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Letter from Washington

During the first Gulf War, Colin Powell, then the Chairman of the Joint Chiefs, famously said that he was blessed to have Saddam Hussein for an enemy. What he meant was that Saddam could be counted on at every opportunity to make self-defeating strategic decisions that ensured the US and Allied victory.

President Obama must be feeling like Colin Powell these days, because the Republican Party seems to be doing everything it can to lose the 2012 election.

Obama is in a very compromised position, completely vulnerable on the economy. There have been some signs of life, and the unemployment rate has inched down a couple of notches but has remained above 8% for the longest period since the Great Depression. The collapse of real estate prices nationally has actually been worse than during the Great Depression, and since the passage of the economic stimulus plan which was supposed to lift 2 million Americans above the poverty line, 6 million have actually fallen below. According to the Christian Science Monitor, "The standard of living for Americans has fallen longer and more steeply over the past three years than at any time since the U.S. government began recording it."

Beside the bread and butter issues, Mr. Obama promised to cut the deficit in half by the end of his first term, and the latest budget submitted to the Congress several weeks ago still forecasts a deficit above \$1T.

All of these factors should make Obama easy prey for a Republican candidate laser-lock focused on the economy. Instead the field of remaining Republicans has allowed the debate between them to be on the social issues, giving the President a pass on his dismal economic performance.

The Republican nominating process has been going on for a year too long already, and has featured a series of candidates each with a meteoric rise, followed quickly by an equally spectacular terminal velocity earth impact. In succession: Pawlenty, Bachman, Perry, Caine, Gingrich, and now Santorum have all come from seemingly nowhere to capture the hearts and minds of the Republican base for a week or two, and then be discarded for the next flavor of the month.

The only common point between all of these temporary poll leaders is that they are not Mitt Romney. Pity Mr. Romney, he has been running for President for the last 5 years and just can't make the sale with the Republican base. His popularity remains stuck at about 30%, roughly where it was in 2008 when he dropped out of the race and deferred to John McCain. Romney has spent a great deal of his own considerable personal wealth in sustaining his candidacy, and his campaign spent \$19M in the Florida primary alone, outspending all of rivals combined by orders of magnitude.

The reason Romney can't close the deal with the base is that while he purports to be a social and fiscal conservative, he has a political track record as a senate candidate and governor of Massachusetts that is really quite the opposite. In order to recast himself as a conservative presidential candidate he has had to backtrack on a number of bedrock Republican conservative principles (abortion, gay marriage, etc), which leaves the base to wonder what (if any) are his core beliefs.

Perhaps the biggest obstacle is that the Obama health care plan, anathema to conservatives and a large segment of independents, was modeled on the Massachusetts plan that Romney enacted during his tenure.

Romney has the most money, the best campaign organization, and is widely believed to be the most electable of all the Republicans in a match-up with Obama. Still no sale.

As the Republican primary season has ground on and on, the mutual attacks on the remaining candidates have become more shrill and more intense to the point that the ultimate survivor of the process will be damaged goods before he ever squares off with Obama.

At this point in the race it appears that former-Senator Rick Santorum has pulled even or slightly ahead of Romney in the national polling. There are two key events coming up that may determine the outcome (or lack thereof). There are primaries this week in Arizona, a state Romney carried in 2008, and Michigan, his home state. If he loses either of those to Santorum, the air will definitely leak out of his balloon.

The following week, March 6 is "Super Tuesday", when ten states will hold primaries. Under the Republicans' rules, the primaries are no longer "winner take all" and each candidate carries forward some proportionate number of delegates to the nominating convention in the summer. What had previously been thought of as impossible now seems entirely plausible, and no candidate may have the number of delegates required for the nomination going in, which will result in a "brokered convention". This possibility has the media positively salivating, and many Republicans thinking wishfully, over the idea that some alternative candidate could emerge and lead the party to victory.

Four sitting or former Republican governors all publicly flirted with the idea of running and then backed out, despite the entreaties of a party establishment not enamored with the slate of existing candidates. Each of them probably have some remorse at this point, given Obama's vulnerability, but only one of them is self-aggrandizing enough to give it a shot. Although she is still the darling of the Tea Party in many respects, the party establishment sees Sarah Palin as a sure ticket to oblivion if she were to somehow become the nominee.

From this vantage point it seems as if the Republicans are stuck with whichever candidate survives to the convention, with some kind of deal likely between them to throw support in return for some political reward.

If there is a bright spot in the Republican's situation it is that despite all of the money that has been spent by the Romney campaign and his associated Super PAC, the voters have not been swayed. Perhaps there is still hope that in the corrupting atmosphere of US politics, money can't always buy the final result.

All of this should make Mr. Obama smile, as the Republican process plays out. The one wild card which may arouse enough anger against the President in the fall is the price of gasoline. Gas prices have risen sharply in the last month, for a variety of factors which include instability in the Persian Gulf as well as the market actions of speculators. The election of 2008 was in part a reaction by many who watched their personal wealth disappear as financial houses collapsed. The financial institutions were subsequently bailed out and made whole in most cases, but the individual investors were not. As a result, there is the widely held belief that the game is rigged in favor of the hedge funds and other speculators who are big enough to move markets at the expense of the little people who play by the rules.

Many analysts are predicting \$5-6 a gallon gasoline by the summer, which will have a real souring effect on both the stumbling economic recovery as well as the mood of the electorate. \$4 gasoline is generally viewed as a threshold, beyond which people start to curtail summer holiday travel, and view the country as being on the wrong track.

One of the conundrums faced by the administration is that despite the clear need to ease the unemployment rate in the US, there is also a clear need and a political imperative to trim the federal budget. As a result, the Budget Control Act that was agreed to last summer requires reducing the Defense Budget by \$487B over the next 10 years. A reduction of that magnitude, not counting the potential of an additional \$500B sequestered if the Congress can't come up with the required \$1.3T in cuts, will have an immediate and negative impact on employment in the defense sector.

Taking a page from former Secretary Gates, Defense Secretary Panetta rolled out the first phase of the department's 10-year plan ahead of the

administration budget request. The reductions, supposedly the result of a defense strategy review and modification process over the late summer and fall, reflects the President's "pivot" toward a Pacific-focused strategy once the Afghanistan involvement winds down next year (in theory).

DoD modernization accounts, which account for roughly 20% of the Pentagon budget, took more than half of the \$45B in cuts imposed on the FY 2013 budget request. \$18B came from procurement accounts and \$6 billion from research, development, test and evaluation.

Of the \$249B that the DoD is required to cut over the rest of the FYDP, the modernization accounts will be cut by \$111 billion, approaching half. That includes \$94 billion to the procurement accounts and \$17 billion to research and development.

Nearly \$40B comes from restructuring and terminating major programs. The F-35 Joint Strike Fighter program was reduced by \$15.1B, with 179 aircraft pushed beyond the FYDP.

Navy shipbuilding has been reduced by \$13B over the same period, with 16 fewer ships over the five years. Other reductions to modernization programs are planned through stretch-outs, a move that inevitably drives up costs.

The Army will take the brunt of the reductions with a planned decrease in end strength by 80,000 troops. In addition, two of four US combat brigades will be withdrawn from Europe.

Normally the President's budget is viewed as a request to the Congress for funding, with the legislative branch having the final say on how funds are allocated. Since both parties have announced that they would not allow any earmarks in the 2013 process, the normal way for Congress to redirect funds to their own priorities is not available. As a result, although there will inevitably be some tinkering on the margins, the program terminations and stretch-outs requested by the President will probably stand up.

Regardless which party wins the White House or ends up in control of the Congress, these reductions will likely stand because the deficit reduction requirement is party-neutral.