

# How To Fix America: A Massive R&D Effort

WASHINGTON – Fareed Zakaria wrote a thought provoking cover story essay in TIME magazine, (“How to Restore the American Dream”, November 1, 2010). His analysis of debt laden America devoting less and less investment to future innovation, if unfortunately depressing, is vividly accurate. US politics are shaped now by a bad mix of left and right populism that invites posturing and grandstanding on issues, this way penalizing focus on serious business.

## **America: not taking care of business**

Indeed, America’s leadership, still inordinately obsessed with gay marriage, creationism v. evolution in text books, or sex education in public schools, or generalizations about “taxing the rich”, or “too much Government”, shows lack of focus and adequate concern for public policies that would nurture the fundamentals, the true underpinnings of current and future prosperity.

These fundamentals include the need to massively re-engage and invest in basic research; the need to make public school teaching a truly challenging and rewarding profession, so that can get better prepared graduates; the need to implement policies aimed at encouraging enterprise, including encouraging brand new Ph.D. graduates from Asia to stay in America and start a business, instead of kicking them out because of outmoded immigration restrictions. If America does not take care of these fundamentals –investments in leading technologies, good education, new enterprises– it is hard to understand what we will basing future wealth generation and therefore prosperity on.

## **Government role in basic research**

In his essay as well as in a companion segment of his CNN show GPS, Zakaria and his guests, (representing a good sample of current and former global business leaders), reaffirmed what we should already know but somehow forgot. With all the unquestioned national rhetoric on “private sector led development”, here in the US we leave out the enormous contributions made by Federal Government spending in basic science and in a variety of (mostly military) technologies. Without this huge Government spending over many decades for anything like aviation and space technologies, supercomputers, information technologies and more recently all sorts of advanced electronics now constituting the core of all new weapon systems, we would not have had the industrial spinoffs that led to America’s world leadership in many leading technologies in the 1970s, 1980s and 1990s. Think of jet engines, global satellite positioning systems, silicon, and last but not least the internet and all the incredible transformations that it enabled in almost anything we do and the way we organize and conduct all businesses.

### **The Cold War pushed military related R&D**

Much of this spending in defense and defense related sectors, at least at the beginning, was spurred by the Cold War and the attendant national security policies aimed at retaining a technological lead over the then Soviet Union. With the Cold War over in the early 1990s, we also had a significant reduction of Government investments in the basic, open ended research that private industry has a much greater difficulty in supporting by itself.

### **Government spending fostered innovation**

It is clear in hindsight that defense related work pushed the US into new sectors, while it bred many of the great minds working at the National Laboratories and at the eminent science faculties of the most prestigious institutions. These engaged scientists in turn mixed with their counterparts in

academia and industry. This innovation friendly “ecosystem” and the ensuing, constant interactions and cross pollinations among smart people who had adequate funds to conduct their research and push the envelope of knowledge is in large measure at the source of America’s ability to be and stay at the forefront of innovation.

### **Now Government spends less, while we are facing competition from Asia**

Well, notes Zakaria, this was then. But now we are no longer making those huge investments, while well funded scientific endeavors have spread to heretofore unimaginable places. Once sleepy backwaters like India or China, (itself at some point semi-destroyed by the lunacy of the Cultural Revolution), are now very active players, making their own large investments, putting to good use newly produced wealth deriving from their recent massive industrialization. So, the field is more crowded, featuring now eager, dynamic new entrants.

But America has somehow retrenched. Not entirely, but to a noticeable degree. Overtime some rebalancing was unavoidable. The spreading of progress means that others now have the basic know how and the funds to do their own experimentations. They are catching up. But precisely because the field has become more crowded and more competitive, it is time for America to redouble its focus on high value innovation, our only chance really, to stay ahead and maintain a lead in at least some key technological sectors.

### **If we do not do more, we shall fall behind**

The motivation now is not about winning a global contest with a defunct Soviet Union, but it is about retaining or regaining competitiveness in order to maintain a healthy economy, a high standard of living, and in order to continue to be regarded as “the magnet” that can attract the best and the brightest. Finally, it is about generating the extra resources

that will allow America to play a positive leadership role in the world.

### **A national sales tax to fund R&D**

Zakaria makes one key, concrete proposal that should be taken as the opening salvo in a serious national debate about innovation policies. He put forward the idea of a national sales tax, (about 5%), whose proceeds would go exclusively to fund basic research. If a strapped and much indebted Government cannot squeeze more money for R&D from general revenue, then let's create an *ad hoc* national fund aimed at acquiring the additional resources to increase the federal funds to be devoted to new scientific endeavors.

### **Another pork barrel project?**

Of course, it is easy to shoot this idea down, claiming that we, (along with the Tea Party), want to give less and not more money to Washington, given Government's questionable record as a steward of tax payers funds. Creating another pot of gold may indeed become an irresistible temptation for politicians who will somehow "discover" that all the really worthy new scientific research has to take place in their districts or states, take your pick. Given the dreadful Washington track record that easily transforms public money into another pork barrel project, this concern about misuse of funds and squandered resources should not be taken lightly.

### **If you do not like this, come up with something better**

Still, if we shoot this proposal down, then what? America needs to redouble its efforts in basic science and technology. We are not investing as much as we used to. We are falling behind. If we do not like Fareed Zakaria's idea, we better come up with a workable alternative, and we better do it fast. Progress these days occurs at lightning speed. Time works against us. Once we have missed the boat on renewable energy, other green technologies, or supercomputing (China just

clocked a big one, with the new world record in computing speed), it will be very hard to catch up.

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## **Needed: A US National Consensus on Debt Reduction**

**WASHINGTON** – America is facing death by garrote-like, slow fiscal strangulation. Overtime, Washington piled up debt levels that beat any historic comparison, except for WWII. We have heard that this is very dangerous; that this level of debt overtime will undermine the very stability of America as a functioning society, while making it impossible for America to be a world leader. Huge levels of debt will progressively crowd out discretionary spending, (already vastly reduced as a percentage of total spending), up to the point that the US Government will cease to have any investment capability or spending flexibility. With the pressing need to pay interest on a larger and larger national debt, there will be less and less money for national defense, for the management of foreign affairs, for building new infrastructure, for medical research, for science and technology, for NASA, for education, let alone foreign aid.

### **Sky not falling**

And yet, optimists observe that with all this debt piling up, and piling up fast, so far at least the sky has not fallen. The US continues to run huge yearly federal budget deficits and to issue new debt to finance the shortfall. But there are buyers for US Treasuries, (China, of course and Japan and many others). We still get the credit –at that, we are also getting extremely good deals, as the interest that we pay on new debt

these days is very low. So, entirely reversing the perspective, one might even think that being in debt is not so bad, after all.

### **Exaggerated fears?...**

And so the average observer may be tempted to conclude that all this doom and gloom talk about the debt is just hype, political scaremongering. Don't we always hear that the country is going to hell and that disaster is just around the corner? Besides, hey, everybody –Japan, Europe– is in debt, some in much worse shape than we are. And they are surviving. So, may be this is not such a big deal. And, somehow we shall find a simple way to get out of this.

### **...No, our debt is structural**

True enough, maybe the debt is not such a big deal **today**. *For the moment, we are not having troubles financing it. But, if we look at unprecedented federal debt, **much of it structural, that is built into the normal operating cost of the US Government and not tied to specific economic contingencies**, plus intractable states debt, and municipal debt, (even though they cannot be lumped together in one single account), it defies credibility that this can and will go on indefinitely and that we shall be able to borrow more and more –essentially forever. At some point there will be insolvency, somewhere. At some point we can have some kind of crisis due to a fiscal breakdown in a large state, (look at perennially challenged California), that will get no more credit and will have to go bankrupt. And thus Washington may be called to the rescue. But rescue with what, as Washington is totally strapped?*

### **When will the sky fall?**

And here we enter the unknown territory of perception and fears. At what point will the good credit of the USA be no longer good? At what point will investors run away from US Treasury Bonds? Or, more likely, at what point will they

demand, unlike today, a huge interest premium to buy them, (think of Greece or Ireland), making thus the whole debt financing operation a lot more costly and eventually crippling? Who knows when this might happen. But piling up more and more debt is a sure way to find out where the breaking point is.

### **Old debt v. new debt**

Sure enough, we should distinguish between debt increases due to the higher cost of current operations, mostly entitlement programs and the recent, (2008-2009), jump in spending and thus debt due to the extraordinary circumstances caused by this unprecedented economic recession. The extraordinary spending due to the crisis will come to an end. But the ongoing shortfalls due to the built-in increased cost of federal transfer payments will not. So, overall, our national debt is not a temporary problem. This is systemic. The current contingency, with all the additional spending aimed at containing the damage of the financial/housing crisis, has only made a bad situation much worse.

### **Our problem: unaffordable entitlement spending**

Unaffordable entitlement programs constitute the bulk of our debt and thus they are the real threat to long term fiscal health. If we keep in mind the higher spending trend due to our gigantic obligations towards seniors as currently framed, to think that there will be a fix other than cutting down spending for current operations –and this means mostly reducing the cost of all welfare programs– is total madness. Likewise, the hope that we can simply grow the economy so that more revenue deriving from an expanded base will get the Federal Government out of debt is wishful thinking.

### **We cannot “grow out” of this debt**

Surely we can and should accelerate growth. This is good anyway. But there is no way that a mature economy like the US

will be able to grow at a China-like 10 per cent a year thus generating the additional revenue that will allow Washington to progressively repay all its debt. So, even though we may not feel it yet, we are in a bad fix. Again, this is not temporary. On top of various needed spending cuts here and there, unless we reformulate our entitlement programs so that they will cost a lot less, there is no way out of this. And so, precisely because as bad as things are today the sky is not falling, this is the time to put together a credible plan for debt reduction.

### **We can debate the timing of a debt reduction strategy, not the need to have one**

Sure enough, assuming that we have agreement on a real debt reduction plan, there are legitimate arguments –given the delicate, indeed fragile economic situation of the country–for implementing it more slowly rather than more aggressively. In this, however, we may have a thing or two to learn from England. After years of profligate spending, the UK, now under new Conservative/Liberal-Democratic management, has just embarked in a truly drastic deficit and debt reduction plan. Some say that this is crazy. Hasty, draconian cuts will simply kill the country's economy. Indeed, the plan to cut public employment by huge numbers may backfire, as it may just add to total unemployment in a time of weakness, thus depressing aggregate demand and slowing down the economy.

### **England has a “Plan”**

Is Prime Minister David Cameron reckless in all this? Who knows. We should revisit the UK plan a year from now. But one thing is clear. While one may debate and disagree with the timing of the strategy, at least England has a “Plan”, and for now a decent national political consensus around it. Here in the US we do not have any national consensus around any “Plan”. And we are supposed to be the world leader?

## **Others have had a “Plan” imposed on them**

In other cases of deficit and large debt affliction, an unpleasant cure has been imposed on otherwise reluctant countries. We have seen what happened to Greece earlier this year. And we have seen that in the wake of Greece's near death, Ireland, Portugal and Spain had to take actions aimed at deflecting international concerns that they were in equally bad shape. Now, of course, we can argue that the US is not close to these countries' conditions. True. But the difference is one of degree. The nature of the affliction is the same: overspending. In our case it is not as acute. But, left untreated, the disease will only get worse.

## **America: no “Plan”**

And yet, here in America, even though we know what happened elsewhere, and much debate notwithstanding, there is no structural debt reduction policy in place. In fact there is not even an embryo of a “Plan”. (We shall have this embryo, once an *ad hoc* bipartisan Commission nominated to study the issue will come up with its recommendations, sometime after the mid-term elections. But its plan, whatever it will be, will not be mandatory. It may or may not be seriously discussed, let alone implemented. Eventually it will be up to the elected representative to take responsibility for any binding decision). And this, lack of any plan, may indeed be the worst part.

It is inconceivable for the largest industrial democracy and largest world economy, in many ways trend setter, not to have any strategy to get back to fiscal stability. You cannot be a perennially semi-broke world leader. You can be semi-broke alright; or may be just broke *a la* Greece; but not a world leader at the same time.

We may indeed argue about timing and fine tuning of any debt reduction plan. But, we must have one, and it better be for

real. The notion that you may be able to deal with this level of debt through half measures such as eliminating congressional earmarks or by abolishing this or that agency is ludicrous. We may eliminate the entire Department of Defense, unlikely as this is, and the substantial savings will still not be enough to get us out of debt.

### **Rise above politics, forge a national consensus**

Our twisted politics aside, it would be almost suicidal not to forge immediately, whatever the political environment after the mid-term elections, the equivalent of a "National Fiscal Pact" that will outline the basic steps of a deficit reduction and ultimately debt reduction strategy that most Americans can buy into. I know that this sounds improbable, given our poisoned political climate. But, if this is so, if our politics do not allow an agreement on this vital issue, then we can kiss good bye to America as a world power. As I said, you cannot be broke and a world leader at the same time. Are we really so shortsighted not to see what is at stake here?

### **Why are we in debt?**

With all that, once again, why are we in such debt? Because Uncle Sam spends much more than what Washington drain from the public via taxation. Once again, most of the overspending is not about this or that pork barrel project. It is due to payments to seniors.

### **Good debt**

Sure enough, not all debt is bad. For Government as in other instances, one could and should distinguish between "good debt" and "bad debt". Good debt is what you get into if you want to start a business or finance a large equipment purchase that will benefit your business operations. You get into debt, all right. But there is a credible plan there that the money will be used to grow the business. Your business plan calculates that through your new equipment financed with

borrowed money you will make more money and you will be able to pay back your debt, the interest charged and at the same time improve your profits. This is the kind of “good debt” that growing businesses routinely get into. Granted, sometimes this does not work. The business plan was not good. The new equipment purchase does not increase profits, etc. etc. And the business may have to retrench or it may go under. We all know that. But at the very least there is a decent expectation, vetted by your bankers, that getting into debt is a way to grow. You invest borrowed resources in order to grow the business.

### **Borrowing to invest, borrowing to finance current operations**

In the case of a Government, we may argue that there is also a distinction between getting into debt to finance capital projects such as new infrastructure that provides lasting economic benefits to the nation and debt incurred to finance transfer payments: such as pensions or veteran benefits.

In the first case you borrow to improve the capital endowment of the nation. A new airport, an upgraded container terminal or improved rail connections usually will have a positive impact on the pace of economic activities, while reducing costs of all businesses using them. So, this would be an investment.

In the second case –transfer payments– you borrow to finance a life style that the nation could not otherwise afford. You can do this for a while; but not forever. This is now America’s predicament. This is indeed unsustainable.

### **America borrows to finance an unaffordable life style**

Washington is on this unsustainable path. ***Indeed, in the case of the US, as well as other mature industrial democracies, most of the money borrowed goes indeed to finance the growing cost of current operations and transfer payments. And this is unsustainable. In other words we have costly IOUs in the form***

*of transfer payments, mostly to seniors, that have become unaffordable. It is as simple as that.*

The welfare state was built at a time in which nobody could fathom how expensive it would become over many decades. At the time when Social Security and later on Medicare were introduced nobody could fathom that today the growing costs associated with them would end up absorbing most of the federal revenue. But this is the issue. Not even a growing economy can generate the additional revenue required to fund progressively more expensive entitlement programs.

### **Welfare state: more expensive than initially thought**

The welfare state as originally designed and later on modified is simply no longer affordable. This does not mean eliminating it. But it surely means restructuring it. The most obvious consideration is that we have to respond to changed demographics. While the problem is huge, it is also very simple.

We have fewer babies. There are fewer working adults paying into the system. At the same time entitlement recipients, the retirees, live much longer. So we have totally altered ratios, due to transformed demographics. Instead of having many young workers paying into the fund that goes to relatively few retirees, now we have fewer active persons paying into the system that finances checks for more numerous seniors who, due to improved health care, live much longer and thus collect for a much longer period of time.

### **Fixing Social Security**

A very simple solution is to postpone retirement age and certainly to postpone the age at which one can collect full benefits. Of course, one can also jack up the federal tax that goes into the Social Security pot. And this will increase solvency. But by far the simplest remedy is to change the age of eligibility. And this can be done without jeopardizing

payments to current recipients or to those already close to retirement.

You give a fair warning to those just entering the work force or who are sufficiently removed from retirement. You tell them that they will be eligible to receive their minimum Social Security checks at 64 or 65 and not at 62, for example, or whatever we want to decide, based on actuarial calculations about projected numbers of recipients and life expectancy. Of course, if the demographics change, you have to revisit the payment schedule.

### **Medicare is the real issue**

The really hard part is a drastic reduction of medical payments to seniors, via Medicare. And this is a lot more complicated than Social Security because we are not talking about a fixed, predictable payment. Here we are talking about an out of control system, with awful incentives to overspend. Fixing Medicare would require a serious health care reform, unlike the one that we just had. This is really complicated stuff. This has to do with forging a real national consensus on what is appropriate health care and what is not. What is needed and what is unnecessary and who can legitimately decide on which is which.

On top of that, a huge chunk of the current Medicare cost is due to care at the very end of life. At what point can we say that giving expensive treatments to a person near death is superfluous? I do not even pretend to have the answers to any of this. But if we do not even begin this conversation, we shall not have any solutions. The current Medicare system, if unchanged, will mathematically bankrupt the nation, as Medicare costs increase at a much faster pace than even the most optimistic rate of economic growth. There is no question about that. So, better start talking now about reasonable alternatives that will provide care to seniors without destroying the country's finances. Other developed countries

manage to provide health care at a lower cost. What is an acceptable compromise that Americans can live with?

### **We know the problems**

As I said, the problems that we are facing are huge but not mysterious. They become complicated, indeed intractable, only if they become political. To the extent that recipients have become accustomed to think of entitlements as “natural rights”, sacrosanct and untouchable, we have a problem, as the public is incapable of viewing what they get in the broader context of national solvency.

The notion that people can continue to get what they get, irrespective of the conditions of national finances, is crazy. Of course, when we get into any belt tightening conversation, then inevitably we get into “fairness”. “Why should I get less than so and so”? And this is why the issues are politically poisonous and thus carefully avoided. There are no good choices, because someone will be hurt by any cuts.

### **Action or no action?**

Nonetheless, we are staring into the abyss. We are not in it yet, but close. If, for lack of political courage, we may conclude that falling into it is better than forging alternatives, then we shall deserve the inevitably bad consequences of our choices.

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## **After the Elections: A More Divided America?**

**WASHINGTON** – Most opinion polls indicate losses for the

Democrats, the majority party now holding both the White House and the Congress, in the upcoming mid-term elections. The extent of the probable losses is not clear; but it looks substantial. Of course, nothing new in a trend whereby the party holding the White House loses seats in the mid-term elections. It happens almost every time.

### **How big a loss for the Democrats?**

The issue is how big a loss and to what extent the voters will be signaling through their ballots either mild or profound discontent with the President's economic and other policies. The scenario this time is unusual, given the historic severity of the economic situation and the unprecedented dimensions of Government actions to remedy it.

Right now, in the US, after the near catastrophe of 2008-2009 the economic recovery advances; but at a painfully slow pace, (around 2% growth). Unemployment at 9.6% is at a historically high level. What is worse is the high proportion of long term unemployment within this mix, as people who have been out of work for several months or years are less likely to find new jobs. In other words, things are barely passable, still quite bad, or may have even gotten worse in the last year or so, depending on how badly the state you live in has been hurt by the crisis.

Given this depressing picture, how does President Barack Obama assess his work as chief executive and the country's political atmosphere on the eve of this vote? A recent The New York Times Magazine story, ("Education of a President", by Peter Barker, October 12, 2010), presents President Barack Obama as a leader somewhat overwhelmed by the complexities of the messy Washington political process and its acrimonious partizanship, yet adamant in claiming that overall, regarding policy, he did the right things.

**Obama: no regrets**

In other words, the Washington political process is uglier and tougher than Obama had thought before coming into office; but he has no second thoughts about his priorities, (the economic stimulus, health care reform), and his agenda. He concedes that maybe he should have been a bit more political, a bit more inclusive, a bit more focused on communication rather than just execution; but, overall he did the right things and so, by his standards, he did well.

### **Real differences on the issues**

He did well? Not so, according to the opinion polls. And this is precisely the point of contention that dominates this campaign for the Congress and that may cause huge losses for the Democrats. The opinion polls preceding these elections, plus a huge wave of money going to support Republican candidates, indicate that a significant portion, perhaps the majority, of the electorate seems to believe that the President did not do well.

Many claim that Obama and the Democrats are taking the country "in the wrong direction". Is this just an issue of misunderstandings, due to faulty communication of the "right policies"? Of course, there is always some truth, reflecting in hindsight, about the importance of how one communicates the message, Perception is reality, in politics probably even more so than in other fields, as so much rides on the credibility and charisma of the political leader/policy-maker. Properly crafting the message may indeed result in persuading more skeptics.

### **Not just a communication problem**

But, even conceding that a more fine tuned message might have gained more converts, America's mood on the eve of the upcoming mid-term elections is quite negative about the President's approach, (a lot of money, borrowed money in fact, thrown at problems), his policies and their outcome.

This would suggest that here there is more than just a matter of improving communication strategies. The problem seems to be substantive. A big chunk of America does not like the direction this President is taking it.

### **The Tea Party Uprising**

The loudest manifestation of general unhappiness has been brought about not so much by the institutional opposition, the Republican Party now in the minority, but by the "Tea Party Movement". The Tea Party is a spontaneous, grass roots phenomenon of middle class, mostly white, Americans who looked at the gigantic wave of Washington activism and spending and had an instinctive, rather than intellectual, rejection of the whole thing. In their view, Obama has pushed for way too much spending, too much state intervention and ultimately too much debt. They see this as fiscally irresponsible and at the same time they see "too much Government" as a threat to individual freedoms.

### **Battle over health care**

Their discontent turned into anger unleashed in full force against the most visible "Big Government Plan" pushed by Obama and the Democrats: the health reform plan. While quixotic, sometime extreme, strange and even nonsensical, the Tea Party opposition was and is against the very concept of a larger state that will end up having a deciding role in the way in which Middle America lives. And Middle America has a knee-jerk antipathy towards anything that feels or smells like public encroachment on private business.

### **The Tea Party phenomenon in context**

Now, let's be clear, the Tea Party Movement, while significant, is one component of the electorate, and thus it does not reflect majority opinion. If we take the population in the populous coastal states, East and West, from New York to California, there are majorities there who

favor more Government activism aimed at promoting social policies and “fairness” in an otherwise very unequal society with growing disparities between the very rich and everybody else. Still, this spirited, popular, as opposed to intellectual, resistance to state intervention is new and it would be foolish to dismiss it as an irrelevant fringe movement.

### **Enter the fiscal conservatives**

Of course, at some point, the anti-government bias of the Tea Party Movement connected with more traditional fiscally conservative positions. Looking at huge spending and public debt rapidly going into the stratosphere, many, including moderate “Blue Dog” Democrats started wondering how far could this go. How much debt can America accumulate? What will be the fiscal and economic consequences of these unprecedented imbalances? And so the aimless Republicans, having rediscovered the virtue of fiscal restraint, repositioned themselves to lead the forces demanding restraint and opposing new measures that, whatever their merit, would end up increasing the deficit and ultimately the national debt.

### **Inherited fiscal problems**

In truth, the trend towards higher debt, driven largely by the dynamics of a more and more expensive welfare systems with costly unfunded entitlement programs, started a long time ago and it is largely dictated by an aging population whose retirement costs will be higher and higher. The problem is that Obama, having inherited huge imbalances getting progressively larger, made them worse by adding to the debt via expensive emergency measures aimed at stabilizing a country faced with a horrible economic crisis.

### **Obama’s deficits**

But he did all this without having the ability to convince

anybody that a healthy fiscal course correction will take place later on. In other words, while some appropriate things have been said about the need to spend a lot now, while we certainly know that we have to create a path to lower spending down the line, for the time being America has seen only the huge increases in spending. There is nothing serious on the table, right now, (except for a bipartisan Commission that will make recommendations on fiscal policies after the elctions), about policies that will change the dynamics of public spending and thus reduce the deficit. On top of that, all this new spending, (think of the stimulus), did not produce the advertised effect. So, from the standpoint of "Joe Public" small bang for the buck. We have got deeper into debt and we do not much to show for it.

### **Anti state revolt**

All this has given the strongest opponents of this President the opening to call him an ideologue, someone who wants more public spending and state control over the economy for its own sake, as a matter of ideological conviction. He does all this, many say, because he is a "socialist". Well, this may be a stretch. But it is not altogether an exaggeration to assert that this President, unlike his Tea Party vociferous opponents, is not uneasy in an environment in which Washington-led public policy manages more and more "stuff".

And here is precisely the problem and the open question: "How much state does America want and at what cost"? –especially since public policy and the gigantic apparatus supporting it is very disappointing in terms of cost effectiveness and results.

### **State action always bad**

The way Middle America sees the picture is ***that it is bad as a matter of principle to give too much power to the Government, because inevitably this state power will restrict individual***

*freedoms. At the same time, the Government is thought to be intrinsically unable to deliver whatever it promises. Or, at the very least, it will do so at a higher cost with mediocre results at best. Unfortunately, the record supports this pessimistic view.*

### **Obama's extraordinary action justified**

In fairness to President Barack Obama, his administration coming in January 2009 did its best in dealing with an economic and financial crisis of immense proportions that seemed to threaten the very fabric of the American economy and its once upon a time revered financial institutions. Extraordinary spending, via the stimulus plan, via the massive bailouts, with Uncle Sam ending up owning auto companies and banks, not to mention "Freddie" and "Fannie", the mismanaged mortgage finance companies, was up to a point both necessary and inevitable to prevent disaster. Yes, up to a point inevitable. But up to *which point*? When did Obama cross the magic line that caused the Tea Party uprising as a reaction?

### **Health care triggered the revolt**

Who knows, really. I venture an idea. I believe that the political choice that ignited the vocal opposition, beyond the handling of the recession, was Obama's thrust on health care reform, (see above). ***The choice of focus on health care reform as the brand new, signature initiative of the Obama administration was not a reaction to the economic meltdown. It was by no means dictated by events. This was deliberate, it was a political choice and in my judgment an ill advised one.***

My theory is that a President elected by a large coalition dominated by "the have not" and by the almost unanimous minorities, that is by those who felt left behind by the socially insensitive or inept Republicans, needed to prove that there were indeed tangible gains coming from the election of a Democrat –and the very first African American President

in US history at that.

### **Health care was a political choice, not dictated by events**

And so Obama decided to respond to this yearning. And so he pushed health care reform as a key social reform aimed at improving the conditions of millions of uninsured, while ending bad practices of the insurance companies, such as refusing to cover people with pre-existing conditions. This way Obama would make a concrete gesture to his natural constituencies , while reaffirming an agenda aimed at promoting fairness –a major theme of his campaign.

This may be fine in principle. But the timing was ill advised. In the midst of a huge recession, while the stimulus was not stimulating much, Obama decided to change the topic, or add another big one, by pushing for health care reform.

### **Reform not going to the core of the issues....**

I have already discussed health reform at length health in other articles. Very briefly, the key point is that while Obama's package has the merit of increasing the numbers of those who will be covered, this partial reform does not do much to address the real systemic flaws that make health care so extravagantly expensive in America. (On average, America spends for health care 6 to 7% more of its GDP than most other developed countries). This reform does not address "wellness polices" and meaningful prevention. Even worse, it does not really address the "fee for service" approach that creates a strong economic incentive for health care providers to overdo, over prescribe and over treat almost anything; thus adding to cost while providing no value.

The perfect storm we have created is a society of millions of people who over many decades developed very unhealthy habits, (think of the obesity epidemic, substance abuse, alcoholism and lack of physical exercise), and armies of doctors who salivate at the thought of more and more millions of diabetics

who need more and more treatment.

These are the structural issues that cause the cost explosion of health care delivery in America. And these have not been directly addressed by the "Obamacare" reform.

### **...but politically contentious: The Tea Party rallied**

But, even if we suspend judgment on the merit and effectiveness of this reform, just because Obama was pushing hard for it, this became the most contentious political issue and thus the issue that gave people the impetus to join the "Tea Party Uprising". Of course, there was much misinformation and a lot of nonsense, (the plan was thought to include forced euthanasia decreed by "Death Panels", as well as denial of treatment), in what was said at thousands of rallies around the nation convened to protest health care reform.

But the instinct of most protesters was not so wrong. This President –they felt– instead of really focusing on policies that would confront the economic crisis at hand, (stimulate job creation, corporate tax reform, a real plan for major investments in renewable energy), chose instead to have a war against the medical insurance companies in an effort to reshape a huge chunk of the US economy to his own liking. To many, this smelled like social engineering by a left wing politician up to no good.

### **The divide became deeper**

In the end the reform passed. But by the slimmest of margins. The acrimonious debate in turn made the overall Washington political climate even more toxic, thus silencing the voices of the pragmatists who are more inclined to go across party lines in order to have compromises. As a result: very little collegiality left after the health care battle and more sharply divided parties.

### **Republicans riding the wave of discontent**

The Republican opposition, while not particularly attractive regarding its ability to present an alternative, modern and inclusive policy vision, correctly understood that there was an emerging anti-Obama movement in the nation and decided to ride this wave. In its wisdom, the Republican Party decided to oppose and in fact obstruct almost everything the administration would present, hoping that this would translate into more votes at the upcoming mid-term elections.

In the Senate, where the rules over protect the minority, nothing gets done, unless a party has more than the 60 votes necessary to end an obstructionist filibuster, (endless debate). Thus a determined Republican minority can and did effectively impede almost any legislation to move forward. By the same token, even an individual Senator can block the confirmation of any White House nominee for the executive branch or the judiciary.

### **Dysfunctional Washington**

In truth nothing new here. This propensity towards gridlock is a consequence of a constitutional system consciously created long ago so that it would be easier to block legislative initiatives rather than ram through the system anything a determined majority may want. In this rather dysfunctional policy-making process not even a party holding the White House and sizable majorities in both branches of Congress has the freedom to implement its programs. Still, all this aside, Middle America is feeling the impact of a recession, while believing that its representatives in Washington are incompetent, misguided or clueless.

And this widespread perception of office holders' incompetence, beyond the Tea Party phenomenon, is at the source of the prevailing anti-incumbent sentiment. This anti-incumbent sentiment is largely driven by many independent voters who had trusted the Democrats in 2006 and 2008, given the disappoint Republican Party record. Now the independents

are unhappy about the Democrats. And so the Democrats, being now in the majority, have most of the incumbents and thus they have more to lose.

### **Elections: catastrophe or just setback?**

In the end, the outcome of the election may be catastrophic for the Democrats or just bad. We shall see in a few days what the voters will decide. Still, whatever the outcome, it would be unwise for President Obama and for the Democrats in Congress to ignore the anti-statist mood conveyed by the Tea Party Movement and now embraced by chastened Republicans who have rediscovered the virtues of fiscal frugality. Sure enough, some spectacularly unfit Republican candidates who won the primaries only because of strong Tea Party groups support, especially in critical Senate races, may end up doing very poorly. Still, it would be a mistake to dismiss the whole movement as amateurish and immature.

### **America's basic politics: center right?**

It has been said that the dominant political instinct in America is center-right. This may not be entirely true, owing to the millions of minority voters who feel semi-disenfranchised and the millions of formerly middle class voters squeezed by outsourcing and other negative consequences of globalization. These voters look at Washington for relief. And perhaps rightly so. Disappointment notwithstanding, they are likely to continue voting for the Democrats. But if this is so, we have a country split in the middle regarding the role of the state in mitigating inequality and promoting growth.

### **Consensus on growth promoting policies is possible**

The trick, and in fact the secret formula for engineering some bipartisanship after the elections is in determining the shape of this relief for the underprivileged, while promoting genuine pro-growth measures. Is it going to be more costly

handouts or policy measures aimed at creating real opportunity?

In a very recent talk in California, Secretary of the Treasury Timothy Geithner pointed out that the way in which Washington can promote long term American prosperity is in redoubling investments in public education, in basic science, in more tax relief for R&D and in lowering US corporate taxes so that companies do not feel penalized by operating in the USA. These are good ideas. Quite frankly, any Republican could have said the same things without fear of being criticized by the orthodox right wing of his/her party.

My hope is that, whatever happens in these elections, it may be possible to gather a policy consensus around sensible ideas like those put forward by Secretary Geithner.

The alternative, I am afraid, is political stalemate and, lacking clear policy guidance from Washington, the further erosion of American competitiveness. Betting on the wisdom of the Washington establishment, believing that when push comes to shove they will eventually do the right things, may be unwise. But sometimes they can surprise us.

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## **India's Rise**

WASHINGTON – The “Big Story” of the decade, in fact of the century, is the rise of Asia, a phenomenon that will rebalance the global balance of power and that will cause major shifts within and among western countries, accustomed as they have been since the industrial revolution to economic leadership, owing to their unchallenged technological primacy. But what is

happening within Asia? Until yesterday it would have appeared that, while Asia as a whole was doing well, China was and will be in the lead. But how is the other giant doing? How is India faring these days?

### **India outpacing China?**

Well, if you look at the latest The Economist newsmagazine cover story, featuring a picture of a running tiger and the headline “How India’s Growth will Outpace China’s”, (September 2 – 8 2010), you not only have a positive outlook –and this is no real surprise–but also a bold and certainly controversial prediction. India, once the laggard within surging Asia, now is doing so much better as to soon surpass China’s rate of growth.

### **Which model works best?**

Assuming that it were indeed so, this would be quite something. If this is so, such a development would force many observers to reevaluate models and paradigms in terms of “what works best” within an Asian context. Among China’s strengths many cited a centralized decision-making process that makes it relatively easy to go from planning to execution of far reaching policies. India, on the contrary, is democratic and participatory. But its democracy is very complex and in fact rather messy. The political process is complicated, fragmented and slow. This is why public policy, relatively speaking, is inefficient, causing major delays in getting to decisions and years to implement whatever policy was agreed to.

### **China doing far better in infrastructure**

An obvious comparison is in the hundreds of billions invested by China in a relatively short time in upgrading its basic infrastructure, with huge benefits for China’s economy; while India is still struggling to bridge a huge highways and ports gap that objectively makes moving goods and thus economic development much more difficult.

## **India's tool kit**

But, were we to believe this The Economist cover story, it would appear that India has something else that maybe China does not have. Hence the rosy prediction. One can read that the extra ingredients consist in a more organic growth model founded on the domestic market, (as opposed to export led growth), a genuine entrepreneurial class, (as opposed to giant state owned enterprises), a solid democratic tradition that, with all its flaws, has legitimacy and thus projects long term political stability and a younger population.

## **The shortfalls are still large**

Having said that, both the leader, (editorial), and the story in the magazine are far less sanguine on this prediction of India overtaking China than the catchy headline would suggest. Yes, the forecast of faster growth remains. But The Economist outlines so many pitfalls, so many unsolved blockages –mostly resting in inefficient services and a semi-paralyzed political system that India must deal with, (see above) – that it makes one wonder as to whether the editors actually believe their optimistic forecast.

## **The Commonwealth Games debacle**

Indeed, one of the examples cited in the news story as evidence of dreadful organizational shortfalls is the appalling level of incompetence and mismanagement revealed by the local New Delhi authorities in charge of organizing the Commonwealth Games that just opened on October 3. Several reports in Indian and international media indicated that India, just days before the opening, was not only way behind in preparing for the event but that the quality of the facilities, in particular lodging for all the foreign athletes, were so bad and unsanitary that many countries threatened to withdraw from the competition. It seemed to be a classic case of Indian old fashioned bureaucratic

incompetence: mishandling: sluggishness, no accountability, unsupervised contractors, bad execution, corruption and so on.

### **Business as usual**

As Divya Gopalan of [Aljazeera.net](http://Aljazeera.net) reported on the Games on September 27, 2010:

*".....[...]. if you ask almost anyone else, be it the taxi driver, the shopkeeper, the college student waiting for a bus, journalists or my auntie – they'll tell you with a shake of a head, it's corruption. It's everywhere, and nothing can be done about it [...]. The Commonwealth Games are being pulled together by a myriad of agencies and contractors who hire sub contractors, who pass it down to more agencies, who field it out to even more sub contractors, and with each link of the chain, palms are greased. So it's no surprise that these are the most expensive Commonwealth Games ever and the budget has been bloated 16 times over. Now, belatedly, Manmohan Singh, the prime minister, has stepped in, trying to get his ministers to get their act together and somehow, with just days to go, get these games and the venues on track. But everyday, failings crop up, and more athletes back down. It seems that no one is taking charge of these games".*□

True enough, in response to outcries and strong international pressures, finally the Indians managed to regain control. As the opening day was approaching, they delivered extra resources and corrected at least the most serious organizational and logistical problems. But the fact that this level of mismanagement for a major international event for which they had had years to prepare was allowed and apparently tolerated up to the last minute is an indication of how dysfunctional at least some key components of India's institutional make up still are.

### **Delhi Metro: a different story**

Yet the picture is hardly black and white. In the same city of

New Delhi a far more daunting project, the construction of a brand new, vast underground metro system, (managed now by Delhi Metro Rail Corporation, Ltd), was planned and executed very well, within budget and according to the highest construction standards. According to its Mission Statement:

*“Delhi Metro will be of world class standards in regard to safety, reliability, punctuality, comfort and customer satisfaction”.*

And so it is. The system works well. Apparently this happened because the project was handled outside the established bureaucracy. Still, be that as it may, this brand new metro system is a major engineering and public service delivery achievement, showing that Indian managers can perform according to the highest international standards.

### **Which one is the real India?**

But then the question is: “which one is the *real India*, the India ultimately in charge and thus determining the pace and quality of economic and societal development?” Is it the almost hopeless India of the messy Commonwealth Games organization, or the modern India that produced the sparkling underground metro system? Trying to assess the relative weight of the two examples, is the prediction about India’s growth overtaking China’s correct? Well, it would be a lot easier to answer this if we really knew for sure which of the two India is and will be in the lead. At the moment, while positive changes encourage new optimism, we really do not know.

### **How big business copes today**

In the worst case scenario, assuming that the old, inefficient bureaucratic system is still dominant, the question that logically follows is whether it will be possible for the productive, vibrant and inventive private sector to go around these public administration dysfunctions in the pursuit of

growth, markets and profits. We already know of many large Indian industrial conglomerates that run their own schools to properly train their workers and their own transportation systems to guarantee that workers will show up, while they have set up independent power supply generators, given the unreliability of public services.

But can this “do it yourself approach”, affordable for huge corporations, be extended to a still poor country of more than one billion and 150 million people? Certainly not. And yet, there is no clear path now to a brighter future of improved public administration and higher quality of service delivery. The future is likely to be patchwork, hit and miss, with notable successes, as the story of Delhi’s metro system indicates.

### **India’s success stories**

Of course, India’s huge positives are there and they should be noted. India is a democracy and not a top-down (mild?) autocracy in which huge state owned enterprises, comfortably bankrolled by publicly owned banks, set the pace for national economic activities, as is the case in China. In India there is a large and diverse private sector. There are 45 million entrepreneurs. There is a genuine business class catering to the needs of a growing domestic market. Some Indian entities have emerged as world class companies. We all know Arcelor Mittal, (world’s largest steel conglomerate), Tata, (diversified manufacturing and consulting group), Reliance, (retail, telecom and more); not to mention Wipro and Infosys, (both IT giants). All this is really good.

Beyond these achievements, many observers indicate that Indian development is more harmonious, as it is led mostly by growing domestic demand and not skewed by over reliance on exporting industries whose long term fate is wedded to ever expanding foreign markets.

## **A young country...**

Besides, India is a young country with an abundant supply of young people eager to participate in its growth. Compare this with China's impending population crisis, owing to the mandatory one child policy aimed at containing population growth. While this worked, it created problems down the line. China will be facing a large older population, while India will have an oversupply of younger people.

## **...But uneducated**

Still, in tomorrow's knowledge economy young people need to be educated, something that India does not do well. More than half of the Indian population lives in underserved, poor rural communities in which public education fails. Within the Indian workforce, 40 per cent are illiterate and 40 per cent failed to complete school. Beyond that, the higher education system cannot adequately supply the economy. The same The Economist article cites the Boston Consulting Group indicating that India will lack "200,000 engineers, 400,000 other graduates and 150,000 vocationally trained workers".

## **India with a modernized government can be unstoppable**

And so, which is which? Is the India of ingenuity and creativity that delivered the super cheap US \$ 35 computer that can bridge the digital divide in the lead? Or is the slow moving public apparatus ultimately setting the pace of development? If we can bet that the state and Indian public administration can be modernized within a reasonable time, with the corollary of successfully engaging the private sector in partnerships aimed at rapidly upgrading infrastructure, then India can truly be unstoppable. But we do not know for sure. The tiger featured in the cover story runs, for the moment; until it will face a huge gap that will be too wide even for its strong muscles.

In the meantime, the Chinese dragon is still busy building

bridges and airports and tracks for super fast trains.

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