

The Worst Case Scenario

The economic consequences of hope and change.

BY IRWIN M. STELZER

What will Barack Obama's sweeping victory mean for the U.S. economy? Here are a few guesses.

First, the president-elect meant it when he promised to redistribute income from families earning more than \$250,000 per year to those earning \$50,000 or less. Taxes on the richer families will go up to fund checks that will be mailed to the lower earners who now pay no income taxes (though they do pay Social Security taxes).

The worry is that congressional Democrats will persuade the new president to lower the \$250,000 cut-off point to the \$150,000 his vice president in waiting, Joe Biden, favors. Some of Obama's advisers are passing the word that he will hold the line at \$250,000 and, moreover, won't risk exacerbating the recession by upsetting the wealth-creating small business sector with an immediate tax increase. Instead, he will simply allow the Bush tax cuts to expire at the end of 2010, returning taxes on high earners to the levels prevailing during the Clinton years. So, too, with inheritance taxes: They will go up in 2010 to something like the pre-Bush levels, perhaps with a bit more forgiveness for those passing on modest inheritances or small businesses. In the end, it will cost high earners more to live and more to die in 2011. Plan accordingly.

But taxes are only one area of

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concern to the business community. The supposedly conservative Bush administration has handed Obama significant control over the commanding heights of the economy. The new president inherits ownership of parts of most major banks, insurance companies, and other financial institutions, and has the funds needed to extend government ownership into

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other sectors of the economy. There is little doubt that he will use that control to restrict executive salaries, direct funds to homeowners behind in their mortgage payments, pressure banks to lend to constituencies he and his congressional allies deem worthy, and otherwise exercise more control over the allocation of the nation's capital resources than any of his predecessors was able to do, with the exception of Franklin Roosevelt during World War II.

Won't President Obama be constrained by the huge budget defi-

cits he will face? Not entirely. Many items on his wish list don't require the direct expenditure of government money. A more-than-willing Congress will enable him to redeem his pledge to the trade unions to push through legislation to eliminate the secret ballot in union-recognition elections. The Environmental Protection Agency probably does not need new legislation to change the rules on carbon emissions so that Obama can achieve his goal of making new coal-fired generation plants totally uneconomic. The Federal Communications Commission can impose so-called "fairness" rules that make it more difficult for the largely conservative talk radio stations to challenge his government's policies. The Food and Drug Administration can make it difficult if not impossible for pharmaceutical companies to gain permission to market new drugs that the industry's critics contend are "merely" improvements on existing drugs, or are not sufficiently efficacious in the eyes of regulators. In short, Obama can obtain large portions of his agenda without asking Congress for new funding.

Certain sectors are most likely to see major changes. Housing will be the first in line. The government has placed the two giant mortgage writers, Freddie Mac and Fannie Mae, in "conservatorship." There is general agreement that the hybrid structure of the past—with private shareholders, but an implicit government guarantee of Freddie and Fannie's debt, in return for encouraging home ownership among lower earners—is dysfunctional. There is no chance that Obama will try to privatize these organizations, which back something like three out of every four mortgages written in America. Even Federal Reserve Board chairman Ben Bernanke, not exactly a raving socialist, says there is a role for government to play in the mortgage and housing markets. Best guess is that Freddie and Fannie will be revived in some form, with a specific mandate to do more of what caused much of the mess we

are now in—make loans to potential homeowners who will have difficulty meeting even the generous mortgage terms that will be on offer.

Then there is the energy sector. Obama meant it when he said that he would make carbon emissions so expensive that any electric utility attempting to build a coal-burning generator would be bankrupted. Biden was more direct—“No coal plants here in America.” Add to that the “no new nukes” implicit in Obama’s refusal to fund nuclear waste facilities, and the “no offshore drilling” implicit in the terms House speaker Nancy Pelosi will insert in any legislation on that subject, and it will soon be apparent that America will not have sufficient supplies of energy to fuel its economy, especially when a recovery takes hold.

Renewables, heavily subsidized, will add a tiny bit to supplies, but if Obama is to avoid watching oil imports soar he will have to do what Democrats since the days of Jimmy Carter have always wanted to do: ration the use of energy. Not with coupon books, but by increasing fuel-efficiency standards that will shrink the size of cars to European dimensions; rigidly enforcing rules that mandate the use of ugly, unsafe light bulbs; mandating expensive efficiency standards for new appliances, and so on.

By the end of his first term, the Obama administration will be exercising significant control over the allocation of bank credit, and similar if less overt control over the allocation of the nation’s energy resources. The financial services sector will be crawling with regulators determined to reduce risk-taking. The rich will be paying higher taxes—no problem for billionaires such as Bill Gates and Warren Buffett, but a big deterrent to the establishment of new businesses. The trade unions will be recovering much of the ground they lost when the muscle-based industries gave way to intelligence-based industries. Americans will be driving smaller, less safe cars, and reading by dimmer bulbs. And—here’s the most important part—an

economic recovery will be underway.

That recovery will come sometime before Barack Obama begins his campaign for reelection. Will it be as vigorous as it might have been in the absence of more intrusive government? Perhaps not. But even an anemic recovery, especially when judged against the current recession, will allow voters to answer in the affirmative the question Ronald Reagan famously put to

Jimmy Carter in 1980—“Are you better off than you were four years ago?” As Obama’s likely opponent, Sarah Palin, might put it in a moment of candor, “You betcha.” Voters will be comparing the economy Obama inherited with the one over which he is presiding, not with the might-have-been condition resulting from a McCain presidency. On to 2016, which might be a different story. ♦