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ECONOMIC NEWS UPDATE

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**We have so much to be thankful for that we can bear
our political class.**

Greece and Italy may be ungovernable. America is ungoverned. The President ducked out of the country for an Asian tour while the super-committee tried to reach agreement on a plan to cut the deficit. It didn't. The Democrats refused to offer specific cuts in entitlement spending, despite a Republican agreement to modifications of the tax code that would produce billions in new revenue, most of it by withdrawing from the wealthy various opportunities to use special provisions to reduce

their tax burden. This increase in tax *receipts*, largely from the rich, did not satisfy the Democrats' insistence on a \$1 trillion increase, to come from higher tax *rates* on "the rich". It might take a sharp reaction from the market to force the politicians to veer off the road to ruin on which they are heading the country.

This stalemate suits the President, whose campaign strategy is to blame the Republican congress for refusing to raise tax rates of "millionaires and billionaires". The failure of the super-

committee to agree will trigger spending cuts of \$1.2 trillion over the next decade, the cuts to start in 2013, absent some change in the law. The largest will fall on the military, reducing it to something like its pre-World War II level of effectiveness according to Leon Panetta, Obama's defense secretary. The President, who has always wanted to cut the US defense establishment down to size and rely more on international organizations to implement US foreign policy, is undoubtedly unperturbed at the prospect. Only a threat by Panetta to resign might force the president to allow a change in the law, but such a surrender of power and perks is not fashionable these days.

With the President having foresworn governing in favor of campaigning, and members of congress paralyzed by ideological differences and obsessed with their re-election chances, the absence of legislators and lobbyists this Thanksgiving weekend -- they are among the estimated 42.5 million

Americans who took to the cars, trains and planes -- left the government no less a force than it will be when they return on Monday. And return they will: a visit to constituents is one thing, remaining permanently among them quite another. No Cincinnatus in this crowd.

In the end, the failure of the super-committee would not matter if the effect of that failure were limited to its direct economic consequences. The economy was growing sluggishly before the super-committee met, and is growing at a relatively slow annual rate of 2% now. Unemployment was high then, and remains high now. Interest rates were low then, and remain low now. The housing market was a shambles before the blame game Now being played, and is no less a shambles now.

But we live in a world in which markets are calling the tune, and worry about governance as well as the usual indicators of solvency drive the borrowing costs of

sovereign states. Robert Zoellick, the insightful head of the World Bank, notes, "Since August," he writes, "you're starting to see markets make judgments about governance." That's why interest rates on the bonds of Italy and Greece, and by extension Spain, have been rising, while Britain, its deficit as high and its economy hovering between zero growth and recession, has been able to sell its gilts at low rates. It is deemed governable, something investors are not sure is the case of Greece, Italy and Spain, each with untested governments that have recently been selected (in Greece and Italy) or elected (in Spain).

That leaves America as the best house in a bad neighborhood -- running a large deficit, our total debt burden rising, our politicians at swords drawn, our President AWOL. But still benefiting from the rule of law, and protesters who prefer to camp out and shoot up rather than burn down shops and businesses. Oh yes, like

Britain, America has its own currency and its very own printing presses, so it will never default in the sense of not repaying its debts. True, if Americans and their elected representatives persist in refusing to cut spending and raise taxes, and simply print money to cover our deficits, the value of the dollars the lenders will get in return for their loans will fall, prompting them to demand growth-stifling higher interest rates. But that is not likely to happen before the November elections, whereas any effort by politicians to cut entitlements or raise taxes would be known before voters make their choices.

But politicians refusing to grasp the deficit nettle might soon be in for a shock, an event that will make voters very unhappy indeed. Banks are under pressure to shore up their capital. The Federal Reserve Board is calling for new, more stringent stress tests of major banks to determine how well-placed they are to cope with a wave of sovereign-debt defaults and

bank failures in Europe. One way to increase capital is to raise funds in the market, but that dilutes the value of the holdings of existing shareholders, included among whom are the executives that would have to order such a move, men not noted for worrying about the national interest. Another way is to curtail lending, in essence hoard capital. Signs are that that is what the banks will do, with a dampening effect on lending, growth and job creation.

Those problems await Americans' return to work and reality on Monday. Until then it is family visits, and consuming the remains of some 45 million turkeys with what the homey among us call "all the fixin's" -- sweet potatoes, pumpkin pie and, to enable the children to have something to protest, broccoli. And, of course, shopping: about half of all Christmas spending was done yesterday. It seems from preliminary figures that consumers, who have responded to stagnant

incomes by dipping into their savings, increased spending over last year by somewhere between 3% and 5%, with online sales up close to 20%. And offered further proof, if any is needed, that the gap between rich and the middle-class and the poor has widened. Best Buy, Wal-Mart, Macy's and other stores catered to early-arriving middle- and lower-income shoppers with offers of \$200 HDTV sets, among other "door-buster" bargains. Meanwhile, it reportedly took posh Neiman Marcus less than an hour to sell all ten of its special-edition Ferraris with matching luggage, a snip at \$395,000.

Just the stuff that fans the flames of Obama's soak-the-rich politics, and testimonial to the failure of high earners, many in their jobs thanks to taxpayer bailouts, to understand that a bit of restraint on their part just might make it easier to defend market capitalism at a time when many Americans are looking for work, and

others are watching their real incomes fall.