

April 14, 2014

2016 (Part 2, The Political Situation)

(N.B. In this report, we are tackling the geopolitical impact of the 2016 elections. Given the size of the topic, it will be discussed over a three-part series.)

As we noted two weeks ago, American presidential elections are important events, although not all are equally critical. Some elections occur during periods of relative tranquility, and elections with an incumbent running tend to have less drama.

However, as we survey the political landscape for 2016, the next presidential election could be historic for two reasons. First, in our opinion, the last three presidents have been unable to create a consistent foreign policy that reflects America's role as the unipolar superpower. The next president will probably not have the luxury of this lack of policy focus. Second, economic stress is weakening the ruling political coalition and we may be on the cusp of significant political change.

In Part 1, we discussed the issues that have led to stagnant economic growth. As we noted, private sector leverage has been the key issue that has kept growth constrained. Allowing the economy to reduce leverage "naturally" could take another decade. It is hard to imagine that the political process could cope with subpar growth and low employment for another ten years.

Thus, in this report, we will examine the domestic political situation. Because this is

a geopolitical report, we usually avoid domestic politics. We are engaging in this rare examination of the domestic political scene because it appears that the U.S. will be hard pressed to maintain its superpower role without a timely resolution of the leverage problem. It should be noted that there are ways that the leverage problem can be resolved that support America's superpower role, while there are also methods that would almost require the U.S. to abandon that role. The resolution of the leverage problem is political in nature, which is why we are analyzing the domestic political situation.

In this analysis, we will use a method similar to our analysis of American foreign policy archetypes (see WGR, 1/9/2012, [The Archetypes of American Foreign Policy](#)). Although we won't use the presidential archetype model, we will use four different archetypes to describe the domestic political landscape. After describing these groups, we will offer a history of the interaction between these groups. We will address the likelihood of various policy outcomes based on the relative strengths and weaknesses of the four political groups. Unlike our usual reports, we will not conclude with market ramifications but instead discuss the transition to Part 3 of this analysis.

The Four Domestic Archetypes

We believe there are four major archetypes, the rentier/professional, the entrepreneur, the right-wing populist and the left-wing populist. It should be noted that these are broad categories; it is rare to find a person who purely matches these descriptions. The point of an archetype is to describe a group for informational purposes.

Rentier/Professional: This group consists of the center-left Democrats and center-right Republicans. In common political analysis, these two groups are thought to be entirely different archetypes. In our opinion, however, we believe they are similar enough to be considered a single class, although they will, at times, appear to be in opposition. It seems that the members of this group agree on more than they differ, and their “opposition” is more in style than in fact.

This archetype is the “establishment” of both of the major parties. This class includes the political mainstream, most of the management of U.S. corporations and the owners of inherited wealth. This archetype generally prefers the status quo. They support high and positive real interest rates. The relationship of this group with the government is generally positive. This archetype tends to use government to support their businesses; they view lobbying as a way to secure an orderly marketplace. In terms of deregulation and globalization, this class is usually torn. Their status in established businesses can be adversely affected by new technology (which can be more easily introduced in a deregulated environment), and thus prefers regulation structured to secure their position in society. On the other hand, their pay levels have mostly been positively affected by globalization which has improved the profitability of the firms they manage and own.

This group tends to support immigration. In terms of social policy, there tends to be some degree of dissonance within this group. Generally, the center-left of this group tends to be somewhat more liberal than the center-right, but neither usually allows these positions to overrule economic concerns. The liberal and conservative parts

of this class can be split, at times, and can join other archetypes to form coalitions, although the differences in policy often turn out to be slight and the splits tend not to last. In terms of Walter Russell Mead’s foreign policy archetypes, this group mostly consists of Hamiltonians, heavily represented in the center-right, although the center-left subtype has some Wilsonians. In general, they support America’s superpower role. This group tends to be associated with the Chamber of Commerce, the Brookings Institution, the Council for Foreign Relations and similar organizations.

Entrepreneurs: The entrepreneurial class tends to be the most disruptive for the economy. This group creates new businesses and introduces new methods or technologies that change the face of the nation and the economy. For the most part, this group is hostile to government. For this class, government simply interferes with their goals. They strongly support deregulation, immigration and globalization. Low inflation and low interest rates are preferred by this group. They want low capital costs and labor costs. Socially, this group tends to be rather libertarian, following a “live and let live” stance. For example, this class tends to oppose the war on illegal drugs and usually supports reproductive rights for women. At the same time, they tend to also strongly support the Second Amendment. In general, the social position is more based on opposition to intrusive government rather than generally held moral beliefs.

In terms of Mead’s foreign policy archetypes, this group tends toward Jeffersonians as they prefer small government and an aggressive foreign policy is inconsistent with this goal. Thus, they generally don’t support the military part of America’s superpower role, opposing an

active military role. However, they do appreciate the ability to tap global capacity, thus supporting the economic part of the superpower role. This class is associated with the Club for Growth, the CATO Institute and the American Enterprise Institute.

Right-wing Populists: This group is, in many respects, the most difficult to characterize. They have the most complicated relationship with the government. This class puts great stock in work and disdains government handouts as it places a high value on personal independence. At the same time, they strongly oppose deregulation and globalization. In terms of the latter, this is currently being expressed by the opposition to immigration. However, this group does not support free trade either. In effect, right-wing populists want high-paying, low-skilled jobs and want the government to build an economy to provide that goal. Although this group tends to oppose government income supports, they will accept them if packaged appropriately. Social Security is seen as a funded retirement plan (even if it is really an intergenerational transfer of wealth), and thus is acceptable. They also applaud Veteran's benefits, which are seen as earned. On the other hand, welfare is not justified. They have mixed feelings about organized labor; although they appreciate unions' role in creating high-paying jobs, membership does tend to undermine the self-made image that this group admires. As the union movement has faded in the face of deregulation and globalization, it appears that this group has become less supportive of organized labor. In terms of Mead's foreign policy archetypes, this group is solidly Jacksonian. Thus, they have a tortured view of the superpower role. They generally oppose the economic part of the

superpower role and the "policing" part of the military role. On the other hand, any besmirching of America's honor is intolerable to this class. Presidents that are considered "weak" are an anathema to this group. They like America being the world's superpower; they are just opposed to the economic costs of that role. This group is strongly represented in the Tea Party and the think tank most closely associated would be the Heritage Foundation.

Left-wing Populists: The left-wing populists also like high-paying, low-skilled jobs but, unlike the right-wing populists, are generally supportive of government income support. In fact, this group supports an active government. They support regulation and oppose globalization, although they tend to support immigration for emotional reasons. This class tends to strongly support inclusive policies, such as affirmative action along with minority and gay rights. The group is usually in favor of strong environmental regulation. They support unions and government employment. In terms of Mead's foreign policy archetypes, left-wing populists are mostly Jeffersonians although some are Wilsonians. They oppose most military excursions and do not support the economic aspects of the superpower role. Their organizations include the AFL-CIO and Economic Policy Institute.

The Archetypes in Practice

It should be noted that none of these four groups can gain and hold power alone; it is only by forming coalitions that these groups can gain control of the political process. In our view, the nation's political history since the Civil War has been a story of evolving coalitions.

The 1870-1929 period was mostly a coalition between the rentier/professional and entrepreneurial classes. It should be

remembered that the working classes did not widely participate in voting. In fact, women didn't receive suffrage until 1920. This era was characterized by the development of the American industrial base created by the entrepreneurial "captains of industry" such as J.P. Morgan, Andrew Carnegie, John D. Rockefeller, Henry Ford and others. Regulation was light, although the rentier/professional class, agitated by writers and activists from the populist classes, pressed for anti-trust and worker protection laws in the early 1900s. For the most part, however, populist goals were squelched in favor of supporting business development. In terms of foreign policy, America did, at times, project power, but generally was satisfied with allowing Britain to shoulder the superpower role.

The 1929-80 period exhibited a major shift in the American political structure. Although the shift was led by a member of the rentier/professional class, Franklin Roosevelt, this era was mostly a triumph of the populist classes. Roosevelt created a coalition of these two classes which was strongly forged during WWII. Although Roosevelt had a large number of left-wing populists in his government, he could not have won the war without the strong support of the right-wing Jacksonian populists. At first glance, Roosevelt seemed to support left-wing causes, like unionization. In practice, his successors were able to prevent the American organized labor movement from becoming a European-style Labor Party political movement that many left-wing populist socialists had wanted to create.

This political coalition created a strongly regulated economy that was characterized by high marginal tax rates, low levels of entrepreneurship and heavy industry concentration. Market disruptive

technologies were confined to the defense and other industries' laboratories.¹ This structure allowed for the creation of large industrial unions, and the market power this industry concentration fostered allowed rising labor costs to be easily passed on to the public in the form of higher prices. High marginal tax rates discouraged entrepreneurship; after all, who would risk everything on an unproven technology only to pay a 90% marginal tax rate if one is successful? This economy created a large number of low and semi-skilled jobs. In effect, a man (and until the late 1960s, almost all men, and nearly all white) could emerge from the school system with a modest education and still gain a middle class lifestyle.

In terms of foreign policy, this period was the advent of America's superpower role. It required a massive buildup of military power and a foreign policy structure to replace Britain's role. The U.S. adopted a structure of containing Soviet power through the Cold War, which required police-type action conflicts into the early 1990s.

Although the standard bearer of this political structure was the populist right-wing, the rentier/professional adapted to the new configuration and left-wing populists gradually grew in strength. The former did acclimate into the new world, with Gen. Eisenhower winning two terms from 1952-60. However, Eisenhower still supported an expansive government, with his crowning achievement being the initiation of the U.S. Interstate Highway System. The left-wing populists steadily gained influence by supporting civil rights, eventually getting major legislation passed by the mid-1960s.

¹ The basics of cell phone technology were mostly developed by Bell Labs in the late 1940s, for example.

This coalition began to fray in the 1960s for three reasons. First, right-wing populists began to oppose the left-wing's policies of inclusion for minorities and women. For the most part, up until the mid-1960s, regulations and laws tended to favor the right-wing populists by creating conditions supportive to a low-skill, high-wage economy. However, civil rights and affirmative action legislation shifted the hand of government from favoring right-wing populists to left-wing populists. This shift was strongly opposed by right-wing populists and disrupted the cohesion of the coalition. Second, the Vietnam War undermined support for America's superpower role. The left-wing populists became vehemently opposed to the war while the right-wing populists became jaded by its limited context. Jacksonians fight for unconditional surrender, not stalemates. Third, the financial part of the superpower role, the "importer of last resort" part, became an increasing burden. Given the devastation after WWII, the U.S. could easily absorb imports from the rest of the world and maintain high levels of employment at home. However, as the rest of the world recovered, foreign competition became a bigger problem. It led to an outflow of gold (foreign nations in the system could demand gold in exchange for dollars) that was eventually ended by President Nixon taking the U.S. off the gold standard in August 1971. Moving off the gold standard and the cost-push elements of right- and left-wing populism erupted into a serious inflation problem during the 1965-1980 period.

During the 1929-80 period, the entrepreneurial class was effectively shut out of political power. The regulatory issues, foreign policy and tax environment marginalized this class and rendered them to the fringes of American political life. This

archetype did rebel as seen in the 1964 presidential election. Barry Goldwater represented much of the interests of this group. Goldwater was a small government and strong defense candidate; although he ran a spirited campaign, the right-left populist coalition proved too strong and Goldwater lost in a landslide to Lyndon Johnson. However, Goldwater's campaign did offer a conservative alternative that would return to the political scene 16 years later.

As inflation began to rise from 1965 into the early 1980s, it was becoming clear that the economy could not generate growth efficiently. Despite price freezes and four recessions from 1969 to 1982, inflation remained elevated. Finally, President Carter began to address inflation through supply side measures by deregulating transportation in 1978 and banking in 1980. And, Carter took the courageous step of appointing Paul Volcker to Chairman of the Federal Reserve in 1979; Volcker promptly moved to strangle inflation by raising interest rates to high levels.

All this stress proved too much for the right-left wing populist coalition. The economy suffered as the Iranian revolution lifted oil prices and led to the return of long lines at filling stations. The right wing became increasingly disenchanted with the perception of American weakness projected by Carter. During his four years, the U.S.S.R. invaded Afghanistan, and 52 Americans were held hostage for 444 days during the Iranian Revolution. Carter approved a rescue operation that failed miserably and further tarnished his image. Meanwhile, Carter's moves to deregulate and Volcker's hard money monetary policy disenchanted the left-wing populists. Senator Ted Kennedy mounted a primary

campaign against Carter in response to the left-wing's anger.

Carter did fend off Kennedy and faced a Goldwater-like opponent in former California Governor Ronald Reagan in the 1980 presidential race. Due to concerns about Reagan's "radical"² positions, Carter was generally leading in the polls into late-October. However, Carter steadily lost support and ended up losing in a landslide to Reagan.

The election of Ronald Reagan ended the right-left wing coalition that dominated American political life since 1929. Reagan ended the entrepreneurial class's exile, making deregulation and globalization the keystone of his economic platform. Marginal tax rates were cut dramatically which changed the calculus for entrepreneurship. Reagan also pulled the right-wing populists away from the Democratic Party by supporting a strong defense. The heavy representation of Jacksonians among the right-wing populists led to support from this group even though Reagan's economic platform was destined to devastate this class's economic prospects. The desire to "feel good" about a strong America triumphed over Reagan's economic plans.

Reagan's presidency marked a new coalition, one dominated by the entrepreneurial and rentier/professional classes. The center-left of the latter group was successful in capturing the White House under Bill Clinton but only by adopting economic policies that were in line with the dominant coalition. The economic goals of

² The center-right of the rentier/professional class was so concerned about Reagan's policies that they attempted to draft Gerald Ford as VP. Ford would only agree to take that role if it was clear he was "co-president," a plan which Reagan rejected.

both the left- and right-wing populists were almost completely isolated in this new coalition. Center-left and center-right politicians would use social issues to draw the populists into voting but rarely passed economic proposals that were championed by either the right- or left-wing populists. In fact, social concerns became "wedge issues" that were used by the ruling coalition to garner votes but had virtually no impact on economic policy.

The Current Situation

Although the entrepreneurial and rentier/professional coalition was very successful in bringing inflation under control, it came at the cost of widening income differences (which was discussed in Part 1). These income differences prompted an unsustainable debt boom that collapsed in 2008.

Although the current coalition retains its cohesion, it is facing a growing populist rebellion. Candidates from the governing coalition need populist voters from either wing to win elections. Since 1980, both the center-left and center-right have used social issues to recruit political support from the populists. On the right, opposition to abortion and gay rights were used to bring voters to the polls. On the left, the center-left championed the defense of reproductive rights and the promise to create a myriad of protected classes. In all cases, however, the economic concerns of the populists have been mostly ignored.

What concerns us is that the populists appear to be adopting the stance of Howard Beale from the 1976 movie *Network*, where a deranged news anchor told his audience to tell the world, "I am mad as hell and I am not going to take it anymore!" The populists are pressing their economic case; merely addressing social concerns may not be

enough to gain support from the populists. In fact, both right- and left-wing populists could be creating common cause for their goals.

The 1929-80 period was one when America embraced its superpower role with a right- and left-wing populist/rentier/professional coalition in power. That coalition worked because the U.S. was in a uniquely dominant position. It should be remembered that about one-third of the world was behind the Iron Curtain and thus did not need to avail itself to the dollar's reserve currency role. And, given the devastation after WWII, Europe and Japan were in no condition to effectively compete with American industry. Thus, a window of opportunity was open that allowed the U.S. to create high-paying, low-skilled jobs. That window is now closed. To create the type of economy that

the right-wing (and to some extent, the left-wing as well) populists yearn for would require the U.S. to abandon its financial superpower role. Trade barriers and high marginal tax rates (to restrict the industry disruption from new technologies) would be required to create the type of economy seen in 1929-80.

Ramifications

This report establishes our view of the political situation and offers a short history of how coalitions developed over the past 144 years. In Part 3 of this series, we will examine the 2016 election and why we believe it is important. This report will be published next week.

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April 14, 2014

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