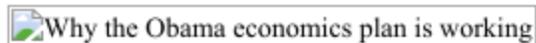


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Why the Obama economics plan is working



Saul Loeb / AFP - Getty Images

"If Obama was a Republican, we would hear a never-ending drumbeat of news stories about markets voting in favor of the President," says one economic strategist.

By Mike Dorning

It's never easy to separate politics from policy, and the past 18 months have only increased the degree of difficulty. The U.S. has been through a historic financial crisis followed by a historic election and a series of historic federal gambles — from bailing out AIG and GM to passing a \$787 billion stimulus and a \$940 billion health-care reform bill. All that risk has made policy more complicated and politics more fraught ("You lie," "Baby killer").

A Bloomberg national poll in March found that Americans, by an almost 2-to-1 margin, believe the economy has gotten worse rather than better during the past year. The Market begs to differ. While President Obama's overall job approval rating has fallen to a new low of 44 percent, according to a CBS News Poll, down five points from late March, the judgment of the financial indexes has turned resoundingly positive. The Standard & Poor's 500-stock index is up more than 74 percent from its recessionary low in March 2009. Corporate bonds have been rallying for a year. Commodity prices have surged. International currency markets have been bullish on the dollar for months, raising it by almost 10 percent since Nov. 25 against a basket of six major currencies. Housing prices have stabilized. Mortgage rates are low. "We've had a phenomenal run in asset classes across the board," says Dan Greenhaus, chief economic strategist for Miller Tabak + Co., an institutional trading firm in New York. "If Obama was a Republican, we would hear a never-ending drumbeat of news stories about markets voting in favor of the President."

Little more than a year ago, financial markets were in turmoil, major auto companies were on the verge of collapse and economists such as Paul Krugman were worried about the U.S. slumbering through a Japan-like Lost Decade. While no one would claim that all the pain is past or the danger gone, the economy is growing again, jumping to a 5.6 percent annualized growth rate in the fourth quarter of 2009 as businesses finally restocked their inventories. The consensus view now calls for 3 percent growth this year, significantly higher than the 2.1 percent estimate for 2010 that economists surveyed by Bloomberg News saw coming when Obama first moved into the Oval Office.

The U.S. manufacturing sector has expanded for eight straight months, the Business Roundtable's measure of CEO optimism reached its highest level since early 2006, and in March the economy added 162,000 jobs — more than it had during any month in the past three years. "There is more business confidence out there," says Boeing CEO Jim McNerney. "This Administration deserves significant credit."

It is worth stepping back to consider, in cool-headed policy terms, how all of this came to be — and whether the Obama team's approach amounts to a set of successful emergency measures or a new economic philosophy: Obamanomics.

For most of the past two decades, the reigning economic approach in Democratic circles has been Rubinomics, a set of priorities fashioned in the 1990s by Bill Clinton's Treasury Secretary, Robert E. Rubin, the former co-chairman of Goldman Sachs. Broadly, Rubinomics was a three-legged stool consisting of restrained government spending, lower budget deficits, and open trade, which were meant in combination to reassure financial markets, keep capital flowing, and thus put the country on a path to prosperity.

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On the surface, Obamanomics couldn't be more different. The Administration racked up record deficits as it pursued a \$787 billion fiscal stimulus on top of the \$700 billion bailout fund for banks and carmakers. Obama has done close to nothing to expand free trade. And while Clinton pleased the markets with a moderate, probusiness image, Obama has riled Wall Street with occasional bursts of populist rhetoric, such as his slamming of "fat cat bankers" on 60 Minutes last December.

The rallying markets haven't been bothered by these differences, largely because of their context. Martin Baily, who was a chairman of the Council of Economic Advisers during the Clinton Administration, says he suspects Rubin and the rest of the Clinton economic team would have made similar decisions — on bailouts, fiscal stimulus, and deficit spending — had they faced a crisis of similar magnitude. "I think we would have gone the same way," he says. The Obama team, he continues, navigated the financial crisis while never losing sight of the importance of private enterprise and private markets (a point Obama stressed in his Feb. 9 interview with Bloomberg BusinessWeek). "A lot of people on the left were urging them to nationalize banks. Instead they injected capital, and now they're pulling capital out. That looks more like Rubinomics than a set of socialist or left-wing economic policies." The Obama economic team looks a lot like Rubin's, too; three of its most prominent members — Treasury Secretary Tim Geithner, National Economic Council Chairman Larry Summers, and White House budget director Peter Orszag — are Rubin protégés.

While the Administration's call for a consumer financial protection agency has aroused opposition from banks, Obama's regulatory reform plan largely leaves the financial industry's structure intact and ignores proposals to break up large financial institutions, unlike the reforms pursued after the Crash of 1929. Amid an uproar over bonuses at government-assisted banks, Obama for the most part chose to respect private employment contracts.

In short, Obama's instincts during the crisis were exceedingly Rubin-esque. Even the \$787 billion stimulus package, while large by historical standards, didn't reach the scale called for by many liberal economists, including the chairman of his own Council of Economic Advisers, Christina Romer, who initially advocated spending more than \$1 trillion. Today, Romer doesn't shy away from comparisons to the last Democratic Administration, but she also makes no grand claims about a new economic philosophy. What unites Rubinomics and Obamanomics, she says, "is the focus on results, the pragmatism of what's right for the economy. We each took the policy that was appropriate at the time."

The similarities go deeper. Like Clinton, Obama has tried to reduce income inequality. Clinton's 1993 deficit-reduction plan raised income tax rates for high-income families to 39.6 percent; Obama plans to return the top rate to the Clinton-era level. He also raised Medicare taxes for individuals earning over \$200,000 to finance his health plan. Clinton aided the working poor with the Earned Income Tax Credit; Obama is doing the same with insurance subsidies in his health plan. A national health plan was an aspiration of both Presidents. Baily argues that the Obama approach is "at least in principle closer to Rubinomics than was the Clinton plan. [Obama's team] is trying to use market incentives to raise the quality and lower the cost, and that looks like Rubinomics."

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Any comparison must take into account the vastly different circumstances each Administration confronted. Clinton entered office as the end of the Cold War generated a peace dividend, then rode the tech boom — and the tax-revenue-generating stock options that came with the runup in tech stock prices — to a balanced budget. Obama inherited two wars and the scariest financial crisis since the Great Depression. Clinton's deference to the bond market was necessary because long-term interest rates were high — above 7 percent on 30-year Treasury bonds — when he took office. Interest rates have been the least of Obama's concerns, with yields below 3 percent when he took office and the Fed effectively keeping short-term rates at zero.

Despite a budget deficit that is projected at \$1.5 trillion this year, Obama wants to move the country toward the kind of fiscal balance it enjoyed fleetingly in the Clinton era, though his budget plans falls short of that. He recognizes that the federal debt load is unupportable. Alan Greenspan — the tacit ally of Clinton and Rubin in the 1990s — warned last month that a recent uptick in yields on 10-year Treasury notes might signal a surge in long-term interest rates driven by investor anxiety over the budget shortfall.

Economic stabilization has not been Obama's handiwork alone. In the months before he took office, President George W. Bush and Treasury Secretary Hank Paulson halted a market free fall with the bank bailout. Obama's stimulus complemented the Federal Reserve's aggressive monetary easing. To build a floor for housing prices, the Fed intervened to support mortgage markets and the White House pledged unlimited financial backing for mortgage giants Fannie Mae and Freddie Mac, and rolled out tax credits for home buyers and mortgage modification programs to stave off foreclosures. It's the entire package that has made the difference.

"When you take it all together, the response was massive, unprecedented, and ultimately successful," says Mark Zandi, chief economist at Moody's Economy.com. Even Obama critics like Phil Swagel, assistant Treasury secretary for economic policy under George W. Bush, acknowledge that White House policies have been successful. "They could have done a better job" by spending more of the stimulus on corporate tax cuts to boost hiring and investment, says Swagel, now an economics professor at Georgetown University's McDonough School of Business. "But their economic policies, including the stimulus, have helped move the economy in the right direction."

While jobs have been slow to return, the country has experienced "an incredible productivity boom" that strengthens the economy for an expansion, says Greenhaus of Miller Tabak. Labor productivity, or worker output per hour, grew at a 6.9 percent annual pace in the fourth quarter, capping the biggest one-year gain since 2002. Over the long run, productivity growth is what raises living standards. Corporate profits also have been rising, up 8 percent in the fourth quarter, putting businesses on a sounder financial foundation to invest and hire as customers return.

The public, alas, does not see the signs of life that economists do, as the downbeat views in the Bloomberg poll demonstrate. And as long as job security remains a concern, it's easy to understand why psychology may trump data. Among those who own stocks, bonds, or mutual funds, only 3 out of 10 say the value of their portfolio has risen since a year ago, according to the poll — a near-impossibility given the size and breadth of the market gains.

The early stages of an economic rebound do not bring political safe haven for Presidents. (Just ask George H.W. Bush, who won a war against Iraq only to lose reelection a year after the 1990-91 recession ended.) Obama, however, may now have reached a pivot point with the economy finally beginning to add jobs. "He can make great strides in short order," says Steven Jarding, a former Democratic campaign strategist who is now a lecturer at Harvard's Kennedy School of Government. "Any indicator he can build on is a good thing. He'll be able to focus all his energy and attention to say, 'Here's what happened this year in the economy.'"

With seven months to go before midterm elections, and more than two years before Obama reaches his own reelection day, there's still time for the President's policies to swing to his political advantage. Again, follow the money: Consumer spending has been rising for five straight months. That may not last, but it suggests Obama is already on the right track with voters' wallets. If the Clinton Administration is a trustworthy precedent—and job growth continues — their hearts and minds could follow.