THE Independence Voice

From: MARK SPRAGUE, ITC State Director of Information Capital

The election is over, and the cloud of uncertainty about the future of America's leadership has passed. Many pressing political and business decisions had been delayed, as people waited to see what would happen. This indecision limbo is over, and now it's time to get back to work. Where does America, and subsequently Texas, now stand?

The US remains as the sole global military superpower, the home to one-fifth of world economic output, the undisputed global reserve currency, and the world's leading universities. This puts the United States in a unique position to export both its influence and its domestic problems. With Europe mired in its deepest-ever crisis and China absorbed by development challenges, US leadership in the economic sphere—whether exercised or not—remains essential. With the US elections over, the question is what kind of impact do we see the next US president— incumbent Barack Obama—and new Congress will have on the global economy.

Republicans maintained control of the House of Representatives while Democrats maintained a majority in the Senate. Democrats had held a 53-47 edge in the Senate previous to the election. Despite having several vulnerable incumbents, the Democrats managed to secure 53 seats to Republicans' 45 in the Senate, while Republicans in the House had at least 233 seats and Democrats at least 193, with 9 seats still being counted.

Two crucial points emerge. First, even though Obama won and Democrats retained the Senate, they will still have to seek compromise with a Republican House. Second, neither party gained a filibuster-proof 60 seats in the Senate. This means that the president will have to try to compromise with Senators of the opposite party in order to pass meaningful legislation.

It follows that the implications of the US elections for the global economy depend less on precise electoral platforms than on the shape of the compromise reached on the big issues, and, against a background of fraying consensus, whether compromise can be reached at all. Thus, the US electoral outcome is likely far less predictive of policy than, say, the Socialists' sweep in France in May or even last year's Conservative/Liberal Democrat victory in the UK.

Lets look at how the presidents main issues affecting the global economy and a best guess as to the likely outcome.

Potential Fiscal Cliff

Both parties are sharply at odds over how to reduce the fiscal deficit, which reached 100% percent of GDP last year. Democrats advocate higher tax rates for upper-income taxpayers (those earning over $250,000 per year) as the key to reducing the deficit. The Republicans advocate cutting entitlements and lowering individual and corporate tax rates while broadening the tax base to make up for the lost revenue.

The immediate source of disagreement, however, is how to go about avoiding the "fiscal cliff"—a precipice consisting of automatic federal spending cuts and tax hikes, including the expiration of the Bush-era tax cuts and the payroll tax cut, scheduled to go into effect at the beginning of 2013. What is the "fiscal cliff"?

The term "fiscal cliff" refers to the simultaneous spending cuts and tax increases that are slated to take place at the end of 2012.

For instance, the Bush tax cuts are currently scheduled to expire at the end of 2012. In addition, provisions that limit the reach of the AMT (alternative minimum tax) and cut payroll taxes are also scheduled to expire at the end of the year. On top of that, automatic spending cuts, as per the language laid out in the Budget Control Act of 2011, are also currently planned for the 2013 fiscal year.

While the tax increases and spending cuts would reduce the size of the national deficit, most economists feel as though the sudden changes would plunge the country into another recession, especially given the fact that the country has been so dependent on fiscal stimulus over the past few years.

For that reason, many politicians want to avoid the "fiscal cliff" that is currently looming in the distance. While most Republicans propose making the Bush-era tax cuts permanent, the administration and the Democratic Party argues they should end for upper-income households earning more than $250,000 per year. However, neither has proposed preventing the $120 billion yearly payroll tax hike. Nothing happened before the election. Therefore, the 'lame duck' Congress that will convene in November could just agree to suspend the cutbacks and tax increases for a few months. This means that the shape of a final deal on the deficit will remain unknown until late 2012 at the earliest, more likely early 2013.

Obviously a compromise is needed and is bound to include some mixture of tax increases and reductions in entitlement and discretionary spending, as well as further deferrals of tough decisions to a point down the road. Of course, there is no guarantee that such a deal will materialize. In the meantime, especially if the US recovery remains hesitant, it is difficult to believe that policymakers will push the US economy over the edge.

Texans and Americans have to see this 'fiscal cliff' avoided to maintain the growth we have had over the last few years. Whatever happens, the chance for another 'national recession' is there.

European financial crisis

Since we have managed our own financial crisis so well (not), we have been happy to tell the Europeans how ugly their crisis is. Europe is believed to have the resources to address its fiscal and financial problems and, so far, have kept the option of US support off the table, including through the International Monetary Fund (IMF). However, while the current administration has pressed mainly for Germany and the troika (the European Commission, the IMF, and the European Central Bank) to step up help for troubled economies, presumably in the form of fiscal transfers and larger liquidity injections, the Republicans have argued mainly for austerity as a way to restore public confidence.

Unless a major cataclysm occurs, the United States will likely continue to take a backseat in the euro crisis by, for example, providing liquidity swap lines via the Federal Reserve.

Energy

The Obama administration supports an "all-of-the above" approach that calls for the development of all sources of energy but differs significantly over how quickly to exploit fossil fuel-based energy sources at home and over what safeguards should be imposed.

Obama's approach includes developing domestic fossil fuel reserves as well as a range of alternative energy sources, including solar, wind, and biomass. For most Republicans, fossil fuels are crucial. They would allow the rapid development of shale gas and oil—and favors less regulation across the board—but also advocates greater investment in nuclear power. Additionally, Republicans are calling for a higher number of new oil and gas leases for offshore drilling.

Though Republicans would likely move to allow more aggressive domestic exploration and speed up the approval of the Keystone XL pipeline, fundamental shifts in US energy policy are unlikely which ultimately is good news for Texas and energy producing states.

Healthcare

Republicans will likely continue to chip away at the healthcare reform law passed in 2010, which was a significant step toward universal healthcare coverage. But it would be difficult to repeal the law entirely, even if there had been a clean sweep of the White House and Congress by Republicans. The Supreme Court in June upheld its constitutionality, and the Congressional Budget Office recently projected that repealing the law would increase federal deficits by $109 billion over the next decade.

Immigration

Obama's position on immigration has not changed, especially on granting permanent residency to and lifting country-based caps and other quotas on visas for highly skilled immigrants. But the two parties deeply diverge on granting permanent-resident status to the 11 million illegal immigrants who are currently in the United States, which the administration favors but will likely have no luck pushing through a Republican Congress over the next four years.

Housing

The re-election of President Barack Obama may lead to some change on the housing-mortgage finance front. However, experts don't expect this to happen any time soon. Don't bet on Ed DeMarco, acting head of the Federal Housing Finance Agency, leaving his post anytime soon. At this point, changing what may be considered the most important post in mortgage finance could prove unnecessarily disruptive.

Mr. DeMarco has been and likely will continue to be a political ping-pong at this point for his firm stance against the FHFA allowing principal write-downs. And with Congress desperately needing a deal to stem the threat of the fiscal cliff in early 2013, most analysts expect the administration to distance themselves on DeMarco in the short term. Secondly there is currently no new nominee for DeMarco's spot — no obvious replacement. This alone makes it unlikely that the president will use a recess appointment to replace DeMarco in the near future. The process of approval would be contentious, and presently the administration needs positive points in lobbying Congress.

In housing, lawmakers on both sides of the aisle may be willing to push forward with the Responsible Homeowner Refinancing Act of 2012, which is known as the Menendez-Boxer Bill. The bill would expand refinancing options – a deal that could prove a boon to lawmakers on both sides of the aisle who want to aid 3 million homeowners and claim the stimulative effects of $2,500 in savings for families through refinancing.

The Menendez-Boxer bill would take away reps and warrants risk for new servicers, eliminate up-front refinancing fees and appraisal costs and would be covered by a 10-basis points surcharge on refinanced home loans.
But everything going forward on the housing front is masked in a high degree of uncertainty. The future of the government-sponsored enterprises (FNMA, FHA, etc.) is still undecided. And banks and financial firms reaction

to the roll out and implementation of final Dodd-Frank rules in 2013 is something that the markets have been worrying about for two years now.

The US fiscal outcome will remain unknown until at least late in 2012, adding to the global economy's jitters. But the US election most likely brings some investor reassurance in the short run but also bad news in the long run. The short run relief, under either candidate, is likely to come from the avoidance of a US fiscal nosedive in 2013, more attention to trade agreements, avoidance of a big trade dispute with China, and the continued development of new energy sources. For better or worse (likely for worse), Europe will be left to its own devices.

The bad news is that the post-election United States is unlikely to make significant headway on its thorniest economic problems: the long-term fiscal imbalances associated with aging, healthcare spending, and inadequate tax revenues that disproportionately show favor to corporations; and the legalization of its large undocumented migrant population. Moreover, the country's lagging primary and secondary education system, which affects our international competitiveness and helps account for soaring income inequality barely made the cut for election debates.

In comparison to a badly aging Japan with a prolonged (20+ years) recession and the euro-challenged euro zone, the challenge of China's state run economy, etc. the United States looks like the shining city on a hill, but before we admire lets realize it is not that pretty. Unfortunately, the hill lies on a deep fault line—a vanishing political consensus.

So despite the US economy's size and vitality, its inability to implement a number of crucial structural and fiscal reforms is reflected in its failure to provide clear leadership on those issues and others to a global economy that is being transformed at unprecedented speed. A patchwork solution to the fiscal cliff is likely to provide some temporary reassurance. But the pattern of putting off a long-term solution to America's fiscal woes significantly adds to the risk that, sooner or later, events like the 2008–2009 global financial crisis will recur, though in a different shape and with perhaps even more disastrous consequences.

So how does this affect us in Texas? Despite our energy resources, tech growth, low tax burden, and low state entitlements that help fuel growth, the economies of states and nations are intertwined. If the national economy falls into recession, Texas will surely follow with it. If the nation continues to recover Texas will continue to lead the way.

So here are some suggestions, none of them original, but all worth thinking about.

- "I could end the deficit in 5 minutes," said Warren Buffet on CNBC. "You just pass a law that says that anytime there is a deficit of more than 3% of GDP, all sitting members of Congress are ineligible for re-election."

- Think about it – the 26th amendment (which granted the right to vote to 18 year-olds) took only 3 months and 8 days to be ratified! Why? Simple! The people demanded it. That was in 1971 - before computers, e-mail, smart phones, etc. Of the 27 amendments to the Constitution, seven took one year or less to become the law of the land - all because of public pressure.

- Pass 'no budget, no pay' legislation that would dock legislators everyday that they fail to pass a budget on time. No extensions.

- No tenure, no pension. A Congressperson collects a salary while in office and receives no pay when they're out of office.

- Congress (past, present & future) participates in Social Security. All funds in the Congressional retirement fund move to the Social Security system immediately. All future funds flow into the Social Security system, and Congress participates with the American people. It may not be used for any other purpose. There is no separation of retirement funds for any group in the US.

- Congress loses their current health care system and participates in the same health care system as the American people.

- Congress can purchase their own retirement plan, just as all Americans do. Again no separation from the public.

- Congress will no longer vote themselves a pay raise. Congressional pay will rise by the lower of CPI or 3%.

- All presidential appointees will be approved or disapproved within 90 days or the nominee is approved by default.

- End the use of filibusters. Period.

- If bipartisan committees are currently not set up, introduce them, have bipartisan seating, and a bipartisan leadership committee. Grade legislative members by the number of compromises that they work on. If we have to compromise everyday, why shouldn't they?

- To create a new department, another has to close. No more redundancy of responsibilities within the govt.

I am just saying we ought to think about it.

If I have offended anyone, I apologize. This newsletter is my responsibility and Independence Title is kind enough to endorse it. So again, if you are in disagreement, please e-mail me. That said, I hope you enjoyed the discussion.

Independence Title

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MARK SPRAGUE, State Director of Information Capital

Office: 512/454-4500 – Mobile: 512/563-4764 – Fax: 512/454-4559