RICH scenario! Some voters might have preferred a clearer presentation of the substantive changes Obama proposes to make. Instead, we were given a chant, a mantra and hope that things will get better. Is that enough?

Consider tax policy as the next item of a totally unclear message of "change." At various times during the campaign Obama seemed to pivot on raising taxes on capital (both capital gains and dividends); re-establishing a more progressive income tax; adjusting social security to make the program a well defined redistributive venue without any clarity as to how the aging of the population can produce a gaping budget hole or cause a raising of taxes on the use of labor? Is this change or fog?

What about the combination of budgetary and tax policies that is on the Obama horizon? Sometimes, when one listens to the campaign rhetoric, one has to ask which calendar we are using. We have a massive budget deficit and an impending, if not actual, recession on our hands. A sharp recession will make for an even bigger fiscal hole. Raising taxes on the taxpaying portion of the population invariably has meant that the tax revenues shrink! Surely Obama knows this—or if he doesn't---his economic advisors know it and can inform him. We suspect they have, but we have heard little. Would detail demote the change message? The silence on substance has been deafening. No plan has been put forward that integrates our contemporaneous deficit explosion and the need to assist the recapitalization of the economy that is a consequence of the current financial implosion. Markets will need more than hope, even if voters can go to the polls with much less.

The list of ambiguities covers nearly all of the current political agenda. Energy policy is a fog on both sides. Consider what it means to claim that we can replace a third or more of our oil imports by means of alternative energy measures. There is an old saying in economics that you can grow bananas in Alaska if the subsidy is high enough. At this point, the blunt truth is that all of the alternative energy measures that lie within reach involve costs per unit of BTU's (as a short hand measure of energy content) that far exceeds all the conventional sources. This means that if we intend to replace a third of our oil imports ---the rhetoric terms this as not importing a single barrel of oil from the Middle East, a distortion of fact as well---a very substantial subsidy to alternative energy in any of its variegated forms is involved. How big is the implied subsidy? I count that as a budgetary cost, but perhaps I just "don't get it!"

We should add that this campaign is notable in one other respect. Neither candidate seems willing to address the subsidization of ethanol! Of course, there are some 28 Senators and many Representatives from states with ethanol refineries. Does "change" mean expansion or contraction of this ludicrous use of precious food growing resources?

All regulation brings with it winners and losers. The trick that politicians play on the public is to disguise the losers and point to the winners. We are all taxpayers, and therefore we are the losers in the ethanol game. The ruse works if we all lose "just a little" as individuals. In the aggregate, it amounts to lots of deficit dollars, and the physical capability of producing sufficient ethanol under current science to bring about the reduction in oil imports is sheer political chicanery. The worst of it is that the current Administration has endorsed the program and neither candidate wants to denounce it. The Ethanol Emperor has no clothes, but he can produce considerable votes for a cornucopia of political redress! A little change here could be for the better!

Last night I took my family for dinner and we were waited upon by a black waitress with a distinct "attitude." We all tried to cheer her up and allow the awful race issue to be suppressed at least for the moment. At one point in our conversation she commented on the election. "If we don't win this time, we're finished." That saddened me, even if it was her conception of what the stakes were tomorrow. Barack Obama used a wonderful line at his breakthrough address to the democratic convention in 2000. He said "there is no blue America; there is no red America; there is just one America." At various times, he has used this theme to speak of binding the



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country together. He has spoken of bringing all groups into the arena, Blacks, Whites, Hispanics, Rich, Poor...etc. It has the ring of a crusade, a crusade that many Americans, particularly young Americans wish to join. It is a crusade that conservatives would also welcome. Racial, ethnic and religious division comes at a real cost to us, both politically and economically. But the tone I heard from our waitress was different. It was a note that bespoke of "our time" on the political scene, a reality that is widely felt by Black America. On the campaign trail, I heard Obama speak about the need for education, while admitting that more expenditures for education was not a substitute for parents reading to their children; helping them with their homework, becoming involved in the PTA's. This was a kind of code for some of the well-recognized ailments of the black family in America. Young whites hear that code and say to themselves that this wondrous black politician understands both sides. I'm quite sure he does understand. But is it likely that he can cure the family issues of Black America. I hope that is what he wants and will do, but our waitress last night clearly had a different understanding of what time it was.

If I have a hope for the outcome of this election it is that this President will gain a purchase that will allow him to lead in an area where leadership can make a difference. He will be uniquely positioned to lead that change. If there is one part of his rhetoric to which we can agree it is that should be that there is only one America. This is an issue of leadership, not of political compromise. This he can do without the endorsement of various political factions and this is where "change" can truly be meaningful. The other changes that he seems to have in mind will involve the usual tradeoff of national politics and the outcomes, let alone the policies he wants to apply, are surely a large uncertainty. The question to ask tonight is 'So! He wins big?' Then what?

**There is much hope that will be expressed in the votes tomorrow, but it is less clear whether all Americans share the same hopes that they will express in those votes, and even less what the real content of "change" will actually turn out to be.**