



## Obama and McCain: Different -- and Evolving -- Visions for the U.S. Economy

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With Americans facing gasoline prices of \$4 a gallon, record home foreclosures and fears about unemployment, presidential candidates John McCain and Barack Obama are increasing their focus on economic policy in their campaigns for the presidency.

For the most part, the positions of the presumptive nominees, Republican McCain and Democrat Obama, fall along traditional party lines: Obama leans more toward government involvement in the economy, while McCain's proposals rely on private sector solutions. Both plans, however, would certainly add to already troubling deficits, according to Wharton faculty and economic policy analysts who point to worrisome elements of both candidates' plans.

"It's early in the election cycle. Both candidates have an opportunity to refine -- and rethink -- their economic policies," says Wharton finance professor [Richard Marston](#). "Both had better do more rethinking before one of them becomes president."

Voters are growing increasingly concerned about the nation's financial situation. More than half of Americans, 56%, describe the country's economic condition as poor, while 33% say the economy is only fair, according to The Pew Research Center for the People & the Press.

"People are very attuned to the economy. In the polls, it has taken precedence over the Iraq war, which has perhaps faded to a dull roar in people's consciousness," says Brooks Jackson, director of Annenberg Political Fact Check, a group based at Penn's Annenberg Public Policy Center that monitors the accuracy of statements by major U.S. political players. "We're going through an unprecedented and very scary period with home prices and an unprecedented increase in energy prices. Nobody knows where it's going to stop."

The divide between the two major candidates is clear in tax policy. Obama wants to let the Bush Administration's tax cuts expire, as scheduled, at the end of 2010 and provide new tax breaks for low-income workers, senior citizens, students and start-up companies. When McCain launched his campaign, he opposed the tax cuts because he said they favored the wealthy and reduced the availability of government resources during wartime. Now he says the cuts should remain in place because allowing them to expire would amount to a tax increase at a time when the economy is already weak.

McCain also wants to reduce the corporate tax rate from 35% to 25%. Obama supports a corporate tax rate cut as well, but has not specified exactly how large. In addition, Obama would raise capital gains taxes on Americans earning more than \$250,000 a year, while McCain would maintain current tax rates on capital gains and dividends.

On the campaign trail, Obama has called Bush "fiscally irresponsible" and said McCain is running to serve George W. Bush's third term -- only more irresponsibly. "When it comes to taxes," Obama has added, comparing McCain to the incumbent president is "not being fair to George Bush." McCain's camp has fired back with charges that Obama's ideas are unrealistic and will result in government intervention that will slow economic growth. Douglas Holtz-Eakin, chief economic aide to John McCain, said Obama's proposals are "like being for kittens, puppies and sunshine."

### Voters Need a Clearer Vision



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According to Marston, McCain's proposal to extend the Bush tax credits amounts to campaign rhetoric in the current climate. "There is no way all of the cuts will be extended now that the political winds have shifted," he says, adding that McCain has not been able to articulate which of his proposed tax cuts is most important. "Voters need a clearer economic vision."

Obama's tax policy, he suggests, is more refined than those presented by the Democratic candidates in the last two elections. For example, his plan explicitly aims taxes at Americans making more than \$250,000 a year. "The thought appears to be that those making less than that will readily approve such tax increases. It remains to be seen whether this is the case, but it's a definite change in strategy." Marston says Obama and his advisors have not addressed the issue of whether higher taxes will have an impact on incentives for businesses to reinvest and create new growth. "Will this affect risk-taking by entrepreneurs who provide the innovation that the country thrives on?" Marston asks. "If so, would other tax increases, say on dividends, be preferable?"

[Janet Rothenberg Pack](#), Wharton professor of business and public policy, suggests McCain's support for the Bush tax cuts is a mistake because they will continue to deepen the U.S. budget deficit. "The deficit and the trade deficit -- which are related -- are hurting us and are going to hurt us a lot more in the future."

As for Obama, Pack says his tax and spending policies are more complicated than McCain's, making it more difficult to gauge their impact. "While I like the idea of undoing the Bush tax cuts, Obama's plan is not that simple and it's not exactly clear what the net effect would be." For example, Obama has outlined plans to spend \$15 billion a year for 10 years on energy technology funded by revenue collected through a system of trading pollution permits. He also would create an "infrastructure reinvestment bank" that would finance \$60 billion in high-speed railways, energy grids and other projects over 10 years.

According to the Tax Policy Center, a joint venture between the Urban Institute and the Brookings Institution, the two candidates' specific non-health tax proposals would reduce tax revenues by \$3.6 trillion (McCain) and \$2.7 trillion (Obama) over the next 10 years, or approximately 10% and 7% of the revenues scheduled for collection under current law.

"Both sets of policies are bad in that they don't balance the federal budget and they would each run up deficits," says Robertson Williams, principal research associate at the Tax Policy Center. "Those are deep holes to fill back in with spending cuts. If we run deficits like that somewhere down the road we will have to worry about paying back those costs." He says the need to raise taxes in the future may outstrip the gains made by cutting taxes now. "Both plans would impose costs on our children and grandchildren at a time when Baby Boomers in retirement will be demanding more and more resources as well."

### **Touching the 'Third Rail'**

Each candidate has already made some statements about Social Security, which is sometimes called the "third rail" of politics because addressing the issue of solvency is likely to rile beneficiaries. [Kent Smetters](#), Wharton professor of insurance and risk management, says Obama wants to eliminate the payroll tax limit, but give an exemption for people making between \$102,000 and \$250,000 a year. He would also eliminate the income tax on Social Security benefits for people making less than \$50,000 a year. He notes that McCain wants to appoint a bipartisan commission to explore changes to the system. Unlike Bush's previous commission, which was handpicked by the White House, McCain will let Democrats pick their own representatives, says Smetters, adding that McCain's commission will likely be composed of members of Congress in order to force the issue on them.

Obama's proposed tax increase on people making above \$250,000, who already pay the majority of the nation's taxes, will mean a marginal tax rate on wages of around 65% in high tax states such as California and New York, up from about 45% today, Smetters adds. "Even then, Social Security and Medicare will be quite broken and so more revenue will be needed from them. So we are talking about a very sharp increase in taxes. While most everyone agrees that the rich should pay a larger proportion of their income in taxes, even John Kennedy thought it was a bad idea to hit the job creators that hard."

He also points out that Obama's tax reduction on those making below \$50,000 essentially defeats the purpose of the Earned Income Tax Credit, which already offsets taxes on the poor.

"However, Obama, being a Democrat, is more likely to be trusted by the public to control the growth rate

of benefits, and so he might be more effective at creating overall reform," says Smetters. "McCain will need the commission for cover."

Smetters argues that the best approach to Social Security is to control the growth rate of benefits for richer people at a rate no higher than inflation, while getting some additional revenue by removing the preferential tax treatment on employee benefits that he says encourages over-utilization.

Medicare, he notes, is a much bigger problem and harder to solve equitably. "To McCain's credit, he voted against Bush's disastrous Part D Medicare expansion even though McCain represents one of the most aged population states in the country. That obviously took a lot of guts. I don't see Obama ever taking that type of risk."

McCain and Obama have at least begun to discuss Social Security fairly early in this campaign, perhaps for two reasons, says Smetters. One is that this is the first presidential election in which the Baby Boom generation is entering retirement. The other is that McCain has used the "privatization" label in the past to describe a proposal to allow young workers to earmark Social Security savings in private plans. McCain is polling well with people above age 65 and needs to reassure them that Social Security will be there for them, Smetters says, adding that Obama will probably use the "privatization" label on McCain's plan because that term polls poorly. The candidates are not likely to put forth more extensive plans before the election, because that might require tough medicine for beneficiaries or "gimmicks. Either way you open yourself up to criticism."

### **Cracking Down on 'Reckless Behavior'**

The candidates' economic proposals come against a background of financial instability linked to the subprime credit meltdown and call for greater regulation of credit companies. In a speech before the National Small Business Summit, McCain said Americans "are right to be offended" by the "extravagant salaries and severance deals" of corporate officers who have engaged in "reckless corporate behavior." He vowed that federal prosecutors will go after wrong-doers.

Meanwhile, Obama has come out in support of measures to help homeowners protect themselves against foreclosure and additional oversight of the credit industry. Pack says the current mortgage meltdown is the predictable result of policies created during the Bush and Clinton administrations encouraging homeownership for people who should not have been qualified for mortgages. "It was crazy at the time and the results could have been foretold, but it was a popular policy among certain people."

Marston predicts financial sector regulation will be a major issue after the election, especially following the rescue of Bear Stearns. "The precedent has been set for the Fed to help rescue an investment bank -- not a commercial bank as it has in the past -- so the new president will have to figure out what that means for regulation," he says. "It's a big issue, but we have no idea what Obama or McCain will do about that."

According to Marston, trade is another area of concern. In the Ohio Democratic primary debate, Obama suggested he might renegotiate the North American Free Trade Act (NAFTA). "I think that is just campaign rhetoric. But it remains to be seen whether he is as much of a free trader as Bill Clinton was," says Marston, who adds that NAFTA would never have been approved without strong support from Clinton.

"Obama probably won't reverse previous advances, but we don't know whether his heart will be in new initiatives. McCain will back free trade just as Reagan and every president since then has done, but Obama is a question mark."

Pack says that to pull back on current trade policies would be a mistake. "There's hardly an economist in the world who would argue that expanding free trade is not a good thing. [A pullback] may be popular with unions or some employees, but it is not the way to go. It's really sad to see that after President Clinton pressed for NAFTA and a reduction in tariffs, this is such a big issue. It's pandering." Pack argues that low-income consumers in the United State benefit from free trade which allows them to buy goods cheaper from developing nations that, in turn, need access to markets to help their populations emerge from poverty. "The major animus is directed at China and there are many reasons for that besides trade. A lot of people are buying things from China they could not otherwise buy. "

## Overseas Views

The trade debate is of interest overseas -- but many economic analysts in key trading-partner nations such as China and India and in Latin America consider the campaign-related comments on trade to be mostly pre-election bluster.

Yuan Zheng, associate director of the U.S. Diplomacy Research Center of the China Social Science Academy, has suggested that U.S. trade policies with China are based on U.S. national interest rather than on the personal views of the president. Some people will send strong signals on certain topics to get elected, he adds, but after being in office for a while, the president will then get back to further boosting the Sino-U.S. relationship.

"You hardly see any Chinese intellectuals with a strong preference [for either of] these two candidates," says Xiao Geng, Director of the Brookings-Tsinghua Center in Beijing. "No matter who wins, things will come back to the expected policies.... [the] China-U.S. relationship is way too important."

Still, some researchers expect the dollar to get stronger after the election, which could have an impact on trade; a weaker dollar makes Chinese products more expensive in the U.S. and U.S. products more expensive in China. As the dollar strengthens, the U.S. trade deficit with China could become a bigger political issue. Jian Feng, director of the structural finance research center at the China Social Science Academy, said in a speech in early April that "if you look at what happened in the past, the dollar generally depreciates pre-election and then appreciates post-election. I think [after] this year, you will mostly see the dollar get stronger."

In the Indian business magazine *Business Today*, V.K. Kaul, professor of business economics at Delhi University, said that rating the most favorable candidate from India's perspective is a futile exercise. "Any U.S. president will look to promote only that country's interests. Who comes to power is, therefore, immaterial."

"If one was to look purely from a trade and outsourcing perspective ... McCain seems to be a better choice for India," says Ravi Bapna, a professor at the India School of Business. "But when push comes to shove, even the Democrats, despite all their rhetoric during campaigning, will not be able to walk away from globalization. No U.S. president can walk away from market-based mechanisms which are now so deeply embedded."

"What are perhaps more important issues are geopolitical stability, the war in Iraq and how to get America back to the intellectual standards that it once had and which have been eroded in recent years," Bapna adds. "In that sense, Obama is much more of a dynamic personality who can really bring back America's intellectual place in the world. And if that happens, then other good things will follow naturally."

Yogen Lal, chief operating officer (COO) of the Mumbai-based Unity Infraprojects, one of India's leading players in infrastructure development, sticks to conventional wisdom. "Democrats have traditionally supported India," he says. "In my opinion, Obama will be better for India."

Pradeep Mukherjee, who previously worked for Citibank for several years in the U.S and now is CEO of Mumbai-based HR consultancy Potential Unlimited, says that if he had to choose, he would opt for Obama, but not for any business or economic reasons. "I expect Obama to ask the question: 'Why does the world hate America so much these days?' He may not have an easy solution, but he will at least be looking for the answers. Secondly, I respect Obama for what he has achieved at his age and against all the odds."

McCain, he asserts, "is an unknown quantity" in India. "Nobody knows what he stands for. But because he belongs to the same party as Bush, he starts off with several strikes against him."

Rajesh Chakrabarti, assistant professor of finance at the Hyderabad-based Indian School of Business (ISB), says that the Bush presidency was quite favorable for India. Chakrabarti spent nearly a decade at the Georgia Tech College of Management and is thus keenly aware of both the U.S. and the Indian political process and sensitivities.

“The Clinton presidency was very good for India too,” Chakrabarti adds. “Of course it is difficult to estimate as to how much of that was because of the presidency or because of world events. If one looks back, since the collapse of the Soviet Union, the relationship between India and the U.S. has warmed and improved almost continuously during both Republican and Democratic presidencies. There was some freeze because of the nuclear testing but that was a one-time event and any president in power would have acted the same. The way in which the Republicans and the Democrats handle the world affairs, especially in the Middle East, could have an indirect impact on India. But here also I don’t see any major difference between the two in terms of new developments.”

Still, Chakrabarti says, he worries about the Democratic Party’s trade stance. “In their election campaigns, the Democrats have been making noises about being more protectionist, less trade oriented, reducing the flow of outsourcing, etc.,” he notes. “Whether it is rhetoric or whether they will actually implement it if they come to power is not very clear. I don’t really believe that they will in fact do any of this if they come to power. However, it seems on the face of it that the Republicans are better for India because of their open trade approach. McCain is probably a safer bet for India in that not much is likely to change in terms of economic policies.”

“Traditionally the Republicans have been more open and less restrictive in terms of trade agreements,” says Ashok Soota, executive chairman of the Bangalore-based software consultancy MindTree Ltd. “Obama, on the other hand, has made some remarks which could be construed as somewhat negative, but that’s more restricted to the NAFTA. My belief is that the forces of globalization are so strong that I don’t think anything fundamental will change with either of them... [However], I believe that we will not see the strong positive thrust that we got with Bush with either McCain or Obama.”

For Latin Americans, says Fausto Hernández Trillo, an economist and researcher at CIDE, the center for research and teaching in Mexico, “the only thing that you need to pay attention to [in campaign speeches] is a certain flirtation with the Hispanic population in the U.S., for purely electoral goals.” No matter who wins the next election. “I don’t think that the close economic relationship between Mexico and the U.S. will suffer.”

Latin America is not a priority for the United States nowadays, Trillo adds, beyond making sure that the relationship between the U.S. and the region does not deteriorate. “Interest [in the region] is more about drug trafficking.”

Still, Hugo Macías Cardona, a professor at the University of Medellín in Colombia, worries about the future of the bilateral U.S.-Colombia free trade agreement. Macías says he believes it would help Colombia if McCain won the presidency. However, if Obama wins, the U.S. will have to continue to maintain a close relationship with Colombia.

Colombia is one of the principal allies of the U.S. on the continent, and one of its partners when dealing with regional problems, especially when it comes to neutralizing the impact of Venezuelan President Hugo Chávez, who has been very critical of the U.S. and the role that it plays in the region, he states. “This relationship has become stronger under the Republican Party, which is much closer from a philosophical view to the approach of the right-wing and center-right groups that have been in power in Colombia.”

As Macías notes, a fragmented form of integration is emerging in the region, in which Central America and the Caribbean are strengthening their ties with the U.S. whereas South America -- except for Colombia -- is coming together and strengthening its relationships with Europe more than with the U.S. In this context, “Colombia will continue to be a strategic ally of the U.S., even under a Democratic-controlled government and Congress.”

Gayle Allard, a professor at the IE business school, points out that McCain has declared his support for the free-trade pact with Colombia. In contrast, Obama has said nothing specifically about the treaty -- which, according to her, is an unfortunate omission. “If you want to know what economic policy the new president is going to pursue, you have to look at the Congress, which might be more in tune with Obama,” Allard notes. She believes that the bilateral treaty will eventually be approved by the U.S. Congress.

## **Outmoded Cuba Policy?**

On the other hand, Allard notes that American policy toward Cuba, which has been the target of a trade embargo by the U.S. for decades, "is a bit outmoded; you have to recognize that fact and change the policy. Obama could very well lead such a change because he can count on a great deal of support from the Congress on this issue." Obama said recently that he favors removing restrictions on traveling to Cuba and sending money to that country.

Beyond such concrete differences, Allard believes that for the world at large, the impact of a victory by one candidate or the other will mostly be on the image of the U.S. "McCain projects more of the traditional image of the American conservative while Obama's image is radically new and more attractive for Europeans," she states. The image of the U.S., which has deteriorated a great deal under Bush, would improve if Obama wins because his "rhetoric about people fighting for global causes extends beyond the U.S." She expressed approval of the effort to elect a president who reflects the country's diversity so well. "This, more than any economic policy that the U.S. might undertake, would be the most positive thing if Obama winds up winning." Finally, Allard predicts that Obama, if elected, would have a greater potential for creating a dialogue with Europeans because he is the son of an immigrant and has an international background.

Now that the long primary campaigns have finally ended, Pack says it seems likely both major party candidates will have to sharpen their positions. "We're not really into the season quite yet although [the candidates] started so early it seems like we've been in it for the last five years," says Pack. "They will probably flesh things out more after the conventions, which is too bad because it gives them a long time to speak vaguely."

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