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Election Implications

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"Political and economic institutions, which are ultimately the choice of society, can be inclusive and encourage economic growth. Or they can be extractive and become impediments to economic growth. Nations fail when they have extractive economics institutions, supported by political institutions that impede and even block economic growth.

Why Nations Fail (2012), p. 83

GDP Growth

There can be no doubt that the present economic and legislative programs in America are extractive and impeding economic growth. Consider the following:

• The third estimate for Q2 GDP was revised from 1.7% to 1.3%, both estimates below the previous three quarters. GDP growth is expected to slow further during the second half of 2012 and trend lower in 2013 due to decelerating job growth and automatic tax increases and spending cuts (fiscal cliff) set for the end of the year.

• The fiscal cliff amounts to 4.5% GDP drag on GDP growth if all tax cuts and transfer payments are allowed to expire and draconian spending cuts are triggered.

• Private consumption the past few quarters does not reflect growth in disposable income, which is actually falling when one considers transfer payments. As transfer payments are phased out in 2013, and some tax cuts are allowed to expire, disposable income growth and consumption growth will slow.

• Four foreign externalities will further impede U.S. growth: 1) a worsening euro crisis; 2) an increasingly hard landing for China due to cyclical factors (weak advanced country growth) and structural causes (a state capitalist model); 3) a generalized slowdown for emerging market economies owing to cyclical factors; and, 4) the risk of higher oil prices as negotiations and sanctions fail to convince Iran to abandon its nuclear program.

Profits

According to Thomson Reuters, third quarter earnings are projected to decline 2.4%, while revenue is expected to be down 0.1%.

• The last time S&P earnings declined was the third quarter 2009 when markets and the global economy were beginning to rebound from the financial crisis.

• For the third quarter of 2009 GDP growth was 1.4%, which is essentially the same as the most recent GDP estimate for 2Q 2012 of 1.3%. Recent projections are showing a decline for 3Q GDP to .9%.

• The divergence between consensus earnings estimates and the S&P 500 of 6% growth for four forward quarters would seem to suggest a fixation on the idea that unconventional monetary policy will ensure that the current economic and earnings slow down will be transitory. If present trends continue, this seems like a tenuous bet.

Job Growth

The American labor market is lousy no matter how you measure it.

• Non-farm payrolls fell from an upwardly revised 142,000 in August to 114,000 in September

• The unemployment rate fell to 7.8% in September from 8.1% in August, the first quarter below 8.0% since 2009.

• An estimated 50% of young college graduates are currently either jobless or significantly underemployed in positions that do not maximize or adequately utilize their skills and/or education.

• The number of unemployed persons in September was 12.1 million. This number escalates to 23 million if involuntary part time workers and the unemployed who have given up looking for a job are included.

• The economic cost of high unemployment is enormous, the negative effects of which can only be solved by an expanding economy lead by corporate profitability and private sector hiring, which will create more disposable income, expand aggregate demand, increase tax revenues and lower the deficit, or at least slow its growth.

Debt & Deficit

The White House claim that "President Obama has led the way on structuring the government to live within its means" is not even remotely true.

• At the end of 2008, US debt was $9.9 trillion, or 69.7% of GDP, and the ballooning deficit was $683 billion. Since then all key indicators have worsened markedly.

• By the end of this year gross debt is forecast to reach $16.3, more than 100% of GDP. The annual deficit is $1.1 trillion, 10% of GDP. US debt is projected to hit $20 trillion by 2016. The Deloitte accountancy firm concluded recently that "America's debate on the nation's finances is largely superficial and the debt crisis is far more severe than business leaders, policy makers and the public realize: "…the US is on track to spend at least $4.2 trillion in interest on the debt over the next decade". This is money that could be invested by the private sector to increase productivity, job growth, and disposable income.

• Chairman Ben Bernanke said Congress must find a way to address the fiscal problems facing the country indicating that the US is in a liquidity trap and that additional monetary policy alone cannot solve the problem. Accordingly to the National Journal he told the Senate Banking Committee; "US fiscal policies are on an unsustainable path, and the development of a credible medium-term plan for controlling deficits should be a high priority".

Taxes

Twenty new taxes for Obamacare are set to be raised or instigated in 2013. The following five are the most onerous.

• *Medical Device Tax* ($20 billion tax increase). A new 2.3% excise tax on gross sales of medical device manufacturers, even if a company does not earn a profit in a given year.

• *Special Needs Kids Tax* ($13 billion tax increase). 30-35 million Americans use Flexible Spending Account to pay for their family's basic needs will face a new government cap (now unlimited) of $2,500, which will be particularly onerous on the parents of special needs children.

• *Surtax on Investment Income* ($123 billion tax increase). This is a new 3.8% surtax on investment income earned by families making at least $250,000. Capital gains will increase from 15% to 23.8% and the tax on dividends will rise from 15% to 43.4%.

• *Medical Itemized Deductions* ($15.2 billion tax increase). The deduction threshold for families with high medical bills will increase from 7.5% of adjusted gross income to 10%, which will be most harmful for near retires and those with modest incomes and high medical bills.

• *Medical Payroll Tax* ($86.8 billion tax increase). This 3.8% tax will apply to those families earning at least $250,000, which amounts to a direct marginal tax increase on small business owners, who are liable for self employment tax in most cases.

Regulations

President Obama presided over the largest increase in new regulations in history as measured by their economic impact, from fuel efficiency in trucks to air-cargo screening.

• Congress passed 81 bills into law while agencies finalized 3,807 rules during his tenure. A forthcoming Competitive Enterprise Institute report estimates the costs of these regulations to be $1.8 trillion.

• When government codifies best practices for an industry, the common result is stasis. Keep in mind that agencies are their own special interest. They want bigger budgets and broader missions, and as a result, objectivity can be a problem.

• Technology and on-the-ground best practices evolve much more quickly than the Code of Federal Regulation. When regulations hold back advances, they wipe out many of the potential benefits to consumers and producers.

As the *Economist* magazine wrote on October 6th, 2012 "This year's election carries big implications for economic policy well beyond the budget and taxes. Barack Obama and Mitt Romney have very different ideas about regulation, monetary policy, international trade and labor markets. The role of government intervention in the economy is the starkest difference between the candidates."

As documented in last month's literature review and commentary, "Capitalism as a Social Concept", this choice is between "more government and more controlled outcomes versus more freedom to choose and more individual opportunity". If one's perspective favors freedom of choice and greater opportunity to determine one's destiny, he or she should vote for the candidate for president who is the best qualified and most likely to expand the economy by creating jobs, reduce the federal deficit and debt, get America on a path to energy independence, and diminish the size and cost of government.

> "A president who justifies his actions only to the public might be induced to change them. A president who has justified his actions to himself, believing that he has *the truth,* becomes impervious to self-correction"
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> *Mistakes Were Made - but not by me (*2007), p. 7

References

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