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Road to the White House: What's at stake in the US election

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Summary

- With the Republican nominee now firmly solidified, the race for the White House can begin in earnest. This Thinkpiece considers some key differences between Barack Obama and his challenger Mitt Romney, and why insurers and financial advisers outside the US should take note.
- Financial regulation has provided one of the biggest policy changes of the Obama administration. New laws have looked to bring more transparency to financial markets and provide greater protection to consumers – though change would be on the cards should Romney be victorious.
- Climate change is an important issue for insurers the world over and the result of the election could have a profound impact on future US policy. A second term Obama presidency might mean greater U.S. leadership on climate change, while Romney remains uncertain it is man-made.
- Above all it will be the economy that is likely to determine the next President of the United States. Events outside the US, especially in the Eurozone, will play a major role in whether President Obama's bid for re-election is successful. In policy terms, Democrats prefer a stimulus driven approach to growth, whereas the Republicans look to the private sector.
- Early indications are for a close fight, with Obama edging it – just. But a lot can change between now and election day (November 6th).

CII Introduction: The world will be watching as Americans go to the polls on November 6th. The battle between present incumbent, Barack Obama and challenger, Mitt Romney promises to be close, with many saying too close to call. Whatever the result, the consequences will be felt all over the world and not just in the US. In this Thinkpiece, Ana Catalano Weeks (Harvard University) considers some of the policy topics that will play an important role in deciding the winner and that will be of global significance to those in insurance and financial services.

As the economy continues to waver, the President could be up against one of the tightest bids for reelection in history this November. Unemployment reports showed that the growth in jobs was down in June, and the Eurozone crisis continues to rear its ugly head – making Romney, the candidate that Republicans were so reluctant to embrace, a considerably more formidable opponent than many previously assumed. This Thinkpiece investigates what Obama will do if he's reelected, what Romney will do if he wins, and how it will make a difference to business as usual in the UK.

Financial Regulation

Along with healthcare reform, the biggest policy change the Obama administration has made was to reform financial regulation after the crisis. On his re-election website, Barack Obama emphasizes his track record on Wall Street reform – namely, passing the Dodd-Frank Wall Street Reform and Consumer Protection Act in July 2010.[1] The law is intended to protect consumers, end "too big to fail" bailouts, and bring more transparency and accountability to financial markets. As part of the law, a new, independent watchdog, the Consumer Financial Protection Bureau (C.F.P.B.), was established to monitor firms and set and enforce consumer financial law.

When it was first introduced, Dodd-Frank was hailed as the most significant reform to financial regulation in the United States since the depression-era reforms – but since then, partisan bickering has weakened it significantly. The C.F.P.B. went without a head for over six months as the Republican-led Senate blocked Obama's appointment, Richard Cordray. While they didn't object to Cordray in particular, Republicans are staunchly opposed to the law that created it. They intended to use their sway to water down the powers of the new agency or kill it off entirely. Finally in January of this year Obama took advantage of the congressional recess to install Cordray in the post without Senate approval – a controversial move that infuriated Republicans and spurred talk of his "aggressive reelection strategy".[2]

Republicans' objections to Dodd-Frank are that it adds more "red tape" to the regulatory burden for Americans, and that its restrictions stop banks from lending to "job creators" (the phrase used by Republicans to denote business owners whose entrepreneurial activities create employment for others). Romney, on his election website, argues that Obama's reform agenda has resulted in an undue burden on the U.S. economy at exactly the time when Americans can't afford the new taxes required to pay for agencies like the C.F.P.B. He promises to repeal Dodd-Frank, amongst other regulations, and replace it with a "streamlined, modern" regulatory framework.[3]

Obama continues to defend his position – and with JPMorgan's recent loss of more than $2 billion in a credit derivatives trade gone wrong, voters may connect with his message more than Romney's.[4] In fact, some are using the losses to push lawmakers to go beyond Obama's overhaul, or at least implement the Volcker Rule, the part of the reform that would restrict the ability of banks whose deposits are federally insured to conduct proprietary trading.

Will the future of financial regulation in the U.S. have any influence on reforms in the U.K.? Many of the provisions that have come under fire in the U.S. are already applicable to U.K.-listed companies – like the corporate governance requirements for a non-binding

[1] http://www.barackobama.com/record/on/wall-street-reform

[2] "Obama Takes Aim at Congress to Hurt His G.O.P. Rivals." *The New York Times.* Jan 6, 2012.

[3] http://www.mittromney.com/issues/regulation

[4] Recent polls show that public opinion is divided on whether Obama has done a good job on financial reform: 49% of Americans have a favorable impression of the Obama administration's increased regulation of financial institutions, with 44% unfavorable and 7% no opinion (May '12, data from *The Washington Post-ABC News poll* of public opinion).

vote on the remuneration of executives and disclosures about the roles of chairman and chief executive. The biggest difference is that Dodd-Frank is compulsory, whereas current U.K. law depends on a “comply or explain” policy. The European Commission may look to impose a similar approach on the U.K. if it believes it is necessary to strengthen corporate governance obligations.[5]

The full implications of Dodd-Frank are yet to be seen, as most of its provisions have yet to be implemented. However, financial markets around the world are so interconnected that there is little doubt changes made in the U.S. will affect users of all financial markets.

What the C.F.P.B. has done so far:	
Introduced a rule allowing it to put large debt collectors and credit reporting companies under regular federal oversight for the first time	Feb ‘12
Launched a consultation on prepaid debit cards, with the intent to extend federal consumer protections to these products	May ‘12
Proposed tighter mortgage lending regulations on origination fees and other mortgage servicing fees	May ‘12

Climate Change

Another major area of difference between the two candidates is energy and climate change. While Obama has already made significant headway on financial reform, he has not seen similar success on his climate change policy. When he won the Democratic nomination in 2008, he claimed that “this was the moment when the rise of the oceans began to slow and our planet began to heal.”[6] Yet, his administration was unable to win a deal on cap-and-trade (a market-based solution to cutting emissions by imposing a cap and allowing tradable pollution credits), and Obama has shown little willingness to follow through on his campaign promises since then. However, recently he went on the record to state that climate change will be a big issue in the coming election: “we’re going to have to take further steps to deal with climate change in a serious way.”[7]

Romney has expressed qualified concern about climate change in the past, but he says that he is uncertain how much of it is human-caused. While he tried to reduce greenhouse gas emissions as governor of Massachusetts, he would not go as far as a cap-and-trade plan to do it. He criticizes Obama for being “in thrall to the environmentalist lobby and its dogmas”, and says that he would increase production of carbon-based energy resources in the U.S.[8] Romney’s biggest target is the Environmental Protection Agency (E.P.A.), which he argues “continues to issue endless new regulations impinging on countless other forms of economic activity – regulations that drive up costs, hinder investment, and destroy jobs.”[9] He would strip the E.P.A. of most of its authority, and aggressively develop American oil, gas, coal, and nuclear power in order to become independent from the oil cartels.

Climate change is one of the few issues that could fundamentally change the world decades from now. So far, the U.S. has refused to join any climate agreements to limit emissions, and it has one of the highest levels of greenhouse gas emissions per capita. But a second-term President might have the opportunity to pursue this agenda without pandering to extremists.[10] In the same recent interview, Obama made his views on this clear: "Frankly, I'm deeply concerned that internationally, we have not made as much progress as we need to make." If he continues down this track, prospects for an international agreement – the likes of which proved so elusive at the Copenhagen talks in December 2009 – look considerably brighter.

[5] “Will Dodd-Frank Influence Any Further Reform of UK Corporate Governance?” By *Peter Baldwin, John Phillips, Lizanne Thomas and Jennifer Lewis.* Thomson Reuters Accelus. January 6, 2011.

[6] Remarks of Senator Barack Obama, St. Paul, Minnesota, June 3, 2008.

[7] “Ready for the Fight: Rolling Stone Interview with Barack Obama.” *Rolling Stone.* By Jann S. Wenner. April 25, 2012.

[8] http://www.mittromney.com/issues/energy

[9] http://www.mittromney.com/issues/regulation

[10] The Tea Party, for example, are highly skeptical of climate change A *New York Times/CBS News Poll* in 2010 found that supporters of the Tea Party are considerably more dubious about the existence and effects of global warming than the American public at large (“Climate Change Doubt is Tea Party Article of Faith.” *The New York Times.* By John M. Broder. October 20, 2010.)

It's the Economy, Stupid

Financial regulation and climate change in the US have clear implications for the U.K. insurance and financial services markets, but of course the campaign won't be decided on these issues. Bill Clinton said it best in 2004 – and it's still "the economy, stupid." Already pundits know that the real debate is what to do about the economy's woes.

Obama is quick to point out that he inherited stewardship when the economy was in freefall, and that the past two years have been marked by job growth. He wants to drive growth through the government – taxes and spending, stimulus packages, and regulation – but it will be difficult with congressional Republicans able to block such measures for their own political advantage. Romney, on the other hand, sees job creation and prosperity coming from the private sector, and aims to encourage it with tax cuts, especially to businesses. He would reduce the size and cost of government.

Obama's approach was endorsed by the economist Joseph Stiglitz, who argues that the real problem is lagging incomes and income inequality. According to Stiglitz, the Romney plan would slow down rather than stimulate the economy, and increase the likelihood of a recession.[11] Former U.S. senator Phil Gramm and dean of Columbia Business School Glenn Hubbard disagree, citing evidence from the two most recent recessions. They claim that in order to grow the economy we ought to take a cue from Reagan's handling of the 1981-82 recession; reduce domestic spending, cut taxes, and decrease regulation. [12]

Ultimately, market conditions are likely to determine who the voters believe on this question. If the debt crisis in Europe deepens – say, the dreaded "Grexodus" occurs – the already weak U.S. economy would be further undermined and it might spell the end for Obama's reelection bid. If unemployment stateside gets any worse, we can expect the same result.

Just as Europe will influence outcomes in U.S. politics, the election is likely to have its own effect on the European economy. Historic data suggests that U.S. election cycles tend to have a positive impact on stock markets, regardless of who wins.[13] However, recent exceptions (e.g. the two elections of George W. Bush) give reason to question the strength of that link. Other theories hold that the winning party determines the direction of the stock market. People expect tax cuts when Republicans run, so stocks tend to run up when they win and vice versa for Democrats. A victory for Romney in the U.S. would reassert free-market solutions and business-led recovery. The election may not immediately change market conditions in Europe, but the results are likely to influence the broader political framework shaping recovery on both sides of the Atlantic.

Early Predictions

An ongoing puzzle in political science is that the outcome of American Presidential elections can be predicted within a few percentage points months before the election, but at the same time pre-election polls can and do vary wildly over the course of those few months. Political scientists Andrew Gelman and Gary King believe that this fluctuation is due to voters becoming more and more enlightened about their rational preferences during the course of the campaign.[14] The final few months of the campaign provide voters with key information that helps them decide which candidate they ought to support. When pollsters ask them questions before the election, voters aren't as informed about where the candidates stand relative to the issues. And the poll isn't a real vote, so they also don't have the incentive to learn at this point.

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[11] "Nobel Winner Stiglitz Sees More Recession Odds in Romney." *Bloomberg.* By Rich Miller. June 5, 2012.

[12] "Gramm and Hubbard: What a Romney Recovery Might Look Like." *The Wall Street Journal.* By Phil Gramm and Glenn Hubbard. June 6, 2012.

[13] The most prominent theory is the Presidential Election Cycle Theory, developed by Yale Hirsch, an investment advisor and founder of the *Stock Trader's Almanac.*

[14] Gelman, Andrew and Gary King. 1993. "Why Are American Presidential Election Campaign Polls So Variable When Votes Are So Predictable?" *British Journal of Political Science* 23(4).

According to this theory, we should take early public opinion polls with a pinch of salt.[15] They are not typically accurate at predicting the outcome of the election, and neither are predictions from media or pundits.[16] However, past Presidential elections have been forecast fairly accurately using models based on measurable economic and political variables (see for example Steven Rosenstone's *Forecasting Presidential Elections*, 1983).

One of the best models of Presidential election forecasting today is widely thought to be the statistician Nate Silver's FiveThirtyEight blog.[17] In 2008, he correctly predicted 49 out of 50 states (he missed Indiana, which went to Obama by 0.9%). His model considers a range of national economic indicators as well as polling. In June 2012, he published his first election forecast for Obama to win with 290 electoral votes (to Romney's 248). However, both polls and economic conditions could change drastically between now and November 6. The key states to watch are Ohio and Virginia, where Obama is given just over 50 percent odds of winning in this forecast. Other models that only include macroeconomic conditions also predict Obama will win, but by so close of a margin that it is within the margin of error – i.e. too close to call.[18]

Conclusion

The U.S. election could have major implications for a number of issues relevant to insurance and financial services. This Thinkpiece has explored three areas in which the candidates have polar opposite views: financial regulation, climate change, and how to fix the economy. An Obama second-term Presidency would mean the ongoing implementation of Dodd-Frank, potentially greater U.S. leadership on climate change, and a focus on job growth through taxes and spending. A Romney win would herald the death knell for the new financial regulatory framework, and regulation in general would be cut back, in particular the E.P.A. Economically, austerity would be the name of the game (although Romney himself prefers to use the term "fiscal responsibility"). The best forecasting models currently have Obama in the lead, but only by a hair's breadth. Only time – and the future of the Eurozone – will tell.

If you have any questions or comments about this Thinkpiece, and/or would like to be added to a mailing list to receive new articles by email, please contact us: thinkpiece@cii.co.uk or by telephone: +44 (0)20 7417 4783.

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15 Recent polls have Obama barely holding on to the lead, with Romney trailing by only 1 percentage point among registered voters (*Reuters/Ipsos* poll. June 12, 2012).

16 See evidence comparing the accuracy of various types of predictions in Gelman and King 1993.

17 www.fivethirtyeight.blogs.nytimes.com

18 Political scientist Ray Fair's model has Obama at 50.17% of the vote. http://fairmodel.econ.yale.edu/

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Traditional approaches explaining human choices in financial services have done little other than reveal our limited understanding of this subject. More recently, researchers have come to realise that emotions have a more powerful part to play in the decisions of casual consumers and professional investors alike. This article explore some of these new theories and their implications to understanding financial markets.

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The debate about an appropriate pension system to suit the current social and economic realities facing the public still wages, even though automatic enrolment will start to enter force later this year. Pierre Coussey offers his own view, exploring the options open, including a new prospect known as Third-Party Sponsorships. He provides a background and case study demonstrate what can be made possible.

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A long-standing review led by the FSA of how investment advice is given to consumers in the UK is reaching its conclusion with a number of major reforms around adviser professionalism, how their services are labelled and how advisers are remunerated coming into force at the end of this year. There has been much debate over whether these reforms would restrict access to all but the wealthiest consumers, and the very people who will most need assistance with how to best save will only be able to afford non-advised solutions.

No.77: **The Money Myth?**, by Alex Davidson (18 May).

With technological advances and ever more complicated investment vehicles, it is easy to forget that financial markets are driven by humans and human nature. The author offers up examples from classical mythology that show human nature has changed little in 2,500 years and provides five rules to help would be investors bear this in mind.

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The European Insurance & Occupational Pensions Authority (EIOPA) was formed in January 2011, at a time when many in the industry were still wondering how a pan-European insurance "supervisor-of-supervisors" could operate in practice without compromising the work of the national authorities. In this article, Gabriel Bernadino, Chair of EIOPA provides a perspective on the Authority's first year of operation.

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With EU insurance regulation landscape more relevant to individual firms than ever before, Karel van Hulle, the European Commission's lead official on insurance & occupational pensions, and author of many of the proposals under discussion in these areas, offers his own strictly personal view of insurance regulation in the post-financial crisis world.

No.71: **The Challenge of Age: Global Longevity Trends and Economic and Social Implications**, by George Magnus (23 March).

George Magnus ("the man who predicted the financial crisis") argues that the current economic turmoil is colluding with rising longevity to severely depress returns for the elderly. Governments, societies and industries must take robust action now in order to ensure that rising longevity is celebrated rather than feared over the decades to come.

Reflective Questions

Reading this Thinkpiece with respect to the learning outcomes below can count towards *Structured CPD* under the CII CPD Scheme. The questions are designed to help you reflect on the issues raised in the article in relation to these learning outcomes. Please note that the answers to the questions are not meant for CPD records purposes.

Learning Outcomes

- To gain an understanding of some of the issues that will play a role the upcoming US Presidential election.
- To be able to appreciate the differences in policy position between Barak Obama and Mitt Romney.
- To be able to consider the potential impact of the US election result on the UK and in Europe.

1. How has financial regulation in the US changed during Barak Obama's Presidency? What impact have the changes had?

2. What are the differences in attitude towards the issue of climate change between the two candidates?

3. What role, do you think, economic performance will play in the election campaign?

4. How might a victory for either candidate impact on insurance and financial services?

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