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US Election Note: Economic Policy after 2012

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Summary points

- With the 'fiscal cliff' of budget cuts and tax rises approaching in January 2013, the two candidates take opposing positions on the proper path for reducing the US budget deficit and federal debt.
- President Barack Obama would hold federal government spending at about 22% of GDP, while Republican challenger Mitt Romney has said he would decrease it to less than 20%. At the same time, Obama has promised to raise taxes on those making more than $250,000 a year, back to the rates they paid during the Clinton administration, while Romney has vowed to lower those rates.
- Obama would cut American defence spending; Romney would raise it.
- Both Obama and Romney say they would complete the Trans-Pacific Partnership (TPP) trade agreement. While Romney has clearly stated he would negotiate a free trade deal with Europe, Obama is still considering this.

Introduction

In 1992, Bill Clinton, the governor of a small southern state, won the presidency largely on the strength of a simple campaign message: 'It's the economy, stupid!' That mantra, crafted by Clinton's political Svengali James Carville, encapsulated the concerns of an American electorate still struggling to recover from the 1990–91 recession.

In 2012, another election year, the American economy is again rebounding from recession, this time from a downturn that was far deeper and far more prolonged than two decades ago, with a recovery that has been less robust. The electorate is sending a clear message: 'It's the economy *again,* stupid!', only this time with greater justification.

The 'fiscal cliff' looms in January 2013, when, as the result of the debt deal struck between Congress and the White House in 2011, dramatic cuts must be made to defence and social welfare spending and taxes must be raised unless a comprehensive deficit reduction plan is agreed to reduce the US deficit by at least $1.2 trillion over the next decade. Given the continued uncertainty in the trajectory of the US economy, how to strengthen economic performance is going to be among the greatest policy challenges the next administration will face. Public opinion surveys show that the economy will be the foremost concern on voters' minds when they enter the polling booth on election day. Recent history suggests that their choice will have implications not just for the future economic health of the United States, but also for the trajectory of the global economy.

Background

The American economy is still struggling to recover from the Great Recession. The real gross domestic product (GDP) grew an anaemic 1.5% in the second quarter of 2012 and the unemployment rate was 8.3% in July, compared with 10% in October 2009.[1] The budget deficit was 7.3% of GDP, down from 10.1% in 2009 (but still well above the 3% level that is the aim of governments in the euro area). The trade deficit was $376 billion in the first six months of 2012, up 20% from the same period in 2010. Inflation was a mild 1.4% in the 12 months to the end of July

[1] Bureau of Economic Analysis, 'National Income and Product Accounts', 27 July 2012, http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm; Bureau of Labor Statistics, 'Labor Force Statistics from the Current Population Survey', http://data.bls.gov/timeseries/LNS14000000.

2012. The federal debt held by the public is expected to be 72.8% of GDP in 2012, up from 36.3% in 2007, before the financial crisis began.[2]

Only one in five Americans say they are satisfied with the way things are going in the country, down from about one in four in recent months.[3] Most give as the reason the economy, which is the number one public concern as the presidential race heats up. Voters say jobs are their principal concern and there is every reason to believe they will still be the public's top interest at the start of the next presidency in late January.

In this regard, Americans are not unlike Europeans in their concerns. A median of 82% of Americans and 88% of Europeans say that a lack of jobs poses a major threat to the economic well-being of their country, according to the Pew Research Center's 2012 Global Attitudes survey.[4] A median of 81% of the public in European countries also regard the size of the national debt as a major threat; 71% of Americans share that view.

But the national debt is far more of a partisan issue in the United States, where 59% of liberals rank debt as a major threat to the economy, compared with 79% of conservatives. In Europe the left–right divide is just five percentage points in Germany, four in France, and three in Britain.

The American people are conflicted about what they want their president to do about these concerns. As Andrew Kohut, president of the Pew Research Center, has written, 'In my years of polling, there has never been an issue such as the deficit on which there has been such a consensus among the public about its importance – and such a lack of agreement about acceptable solutions.'[5]

There is strong public resistance to any cuts in government-funded entitlement programmes – such as Social Security or Medicare, respectively the national pension scheme and health insurance for the elderly – in order to reduce the deficit. Fully 51% of Americans say that maintaining benefits as they are trumps deficit reduction.[6]

The public does support a combination of budget cuts and tax increases, especially for the wealthy. By two to one (44% to 22%), Americans say that raising taxes on incomes above $250,000 would help the economy rather than hurt it.[7]

Thus whoever takes the presidential office in 2013 faces a serious conundrum. The American people want the economy fixed but they are resistant, or divided at best, on the sacrifices required to achieve a solution. The presidential election is likely to turn on how voters assess the future implications of each candidate's economic platform.

Complicating matters, in their August 2011 deal to raise the permissible amount of government debt, as noted above, Congress and the White House agreed that if an agreement could not be reached to cut the deficit significantly, automatic spending cuts and tax increases would take effect in January 2013. These would include dramatic cuts in defence and social welfare spending, and a return to the higher across-the-board tax rates that existed in the Clinton administration. No deal has yet been agreed upon on how to avoid this 'fiscal cliff'. The Congressional Budget Office has predicted that removing such a large amount of money from the economy overnight would be likely to throw the United States into recession.[8]

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[2] Congressional Budget Office, 'An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022', http://www.cbo.gov/sites/default/files/cbofiles/attachments/08-22-2012-Update_to_Outlook.pdf.
[3] Gallup, 'U.S. Satisfaction Slips Slightly to 20%', 13 June 2012, http://www.gallup.com/poll/155162/Satisfaction-Slips-Slightly.aspx.
[4] Pew Global Attitudes Project, 'European Unity on the Rocks', 29 May 2012, http://www.pewglobal.org/2012/05/29/european-unity-on-the-rocks/
[5] Andrew Kohut, 'Debt and Deficit: A Public Opinion Dilemma', 14 June 2012. Pew Research Center for the People & the Press, http://www.people-press.org/2012/06/14/debt-and-deficit-a-public-opinion-dilemma/.
[6] Pew Research Center for the People & the Press, 'Medicare Voucher Plan Remains Unpopular', 21 August 2012, http://www.people-press.org/2012/08/21/medicare-voucher-plan-remains-unpopular/.
[7] Pew Research Center for the People & the Press, 'Raising Taxes on Rich Seen as Good for Economy, Fairness', 16 July 2012, http://www.people-press.org/2012/07/16/raising-taxes-on-rich-seen-as-good-for-economy-fairness/.
[8] Congressional Budget Office, 'An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022', 22 August 2012, http://www.cbo.gov/publication/43539.

Policy positions

A second Obama term

President Obama's annual budget proposals for 2013 reveal his economic plans with some specificity. They include increasing government outlays by 19% to the end of 2017, the year after he leaves office.[9] He argues that more government spending is needed to create jobs. And the American public agrees. In a recent survey, roughly half (51%) of voters said the best way to create jobs was to spend money on projects such as roads, bridges and technology development. Only 37% said the best way to boost employment was by cutting taxes.[10]

Obama's budgetary policies would result in a larger role for government in the economy. The White House estimates that government spending will account for roughly 24% of GDP in 2013, and his relatively stronger support for a social safety net reflects a belief that the state has a role safeguarding those in need.

President Obama would cut defence spending from 4.6% of GDP to 2.9% by 2017. He has also said he would cut the federal budget deficit from 8.5% in 2012 to 3% by 2017. He has called for an extension of the current tax rates for 98% of the American public making less than $250,000, and he advocates raising rates from 35% to 39% for those making more than that amount.

On trade issues, President Obama has pledged to complete the Trans-Pacific Partnership (TPP), a free trade agreement with at least nine Pacific Rim nations, and in December 2012 he will decide on whether to pursue a free trade agreement with Europe.[11] He has increased trade enforcement activities against allegedly unfair foreign trade practices, especially with regard to China.

The 2012 congressional elections are likely to result in continued Republican control of the House of Representatives and a possible Republican takeover of the Senate. Such divided government could make it even more difficult than currently for Obama to gain congressional approval of his economic plans.

A Romney presidency

As the presidential challenger, Romney's tax and spending proposals are less specific, in part because he has not had to produce a detailed budget.

Romney has promised to cut federal government spending by $500 billion per year by 2016 and hold such outlays to less than 20% of GDP, down from the current 24%.[12] His proposed tax cuts are estimated to reduce revenues by $3.4 trillion over the next decade.[13]

Romney has made it clear that he wants government to have less of a role in the economy. He believes that shrinking the public sector will spur private-sector activity, which will in turn stimulate growth.[14] And he argues that individuals shape their own economic destinies.

On these pivotal issues, Romney seems to have broad support. More than half (55%) of the American public say they want a smaller federal government even if that means fewer government services.[15] (Although polls also show they are loath to reduce major government spending programmes such as Social Security and Medicare or revenue-reducing tax benefits such as the home mortgage deduction.) Two-thirds of Americans say people are better off in a free market

[9] Office of Management and Budget, Historical Tables, http://www.whitehouse.gov/omb/budget/Historicals.
[10] Washington Post-ABC News Poll, http://www.washingtonpost.com/wp-srv/politics/polls/postabcpoll_20120825.html
[11] See Joseph K Hurd III, Election Note on International Trade Policy after 2012, June 2012, http://www.chathamhouse.org/sites/default/files/public/Research/Americas/0612usen_trade.pdf
[12] See Mitt Romney's spending plan, http://www.mittromney.com/issues/spending.
[13] CNN Money, http://money.cnn.com/2012/02/29/news/economy/romney_tax_deficit/index.htm.
[14] CNN Election Center, 'Campaign Issues', http://www.cnn.com/ELECTION/2012/campaign-issues.html.
[15] *Washington Post* and Kaiser Family Foundation, 25 July–5 August 2012, http://www.washingtonpost.com/politics/polling/would-government-government-services/2012/08/23/9d3e35ca-e984-11e1-9739-eef99c5fb285_page.html.

economy.[16] A majority (58%) say that it is more important that people have freedom to pursue life's goals without state interference than it is for the state to guarantee that no one is in need. And 62% of Americans believe that their success in life is determined by their own actions rather than outside forces.[17]

Romney's budget proposal would increase defence spending to 4% of GDP, adding $2.1 trillion to military outlays over the next ten years.[18] But he has promised to cut foreign aid and said he would not help bail out EU banks if they get into trouble because of the euro crisis.[19]

On trade issues, Romney has pledged to finish the TPP, stated more explicitly that he would pursue a free trade agreement with Europe and vowed to cite China for currency manipulation if there is no change in response to an alleged undervaluation of the renminbi, which could trigger a trade war between the two countries.

International implications

The relevance of the economic choices confronting American voters to those outside the United States could not be greater.

As the world's largest economy, despite all its troubles, America remains the principal engine of global growth. It is the number one importer of both merchandise and commercial services, according to the World Trade Organization and the world's largest international investor.[20] Any slowing or acceleration of the US economy, in the short and long term, in response to the next administration's budget, tax and trade policies, will ripple through the world economy.

Stripped of the details and value judgments about the relative efficacy of the Obama and Romney plans for the US economy, the choices facing the American voter about the role of government in the market and about the timing and degree of fiscal belt-tightening and other economic decisions will have important international implications.

A victory for Romney is likely to be interpreted by his administration as an endorsement of a small-government, free-market, 'rugged individualism' approach to the economy. Romney might find philosophical soul mates in the German, British, Finnish and Polish governments, much as President Ronald Reagan did in British Prime Minister Margaret Thatcher three decades earlier.

But Romney's espousal of unfettered capitalism puts him (and the American people) at odds with much of the world's public. A median of 50% in 20 other countries surveyed by the Pew Research Center in 2012 say people are better off in a free market system. While the support of Americans for free markets has remained roughly unchanged since 2007, before the beginning of the Great Recession, backing for capitalism has fallen 23 points in Italy, 20 in Spain, 15 in Poland and 11 in Japan. In fact, the only other populations that share Americans' strong faith in free markets are the Brazilians (75%), the Chinese (74%) and the Germans (69%).[21]

Similarly, there is greater support in Europe than in America for a strong state role. Two-thirds of the Spanish, 64% of the French, 62% of the Germans and 55% of the British say that it is more important for the state to guarantee that no one is in need than it is for individuals to have the freedom to pursue their goals in life without state interference. Moreover, Europeans are less sure that they are masters of their own fate. Fully 72% of Germans, 57% of the French and 50% of the

[16] Pew Global Attitudes, 'Pervasive Gloom About the World Economy', 12 July 2012, http://www.pewglobal.org/2012/07/12/pervasive-gloom-about-the-world-economy/.
[17] Pew Global Attitudes Project, 'The American-Western European Values Gap', 17 November 2011, http://www.pewglobal.org/2011/11/17/the-american-western-european-values-gap/.
[18] CNN Money, http://money.cnn.com/2012/05/10/news/economy/romney-defense-spending/index.htm.
[19] CBS News, 'Face the Nation transcripts', 17 June 2012, http://www.cbsnews.com/8301-3460_162-57454827/face-the-nation-transcripts-june-17-2012-gov-romney-senator-graham-gov-dean/.
[20] World Trade Organization, 'International Trade Statistics 2011', http://www.wto.org/english/res_e/statis_e/its2011_e/its11_world_trade_dev_e.htm.
[21] Pew Global Attitudes, 'Pervasive Gloom About the World Economy'.

Spanish say that success in life is determined by forces outside their control. Only the British (55%) share the faith of Americans in individualism.[22]

A second Obama administration, with its acceptance of a relatively larger role for government in the economy and its greater commitment to a social safety net, would be more in tune with the views of much of the foreign public, especially in Europe.

But the fundamental difference in worldview between Americans and many in the rest of the world would remain. Americans will continue to be more individualistic, more sceptical of government and more supportive of capitalism than many others.

Whoever wins the US election, on fiscal policy issues there will be both differences and some similarities in attitudes between the president and public opinion around the world. Romney has espoused fiscal austerity at home, while criticizing fiscal profligacy abroad. The former Massachusetts governor has frequently chastised European governments, in particular, for their failure to hold down public spending.

Such a sentiment actually resonates with some European publics. Approximately half of those surveyed in 12 European countries support cutting spending to reduce public debt rather than maintaining or increasing public spending to stimulate economic growth.[23] But it also gives Romney strange political bedfellows. It allies him with the French (65% back decreased spending) and the Spanish (55%) publics, whose governments he has explicitly or implicitly criticized in the past for their 'socialist' tendencies, while putting him at cross purposes with the German (47%) and British (26%) publics, to whose governments he is philosophically closer.

Obama's approach to government spending is driven by a greater belief in the efficacy of public outlays as a means of priming the economic pump. His budgets provide a longer glide path in the reduction of government spending. Obama too could find support abroad. In 2012, the French elected a new socialist president and government on a platform that was sceptical of the economic payoff from austerity. And polling shows that if an election were held any time soon in the United Kingdom, the Labour party would win on an anti-austerity platform.[24]

Future US spending plans go hand in glove with future US tax policy, which will have an impact on other countries given the growing competition in tax regimes among major economies. Romney has proposed a cut in the highest marginal income tax rate from 35% to 28%. This would mean that the wealthiest American taxpayers would pay a lower federal income tax rate than that imposed in 25 of 33 OECD countries, possibly leading some foreign entrepreneurs to see the United States as a better place to make their fortunes.[25] Moreover, his proposed cut in the corporate tax rate from 35% to 25% would move the United States from having the highest rate among the major economies to having one that is close to the OECD average of 23% – again possibly making the United States a more competitive home for corporations.

Obama has proposed reducing the corporate tax rate to 28%, but he advocates raising the top marginal income tax rate to 39%, as happened in the late 1990s, arguing that such a rate in no way hampered US competitiveness.[26]

There is some support abroad for Romney's formula of reducing the government's deficit through cutting spending rather than raising taxes. But there is also sympathy for Obama's view that the rich should bear more of the tax burden. A recent survey found that 68% of the French said they wanted budget rebalancing to come from cutting government spending and reducing public services. Only 2% backed increasing taxes, while just 20% wanted a mix of the two. (Of course, the highest marginal tax rate in France is already 40%.) At the same time, 73% of the French public say they would back a 75% marginal tax rate for people making more than one million euros per

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[22] Pew Global Attitudes Project, 'The American-Western European Values Gap'.
[23] Transatlantic Trends, 'Topline Data 2012, http://trends.gmfus.org/files/2012/09/TT-2012-Topline-Data.pdf.
[24] YouGov/*The Sunday Times*, 24 August 2012
[25] OECD, 'Personal income tax rates and threshold for central governments', http://www.oecd.org/tax/taxpolicyanalysis/oecdtaxdatabase.htm#pir.
[26] The White House, 'Remarks by the President on Extending Tax Cuts for Middle-Class Families', 9 July 2012, http://www.whitehouse.gov/the-press-office/2012/07/09/remarks-president-extending-tax-cuts-middle-class-families.

year.[27] Similarly, 47% of respondents in a January poll in the United Kingdom said the government should cut taxes to encourage growth; only 11% backed increasing taxes to help reduce the deficit. At the same time, 62% said that taxes should be raised on the wealthiest people in the United Kingdom.[28]

How foreigners judge the American president's decisions on taxing and spending may depend on their implications for the US budget deficit and government debt. The government debt held by the public is of particular interest to the rest of the world, because financing a larger debt is likely to drain much-needed capital from other economies to reduce the American imbalance. It could also slow American and thus world growth, and it might heighten the risk of renewed financial turmoil internationally.

The 2013 Obama budget proposal claims that the deficit will fall to 3% by 2017. Romney has set no specific short-term budgetary target, but he has said he would balance the budget by the end of his second term (2020).

Deficits add to the government debt. The non-partisan Congressional Budget Office foresees government debt climbing to 89.7% of GDP by 2022 under current policies.[29] The Obama budget forecasts a debt-to-GDP ratio of 77.1% by 2017.[30] The Romney campaign has not released enough details about its economic plans to produce any estimate of the impact of its proposals on government debt.

Beyond budgetary and debt policy, the future trade policy of the United States, the world's largest importer and second largest exporter, will also have international economic implications. Both Romney and Obama have promised to increase trade, while being tough on countries – especially China – that allegedly practise unfair trade. While 67% of Americans say that international trade and business ties are good for the US economy, this was the lowest level of support among 21 countries surveyed in 2011. By comparison, 95% of the Germans, 89% of the Chinese, 87% of the British, 83% of the French and 82% of the Indians see international commerce in a favourable light.[31] In addition, surveys show that Americans believe trade kills jobs and undermines wages, and are not convinced it lowers prices. This lack of public faith in trade may mean that whoever is elected in November could receive tepid public support for his trade promotion intentions in Europe and in Asia.

With regard to promises by both Romney and Obama to be tough with China, there may be an even greater disconnect between future US trade policy and attitudes abroad. A majority of Americans see China as an economic threat (59%), while only 45% of Europeans see it as a threat.[32] None of this will necessarily translate into protectionist actions by the next administration that could inhibit world economic growth. But it does suggest that Washington's offensive efforts to promote trade may be met with public scepticism, while defensive actions may find public support.

Conclusion

The outcome of the American presidential election is likely to turn on economic issues. And the contrasts between the Obama and Romney prescriptions for the US economy frame the electoral debate and provide voters – and foreigners who have a stake in the outcome, if not a vote – with alternative roadmaps for the future of the economy.

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[27] See Sondages en France for more information on these polls, http://www.sondages-en-france.fr/sondages/Actualit%C3%A9/Imp%C3%B4ts.
[28] YouGov/*Sunday Times* Survey, 26–27January 2012, http://cdn.yougov.com/cumulus_uploads/document/5bal45p4b2/YG-Archives-Pol-ST-results-27-290112.pdf.
[29] Congressional Budget Office, 'An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022', August 2012, http://www.cbo.gov/sites/default/files/cbofiles/attachments/43539-08-22-2012-Update_One-Col.pdf.
[30] The White House, 'Summary Tables', http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/tables.pdf.
[31] Pew Global Attitudes Project, 'China Seen Overtaking U.S. as Global Superpower,' 13 July 2011, http://www.pewglobal.org/2011/07/13/chapter-5-economic-issues/.
[32] Transatlantic Trends, 'Topline Data 2012, http://trends.gmfus.org/files/2012/09/TT-2012-Topline-Data.pdf.

The success of either the Obama or the Romney fiscal plans could prove a powerful example for both publics and governments around the world. But if they result in a slowdown in US economic activity, it would not just be the American economy but also the world economy that would suffer.

About the Author

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http://pewglobal.org/

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