



December 9, 2008

Letter from Washington

Acting with surprising speed, President-elect Obama has announced his nominees for the key financial and national security posts in his administration. Normally the period between the early November election and the late January Presidential inauguration is a period of confused milling around, with the successful candidate suddenly acting like the dog that finally caught the car.

Most Presidents at the time of their election have really not had the luxury of giving much thought to how they would govern or whom they would appoint, and the process of selecting and vetting candidates usually drags on well in to the administration.

In Obama's case there are two very interesting things at work. First, he was in some ways forced to name the financial team quickly because of the deepening credit and financial crisis. In mid-November incumbent Treasury Secretary Paulson announced that he wasn't really sure of what to do with the remaining US\$350B that had been authorized by the Congress for the acquisition of so-called "toxic" debt that was bringing down the investment banks. Paulson indicated that he might just not spend it and leave it for his successor in January. The market interpreted that comment as "I'm out of ideas and don't have a clue what's going on" and promptly tanked almost a thousand points (more than 10%) over the next several days.

Obama's quick naming of Timothy Geithner as Treasury Secretary and Lawrence Summers (former Clinton Treasury Secretary) as chairman of the White House National Economic Council, had a calming effect on the markets, since both men have been involved in the current crises and are viewed as pragmatic non-ideological policy makers.

Obama desperately does not want to have ownership of or responsibility for any economic policy prior to his inauguration, and with good reason. He has said a number of times "we only have one President at a time", but increasingly the current incumbent is maintaining so low a profile as to be inconsequential and Obama and his appointees are filling a void. There is no precedent for a President-elect taking such a direct and forceful role so far in advance of the inauguration.

Similarly, Obama's picks for the national security team are pragmatic centrist types, particularly in the holdover of Secretary of Defense Gates from the Bush administration. In the case of Hillary Clinton, the ultimate retread from the Clinton administration, Obama was either displaying a supreme amount of self confidence in naming his bitter adversary (and all of the Clinton baggage) to the key post, or extreme political shrewdness in neutralizing her as a potential 2012 downstream rival.

The other interesting selection was retired Marine General Jim Jones, former Marine Commandant and NATO commander, as the National Security Advisor. Jones had campaigned for McCain and would probably have had a role in a McCain administration as well.

Obama of course ran on a platform of "change", and resolute opposition to the war in Iraq, promising to have all combat troops withdrawn within 16 months. He has picked a strange group of familiar faces to carry out the change mandate, and particularly to draw down the troops. Gates and Jones are both on record as favoring the shift of resources from Iraq to Afghanistan, but only in a measured and careful way that does not destabilize the one country while trying to gain control of the other. Neither Gates nor Jones has signed up to the arbitrary 16 month schedule.

So far the left wing of the Democratic Party has muted their criticism of the cabinet selections, taking a wait and see approach. That probably won't last too long into January, and Obama is in some danger of violating one of the primary rules of US politics: "you dance with who brought you to the party".

In a hefty 792 page report, a Congressionally-directed panel, the Project on National Security Reform, delivered its findings last week. The Panel recommended several key structural changes to the White House and National Security Council. More importantly, the bi-partisan panel recommended a level of integration to the national security budget that would be revolutionary. The panel's key finding is that the Department of Defense is allocated approximately 70% of the national security budget, with State, the Intelligence Agencies and Homeland Security and Treasury receiving the rest. Since each agency has a different budget process, there is no way at the White House level to understand what the trade-offs are between, for example, money spent to acquire the Joint Strike Fighter and money allocated for increased diplomacy.

The report will find some receptive ears on the part of Gates and Jones, who despite their military grounding, are advocates of increased use of "soft power" in achieving US goals. The commission recommendations are probably too big a step to enact all at once, but given the change mandate, some portions of it may well be looked at seriously. The notion of the Departments competing directly for diminished resources will have some appeal.

The other crisis facing the Obama team six weeks before they should have to deal with it is the plight of the US "Big Three" automakers. The CEOs of GM, Ford and Chrysler got off on the wrong foot with the Congress by flying in to Washington from Detroit in three separate corporate jets, to ask for a US\$15B dollar handout. For their display of tone-deafness they were sent away empty-handed. By the time they returned a week later with some level of detail as to what structural changes they would make, the bailout number had grown to US\$34B and their predicament had become more dire. GM apparently does not have the cash to make it past the end of December without a government infusion.

The attitude of more than 60% of the public is that the car manufacturers have brought their problems on themselves through years of poor management and making crappy cars, and they should be allowed to fail. This message has been communicated to the Congress clearly, and while there is a weak argument to be made that the car industry has a strategic importance to national security, the bigger problem for the Congressional Democrats is that labor unions in general and the United Auto Workers in particular are their natural constituency. The so-called "Reagan Democrats" returned to the party in large numbers in November.

The plan taking shape at mid-week would provide an initial US\$15B to keep the three alive until February or March. During that time, the companies will work on restructuring plans under the supervision of a federally-appointed "car czar". In effect, the Congress has just nationalized the US car industry, but instead of appointing an overseer with some background in the business, they have selected an organized crime prosecutor from Manhattan. That probably tells you more about how the members of Congress think this is going to go.

The US\$15B is a "Merry Christmas" message to the United Auto Workers, basically to keep them from being laid off on Christmas Eve. Any necessary restructuring of the auto industry is going to require the UAW to either participate in their own autopsy, or to be broken as a political force. Neither prospect appeals to the Democrats, and the Obama team will be faced with sole responsibility for dealing with it in the first weeks after the inauguration.

Happy Holidays to all.