Will Obama force a haircut on bondholders?

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What happens if the US government fails to raise the debt ceiling, which is already set at an imposing figure of $14.2 trillion by August 2 this year? Haircuts apart from an impending global economic disaster would be inevitable. Incase you are about to fix an appointment with your barber the coming month, just hold on. Haircuts here basically mean the losses incurred by US bond holders in case the Fed defaults on its debt.

The debt ceiling, created in 1917, is a cap on the amount of debt the US government can borrow and fund its expenses. It was created to control the spending habits of the US government and since 2001, the ceiling has been increased 10 times to the present $14.2 trillion. While almost everyone in Capitol Hill agree that the debt ceiling needs to be increased, the problem lies in the conditions attached to it. Republicans vowed that they won't vote for an increase in debt ceiling if spending is not slashed by 40 percent and the democrats have also persisted for an equal rise in taxes for the debt ceiling cap to be slashed.

President Barack Obama had also promised in his first budget that he would cut deficits in half by 2013 and with public debt at its highest levels in the last 50 years, raising the cap would be contrary to what Obama promised.

So how did the US manage to burden itself on a huge pile of debt worth trillions of dollars in the first place? Back in 2001, the US owed $5.8 trillion and in just 10 years, the number grew by $9 trillion to the present $14 trillion worth of debt. The stratospheric rise in debt was mainly contributed due to the wars in Iraq and Afghanistan, which cost the exchequer $1.3 trillion. Not only the wars but also the tax cuts during George Bush's presidency hurt the US by a further $1.5 trillion.

Obama however kept government spending under control and the economic stimulus package to revive the US economy post recession cost the US debt to rise by over $800 billion. This figure however seems pale in comparison to the massive tax cuts, war costs and overdue interest that were incurred during the Bush regime.

On July 23, the most unpalatable situation took place when John Beuhner, the most influential republican in Congress, walked out of White House in a meeting with the president and the decision of raising the debt ceiling hung in balance. The US has about a week to decide and any failure to reach an agreement within August 2 will put the US economy in doldrums for good.

Both Standard and Poor's and Moody's have put the US debt ratings under review and have hinted for a possible downgrade due to the delay in reaching an agreement on raising the US debt limit. As a consequence, investors are already shorting on US 30 year treasury bonds as concerns rise over the country's ability to repay its debts.

If the debt ceiling is not increased, the confidence in the US treasury notes considered the closest equivalent to cash and the trust in US being the world's most bankable borrower would be squashed almost immediately.

Back in 1998, when US credit rating agency Moody's downgraded Japan's AAA rating , the Japanese yen tanked to its lowest level in six and a half years along with a fall in the prices of government bonds. If a similar situation confronts the US, the already weakened dollar would sink to its lowest levels and lead to higher inflation due to cheaper imports. The falling dollar would also cause American companies to shell out more money in foreign investments or acquisitions due to loss of the greenback's purchasing power.

AFP

US President Barack Obama steps on the stage to speak on efforts to find a balanced approach to deficit reduction at the University of Maryland in Maryland on July 22.

Of the $14.3 trillion in US debt, almost $5 trillion in the form of US treasuries rated AAA until now is held by foreign countries. China holds $1.5 trillion and Japan holds $1 trillion of these debts. If China, Japan and other countries were to abandon their holdings as a result of a default, the cost of borrowing for the US will rise and increase the burden of the already burdened American taxpayer.

A 50 basis points increase in treasury rates will cause an outlay of $75 billion a year for the American taxpayer. Interest rates will rise across the board as investors look for greater returns due to the higher risk they are betting on. As a result, businesses that have been enjoying low interest rates due to Fed's QE2 policy to revive the economy will have to foot a higher bill on loans taken at floating rates and thus, discourage the investment climate in the country.

With the rise in borrowing costs, the US will have to pay a higher interest bill on the outstanding debt it already owes to its creditors and that again would be a drain in the country's weak fiscal condition. Standard and Poor's also indicated that even if the US were able to go forward with raising the debt cap, it might downgrade the US rating to AA+ if $3 trillion spending cuts were not enforced.

On the other hand, the US might deliberate not raising its debt limit and choose the creditors it might want to pay on an immediate basis. The US might consider clipping social security benefits, medicare benefits or military costs but with Obama gunning for a second presidential bid, doing away with populist measures can hurt him badly in 2012. However, if he chooses to dishonour interest payments on US treasuries held by China and other countries, the world economy might head for a tailspin.

The US government is within days of losing its AAA rating that it has held on to since 1941 and the only way to avert it is by ensuring the debt ceiling limit is raised before August 2.

Obama has to make some tough decisions and we thought being the president of the world's most powerful economy is easy.

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WOMEN IN BUSINESS

Still lonely at the top

Several governments are threatening to impose quotas for women in the boardroom. This is a bad idea

THE ECONOMIST

In François Ozon's latest film, "Potiche", Catherine Deneuve (pictured) plays a trophy wife, a potiche, who spends her days jogging in a scarlet jumpsuit, making breakfast for her cantankerous husband and writing poetry perched on a sofa. But then her husband, the boss of an umbrella factory, is taken hostage by striking workers. Ms Deneuve takes over the factory and charms the workers into returning to work. She jazzes up the products and generally proves that anything a man can do, a woman can do better.

The film was set in 1977, when the only women in a typical Western boardroom were serving the coffee. Times have changed. These days no one doubts that women can run companies: think of Indra Nooyi at PepsiCo, Carol Bartz at Yahoo! or Ursula Burns at Xerox. Sheryl Sandberg, the number two at Facebook, is more widely applauded than her young male boss, Mark Zuckerberg.

Yet the number of female bosses of large firms remains stubbornly small. Not a single one on France's CAC 40 share index or on Germany's DAX index is run by a woman. In America, only 15 chief executives of Fortune 500 companies are women. Britain does better, but not much: five of the FTSE-100 firms have female bosses.

Several governments, especially in Europe, have decided that radical action is required to increase the number of women in the executive suite. Norway passed a law in 2003 that obliged all publicly listed firms to reserve 40 percent of the seats on their boards for women by 2008. Spain passed a similar law in 2007; France earlier this year. The Netherlands is working on one.

On July 6th the European Parliament passed a resolution calling for EU-wide legislation stipulating that at least 40 percent of seats on listed companies' supervisory boards will be reserved for women by 2020. This does not oblige member states to do anything, but it reflects a spreading mood. The German government is considering whether to impose quotas. America is not, but new rules from the Securities and Exchange Commission will require firms to reveal what, if anything, they are doing to increase diversity at the top table.

Viviane Reding, the EU commissioner for justice, argues that compulsion is the only way to overcome entrenched discrimination. For a whole year she has tried to cajole companies to take voluntary measures to promote more women. In March, she posted a "Women on the Board Pledge for Europe" on her website. This allows companies to promise that women will make up 30 percent of their boards by 2015 and 40 percent by 2020. Only seven companies have signed up so far. Moët Hennessy Louis Vuitton (LVMH), a French luxury-goods maker, added itself rather ostentatiously on July 12th. But cynics doubt that this owed much to the commissioner's powers of persuasion. LVMH was only pledging to do what the new French law already obliges it to.

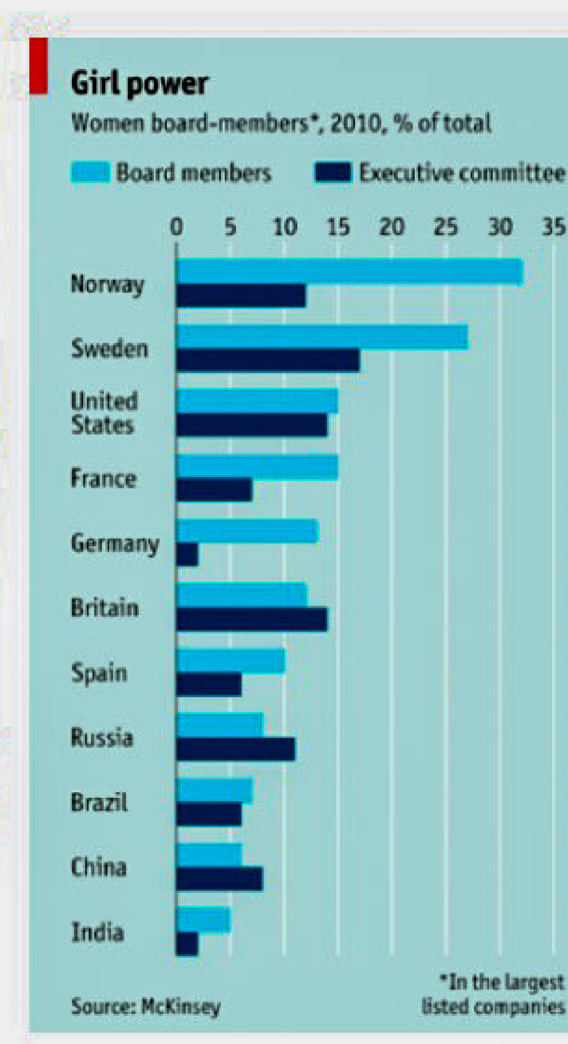
There is a powerful business case for hiring more women to run companies. They are more likely to understand the tastes and aspirations of the largest group of consumers in the world, namely women. They represent an underfished pool of talent. And there is evidence that companies with more women in top jobs perform better than those run by men only.

McKinsey, a consultancy, recently looked at 89 listed companies in Europe with a very high proportion of women in senior management posts and compared their financial performance with the average for firms in the same industry. It found that these firms enjoyed a higher return on equity, fatter operating profits and a more buoyant share price. The authors described the correlation between promoting women and doing well as "striking", though they admitted that they could not prove what was causing what. It is possible that firms that are already doing well tend to hire more female directors.

Proponents of quotas cite the superior performance of firms with female directors as evidence that quotas will benefit companies and their shareholders. Sceptics doubt this. The women that companies voluntarily appoint to boards are mostly excellent (indeed, they may have had to be particularly talented to overcome the barriers in their way). The effect of quotas, however, will be to elevate women who would not otherwise get onto the board. It would be surprising if they proved as able as those appointed without such help.

The evidence from Norway, the first European country to impose strict quotas, suggests that compulsion has been bad for business. Norwegian boards, which were 9 percent female in 2003, were ordered to become 40 percent female within five years. Many reached that target by window-dressing. The proportion of board members in Norway who are female is nearly three times greater than the proportion of executive directors.

A scene from Potiche, a French film that portrays how a trophy wife takes the reins of the family business and proves to be a remarkably effective leader, after her husband is taken hostage by his striking employees.



To obey the law, Norwegian firms promoted many women who were less experienced than the directors they had before. These new hires appear to have done a poor job. A study by Amy Dittmar and Kenneth Ahern of the Ross School of Business at the University of Michigan found that firms that were forced to increase the share of women on their boards by more than ten percentage points saw one measure of corporate value (the ratio of market capitalisation to the replacement value of assets, known as Tobin's Q) fall by 18 percent.

If quotas aren't the answer, what is? The question is fiendishly complex. In most rich countries, women do as well as men or even better at school and university. In America, most new master's degrees are awarded to women. Women also hold more than half of the entry-level jobs at American blue-chip companies.

But corporate women start to fall behind their male peers right from the beginning. They are less aggressive than men when negotiating their first salary and every subsequent pay rise. Linda Babcock of Carnegie Mellon University found that her male graduate students secured starting salaries 7.6 percent higher than her female graduate students. In general, men are four times more likely to ask for a pay rise than women are. Compounded over time, this makes a huge difference.

The higher you gaze up the corporate ladder, the fewer women you see. According to Catalyst, a researcher in New York, women are 37 percent of the middle managers in big American firms, 28 percent of the senior managers and a mere 14 percent of executive-committee members.

Is discrimination to blame? While firms that discriminate a lot will be eclipsed by those that promote on merit (and possibly sued), that can take time. And men do persistently underestimate women, argues Herminia Ibarra of INSEAD, a business school in France. Ms Ibarra looked at more than 20,000 assessments of INSEAD's executive students. The men on the faculty judged the women to be just as capable as the men (or more so) in most areas, but thought that they lacked strategic vision. No such lack was seen when their female colleagues judged the students.

The way patronage and promotion work within the corporate world may count against women. Nearly all the executives who rise to the top have had a powerful backer, according to Sylvia Ann Hewlett, the author of "The Sponsor Effect", a report for the Harvard Business Review. Yet women often fail to cultivate what Ms Hewlett calls "relationship capital". They hesitate to call in favours for fear of seeming pushy. And many are afraid of the gossip that a close relationship with a senior male colleague might provoke.

No doubt all of this plays its part. But a much bigger obstacle to putting more women in boardrooms is that so many struggle to balance work and a family.

In all societies, at least for now, women shoulder most of the burden of looking after children and ageing parents. European women devote twice as much time as men to domestic tasks, according to McKinsey. It varies from country to country. Latin men are slacker than Nordics. Italian men spend only 1.3 hours a day on domestic chores, whereas Italian women spend 5.2 hours. In Sweden, the ratio is a somewhat fairer 2.3 hours to 3.4.

Partly because it is so tricky to juggle kids and a career, many highly able women opt for jobs with predictable hours, such as human resources or accounting. They also gravitate towards fields where their skills are less likely to become obsolete if they take a career break, which is perhaps one reason why nearly two-thirds of new American law graduates are female but only 18 percent of engineers.

A study by the Centre for Work-Life Policy, a think-tank based in New York, found that, in 2009, 31 percent of American women had taken a career break (for an average of 2.7 years) and 66 percent had switched to working part-time or flexible-time in order to balance work and family. Having left the fast track, many women find it hard to get back on.

Some governments try hard to help women combine a career and family. France and the Scandinavian countries help with child care. Crèches and nurseries are subsidised. State schools will hang on to the little monsters well into the evening. This contrasts starkly with American and British schools, which boot them out long before an adult's work day is over. American parents must also square the circle of ultra-short holidays for grown-ups and absurdly long ones for kids.

German parents enjoy 14 months of Elterngeld (taxpayer-funded parental leave). The aim is to encourage women to take shorter breaks from their job after giving birth. The law, which passed in 2006, was pushed by Ursula von der Leyen, the then family minister (and a mother of seven). Ms von der Leyen also sponsored a 2008 law promising every one-year-old the right to a free nursery place by 2013.

Now the labour minister, Ms von der Leyen is pushing hard for Germany to introduce Norwegian-style mandatory quotas for women in boardrooms. German companies are scared. Some are setting themselves voluntary targets in the hope of avoiding state coercion.

Deutsche Telekom, a German media behemoth, has declared that 30 percent of its middle and upper management jobs will be filled by women by 2015. "We have tried mentoring, coaching and networks, but nothing worked," says Anne Wenders, a spokeswoman for the company. Women made up 30 percent of Deutsche Telekom's staff and 13 percent of the company's top managers in Germany when the policy was introduced last year. These numbers have yet to budge. Still, following Deutsche Telekom's example, all 30 companies in the DAX index recently agreed to set themselves similar goals.

Women bring unique strengths to a company, reckons Lisa Gersh, the boss of Martha Stewart Living Omnimedia, a merchandising and media firm founded by a lifestyle guru. They are more collaborative than men, says Ms Gersh, and better at multitasking. Those with children quickly become efficient. They know that they have to be home at a certain time.

Companies everywhere are trying to figure out ways to help employees juggle their work and family life. Technology should make this easier. Thanks to broadband internet, many tasks can be done from home. Nearly 20 percent of American employees telecommuted last year. Some female executives routinely take calls while outside the school gates. As the tussle for talent intensifies, such scenes will grow more common.