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Roosevelt, Carter, or Clinton?

Late on election eve 2008, in Lincoln, NE, a few hundred University of Nebraska students spontaneously spilled out of the drinking establishments on the fringes of the campus carrying American flags and chanting U-S-A and O-BAM-A. This emotion and energy was real, vibrant and heartfelt – in a red state, no less.

I felt a kinship with these kids because, in 1976, my first vote for President of the United States went to Jimmy Carter during challenging times. There weren't as many spontaneous celebrations then, but there was the hope of youth that Carter would fix our economic problems (high oil prices, 5% inflation and 8% unemployment). Further back, during the very dismal days of 1932, after the election of Franklin Delano Roosevelt, they were singing "Happy Days Are Here Again" in the midst of the Great Depression and 25% unemployment.

And just sixteen years ago, with less enthusiasm, and less than 50% of the popular vote, Bill Clinton became the 42nd President. While he campaigned on a theme of "the worst economy in 50 years," this was never really true. As a result, his crisis was ephemeral. The economy was actually growing quite rapidly when he moved into the White House.

While history never repeats exactly, it would seem logical that Barack Obama would follow a path similar to one of these three Democratic Administrations. Call it a three pronged probability map that markets must deal with for the next few years. Will President Obama govern like Roosevelt, Carter, or Clinton? The decision is important for both his political future and the nation.

If you view the world like Ohio State Football coach Woody Hayes, these are not good odds. When asked why he didn't pass the ball much, he said "when you throw the ball only three things can happen, and two of them are bad." No wonder the Dow Jones Industrial Average was down 10% in the two days following the election. Equal probability means there is a two-thirds chance that we will repeat either the 1930s or the late 1970s.

If Barack Obama governs like Roosevelt, and grabs the reigns of power tightly in an attempt to run the economy from Washington, denounces the private sector as evil, and follows every whim of a very liberal Congress, then the markets and the economy are in for an awful and dangerous ride. Roosevelt had little belief in the free market and the economy remained in Depression until World War II.

While Roosevelt was able to get away with this in the 1930s, blaming all bad things on the private sector, Herbert Hoover or just bad luck, it is doubtful that in the age of the Internet, this could happen again. In today's environment, governing like Roosevelt would be a huge loser. It certainly hasn't worked well for George Bush. The more the Treasury Department interferes with the private sector the worse things become.

If Barack Obama governs like Jimmy Carter, wearing a malaise-like, defeatist frown on his face, throws up his hands and says, "America is in decline, accept it," the ride could be bumpy, but not completely catastrophic. The US muddled-through the late 1970s with some good moves (like capital gains tax cuts, some deregulation, and the appointment of Paul Volcker to head the Fed). But there were many bad policies (solar energy subsidies, synfuels, raising the social security tax, price controls, tax credits for job creation, the Humphrey-Hawkins Act, and a Windfall Profits Tax on oil companies).

At the end of Carter's first, and only, term, the economy was in much worse shape that it had been in 1976 and those (including myself) who supported Carter became disillusioned. Ronald Reagan put words to this disappointment and won. So, for all the young people that voted for Barack Obama, muddling through with a message of decline just won't do.

The Clinton years were different. After initially moving left politically, with tax hikes and an attempt to nationalize healthcare, Clinton was quickly forced to move right. In Bob Woodward's book *The Agenda*, it was reported that President Clinton said, "You mean to tell me that the success of my program and my reelection hinges on the Federal Reserve and a bunch of ….bond traders?"

No matter how many times people say that the Clinton tax hikes of the early 1990s did not hurt the economy, it's just not true. Real GDP grew 4.2% in 1992, but just 2.5% in 1993 after the tax hikes. The S&P 500 increased just 2.2% per year between December 1992 and December 1994. Most importantly, bond yields (Clinton's scorecard) soared.

Republicans beat the Democrats handily in the mid-term elections, taking back power for the first time in 50 years. And after this, Bill Clinton changed.

In his 1995 State of the Union Address, Bill Clinton said "the era of big government is over." He then signed onto capital gains tax cuts on stocks and housing, welfare reform and remained a solid free-trader. These were the policies that led to a boom in economic activity late in the 1990s. Taken as a snapshot, the middle four years of Bill Clinton's presidency saw the best supply-side policy mix since Ronald Reagan.

Clinton was also blessed with extremely good timing. His tax hikes could have been more damaging to economic activity if the Iron Curtain had not come down. This, along with new technology and low inflation engineered by Paul Volcker and Alan Greenspan, helped spur a boom in entrepreneurial growth.

If Barack Obama follows the Clinton path of triangulating – stealing ideas from the other side to become more electable to a second term – the economy and world will not repeat the 1970s or 1930s. And it appears that instead of the bond market, the Obama barometer will be the stock market. If he gets that right, two terms are a lock. His other choices, of following a path of Roosevelt activism or dour acceptance of decline will not do.

One major problem that an Obama administration will have is that many of its supporters truly believe that handouts will be coming soon. Expectations of "sharing the wealth" are widespread. Obviously, this will not happen to the extent that many believe, so the only way to overcome these expectations is with a strong economy and more opportunity.

Once in power, there is no way to hide behind vague responses or the brush-off of serious questions. The markets want to know what tax rates will be so that the cost of capital and return on investment can be calculated. The markets want to know if they really are the enemy, or not. There is no halfway point here.

And the longer it takes to get those answers, the deeper the current crisis could become. In some ways, this could play into the hands of an Obama Administration, and some cynics think this is exactly why the Obama team will take its time articulating a plan. The deeper the crisis is today, the better a new team will look next year. On the other hand, a belief that tax rates will go up next year will incentivize many to shift income into this year. If that happens as it did at the end of 1992, it would make this year look better relative to growth next year and could be one reason that the Obama team is unwilling to talk about its plans for raising taxes.

In the end, it is impossible to know exactly what policies will be followed. However, an Obama White House that wants to be elected to a second term must get the stock market to respond positively. As a result, we look for an Administration that looks much more like the Clinton years than either Roosevelt or Carter.

Brian S. Wesbury, *Chief Economist*
Robert Stein, *Senior Economist*