

GOP and Democrats Should Back Legislation Pushing For The Use Of Cheap, Domestic Natural Gas As Transportation Fuel – Huge Savings For Consumers, Improved Energy Security For US

[the-subtitle]

By Paolo von Schirach

February 27, 2012

WASHINGTON – This being an election year, rising oil and gas prices have unleashed predictable polemics about whose fault it is that energy costs are going up in America. Easy enough for the Republicans to claim that it is all Barack Obama's responsibility, because his administration is biased against fossil fuels, making it more difficult to drill and extract more. And then Obama recently vetoed the Keystone XL pipeline that would have carried more Canadian crude to the refineries in Texas, thus increasing US supplies.

Sterile political arguments

These arguments are mostly political and not very compelling. Not much that can be done in the short run to insulate America from higher oil prices now rising because of fears of supply constraints due to the confrontation with Iran and its contentious nuclear power development, widely believed to be a precursor to nuclear weapons development. Right now, some more

oil from Canada or from increased US off shore sources would not be enough to decouple the US market from a rising world wide oil price. So, in the near term, we are stuck with whatever the oil price is.

Long term US could rely only on North American oil supplies

That said, if the US were truly aggressive in pushing more domestic oil extraction (North Dakota alone will soon produce close to 1 million barrels of shale oil) while at the same time building more pipelines from Canada, the home of gigantic oil sands deposits, over time this would really change the picture. We could be talking about getting three or four additional million barrels from domestic and Canadian sources, eventually relying entirely on North American oil, with no more imports from the Gulf, from Nigeria or from Angola. This would be a game changer and it would lead to the creation of a US oil price, based on North American demand and supply insulated from the rest of the world. But this is not for now.

Natural gas is a real alternative –today

However, if decoupling US oil prices from the rest of the world is a real but distant possibility, we have now the real opportunity to drastically diminish our reliance on oil –foreign or domestic– by aggressively adopting liquefied natural gas (LNG) and compressed natural gas (CNG) as viable alternatives to diesel and gasoline. And this is opportunity is provided by the shale gas revolution now in full swing in America.

Indeed, due to our ability to extract natural gas from shale formations through “hydraulic fracturing”, (known in the industry as “fracking”), combined with horizontal drilling, America is now the largest natural gas producer in the world, having surpassed Russia in 2009. Given the huge supply increase, prices have gone down significantly, with immediate benefits for the electrical utilities that use natural gas as

their fuel, not to mention the plastics and chemical industries that rely on natural gas as a basic feed stock for many of their processes.

Natural gas as transportation fuel

While all these benefits are real and immediate, the next opportunity provided by all this cheap and domestically produced natural gas is to use it as transportation fuel, given its low cost and the added bonus of much lower emissions (natural gas is cleaner than oil) that would greatly benefit the environment. T. Boone Pickens has been pushing this transportation fuel revolution via his "Pickens Plan". And do keep in mind that there is nothing novel or revolutionary in building cars or trucks with engines running on natural gas. The technology is old, tried and tested and widely used in other countries. Nothing experimental here.

Challenges: cost of new vehicles, lack of refueling stations

There are however many challenges. And they have to do with absorbing the up front cost of new vehicles, initially more expensive than the traditional ones we are used to and in creating, practically from scratch, a national network of refueling stations (an American Natural Gas Highway) that would make natural gas powered vehicles practical.

Given these constraints, the consensus is that it would make sense to start a conversion process beginning with heavy trucks operated by major companies, like AT&T, FedEx or UPS. They are on the road most of the time. They burn a lot of fuel, and they rely on centralized refueling stations. Given trucks large fuel use, it would be much faster for fleet operators to recover the up front cost of a new natural gas powered vehicle, because of fuel savings of at least 40% compared to diesel.

Instead of complaining about high gasoline prices, switch to natural gas

So, from the above we get a simple advice. Instead of complaining about high oil prices (beyond our control) that translate into high gasoline prices, do away with gasoline altogether, at least for a large chunk of our user base. Switch to cheap and domestically produced natural gas, starting with heavy trucks. *Save money, contain the cost of all transported goods, enhance US energy security by cutting down oil imports, and do something nice for the air we breath—all at the same time.* But, surprisingly, there is not much action on any of this. Frankly, given the clear benefits and the added incentive of higher oil prices, this is really amazing.

We need new public policy

Some resistance is understandable. It is obvious that there will be huge opposition to any large scale switch to natural gas from the many components of our economy that are tied to oil. They have a good thing going, and do not want to change it.

But policy-makers should have the national interest at heart. They should recognize this incredible opportunity and grab it. It is quite possible to incentivise end users to switch to natural gas powered vehicles by making the transition easier via tax credits and other facilitations. (We are already doing this for hybrids and electric vehicles). Natural gas powered vehicles are now economically viable because of the shale gas revolution that increased supplies while lowering prices. What we need now is to build the necessary momentum to push this transformation forward.

So, instead of this silly name calling about who is at fault regarding gasoline at 4 dollar a gallon, it would be much more productive for Republicans and Democrats to get behind a major national policy initiative aimed at using our own domestic gas instead of imported oil. But this would require statesmanship, and this is a US commodity in even shorter supply than cheap

oil.

World Bank And Chinese Think Tank Recommend Overhaul Of China's Large System Of State Run Enterprises – A Surprise That Such A Sensitive Issue Is Publicly Debated – Economic Reforms Coming Up In Beijing?

[the-subtitle]

By Paolo von Schirach

February 25, 2012

WASHINGTON – Many believe that China's spectacular growth rates are due to its ability to expertly manage a combination of state run corporations and relatively new privately owned companies. China seems to be the best and most successful expression of a mixed economy model in which state owned enterprises, SOEs, still control almost half of the entire economy, including most strategic sectors, such as banking and telecoms. But it would appear instead that China has done so well in the past 30 years *in spite of state capitalism*. And it would also appear that, in order to maintain a high rate of

growth, China should make sure that going forward its many SOEs are run as real profit making enterprises, as opposed to being in large part powerful tools to assert government control over the rest of the economy.

China 2030

This is some of what is coming out of a preview of "*China 2030*", a report prepared by the World Bank, (acting in an advisory capacity), jointly with the Development Research Center, or DRC, a very influential Chinese think tank that is supervised by China's top policy-making body, the State Council.

Open debate?

What is most surprising about this report is not really the content, but the fact that it was commissioned in the first place and that its key finding and recommendation are becoming public. Just a few years ago, a document discussing issues that go to the very core of the Chinese state and economy would have never been aired in public. So, I would call this "openness" very good news. At least in principle, this is beginning to look like a debate on public policy.

SOE model worked well

As to the key findings, I am in perfect agreement. China did very well in harnessing most of its national resources in a gigantic effort to create an export-led economy. It had all the key components to capture a huge slice of labor intensive manufacturing: cheap land for industrial sites, cheap capital provided by state owned banks and tens of millions of migrant workers willing to move into cities and work in factories for really low wages. What Chinese migrant laborers turned into factory workers lacked in terms of skills they compensated with low wages.

Chinese products, while not the best, especially at the

beginning of this industrial effort, were certainly the cheapest. And so it did not matter that inexperienced Chinese workers were not particularly productive.

Besides cheap products, the Chinese were smart enough to understand that in order to gain and keep overseas customers they needed massive infrastructure investments. Cheap labor is a huge asset, but quick reaction time and time to market are equally important.

Tomorrow is about value

But this is the old story. Tomorrow's story will be about quality, innovation and moving up the value chain. And here is where state run enterprise will show their weaknesses. And this is mostly because SOEs are still large bureaucracies run by government appointees. While China for sure has its own variation on the SOE model, by and large the state is not a good entrepreneur. It was fine when the matter at hand was to mass produce cheap consumer goods for Wal-Mart, with the obvious advantage of ridiculously low labor costs.

But now China has to assert itself by becoming a flexible, innovative and high quality producer. Even intuitively we can appreciate that a state run bureaucracy is not the best instrument to foster innovation. Invariably, SOEs are influenced by politics and tend to allocate resources on priorities that have little to do with increasing value. And, in the long run, this is their fatal weakness, be it in China or anywhere else.

Will there be serious reforms?

That said, reforming the Chinese SOEs system would be a monumental effort, precisely because SOEs are so relevant and so deeply entrenched in the very fabric of the political system. Still, if China wants to rise to the next level economically, this issue will have to be tackled.

Ironically, by privatizing –if it will come to that– large SOEs that have also been used as levers to exert political influence, the Chinese Communist Party would diminish its powerful grip on the Chinese society. Should serious reforms take place, how all this will end up is anybody's guess. Meantime, we should welcome this Chinese debate, especially if it will be carried out in the open.

US Does Not Have The Military Means To Stop Iran's Nuclear Program, According To Leading Experts – With Limited Options, We Have To Live With The Uncertainty – Hope That Iranian People Will Get Rid Of Theocracy

[the-subtitle]

By Paolo von Schirach

February 23, 2012

WASHINGTON – Any bright new ideas about how to stop Iran's nuclear program? Well, not really, unless you want to count the bellicose pronouncements made by some of the Republicans now fighting for their party's nomination. These are our

action guys. They vow to stop Iran with whatever we've got. Rick Santorum openly disagrees with Chairman of the Joint Chief's Martin Dempsey advice for caution in assessing the Iran situation and any US (or Israeli) response.

Bellicose Republicans vow to teach Iran a lesson

"Listening to the commanders in the field –Santorum said– when they are going up against a dangerous theocratic regime that wants to wipe out the state of Israel, that wants to dominate the radical Islamic world and take on the 'Great Satan', the United States, we do nothing. That is a president [Obama] who must go and you want a leader who will take them on. I will do that."

Meanwhile, Gingrich said, *"If you think a madman is about to have nuclear weapons and you think that madman is going to use those nuclear weapons, then you have an absolute moral obligation to defend the lives of your people by eliminating the capacity to get nuclear weapons."*

So here is the Republican juxtaposition. On one side you have the wavering and fearful Obama administration incapable of showing resolve, and therefore emboldening the evil Iranians. On the other side you have brave and resolute Republicans who cannot wait to teach the bad guys a serious lesson.

US does not have the tools to eliminate Iran's program

But here is the problem. Beyond the belligerent Republican words, the truth is that the US, whatever your judgement about Obama's courage, in this unhappily constrained environment, does not seem to have the resources to seriously follow up on any threat. And this is what came out from a February 23 CSIS Dialogue hosted by Bob Schieffer, anchor of CBS Face The Nation, featuring retired General James Cartwright, former Vice-Chairman of the Joint Chiefs, retired Admiral William Fallon, former Commander of the US Central Command and David Sanger, chief Washington correspondent of The New York Times

and a leading expert on US foreign and security policies.

What came out of this discussion is that the US does not have the tools to go to war with Iran on this issue. Apparently the US lacks the military resources to destroy the Iranian nuclear program. Even an extensive US air campaign at most may delay it, but it will not cripple it. The Iranians now have the knowledge to start all over, even if precious facilities are destroyed through massive bombings. If this is so regarding much stronger America, even less likely that bombing strikes by Israel acting alone will be more effective. Israel simply does not have an air force large enough to accomplish this mission.

Well, this sobering consensus alone coming from people who do know the military speaks volumes about America's diminished resources and consequent inability to influence events through meaningful threats. Iran is not the old Soviet Union. It is a significant country, but it should be no match for America, until yesterday the most powerful country on earth.

Nobody has a fix on Iran's true intentions

Beyond that, according to the all discussants, we still do not fully understand Iran's game plan. Are they just trying to go near the threshold of obtaining nuclear weapons or do they really want to get them? And, assuming they get them, what will they do with them? Lots of theories and speculation, but no real consensus. Also not clear for any of the panelists what the Obama administration may or may not do, should the Iranian enrichment program go beyond any level deemed permissible for civilian purposes. Lines have been drawn; but what will happen if the Iranians decide to cross them is anybody's guess.

Sanctions are working

The only positive note is that there is consensus that the international sanctions this time are strong enough to inflict

real harm. The Iranians can no longer conduct regular business because their banks no longer have access to international exchanges. Difficult for them now to have any normal international transaction. And with the oil boycott, they may be forced to sell their crude at a discount. All this hurts. But again, not clear how the Iranians take all this. Will these punitive actions convince them to get a deal with the US and the rest of the world? Or is this something that pushes them to redouble their efforts? Amazingly, no one has a real handle on any of this.

Bottom line: the only people who really know what to do (even though they cannot really tell us how) are Rick Santorum and Newt Gingrich. However, since their chance of getting elected president and thus actually leading the charge are slim, it looks as if we will have to live with this Iranian nuclear uncertainty for quite a while.

The real issue is political intentions

In all this, it is clear that the problem is not about a nuclear program, but it is about the alleged political intentions of those promoting it. Germany and Japan have civilian nuclear installations, but no one is afraid that these are just precursors to aggressive nuclear weapons programs. Germany and Japan are stable democracies with no bellicose intentions.

The end of the Iranian theocracy would solve this problem

In Iran's case we simply do not know about intentions, given the rather bizarre nature of this regime. We can only hope that at some point the Iranian people may be able to put an end to this grotesque theocracy, thus re-creating the basis for a normal dialogue with the rest of the world. While apparently no one can fathom the secret goals of the Mullahs, I would think that a more representative Iranian leadership would not be such a difficult customer.

Close Partnerships Between US Community Colleges And Corporations Produce Graduates With Skills Required By Industry

[the-subtitle Time to go national on the basis of this collaborative formula]

By Paolo von Schirach

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February 21, 2012

WASHINGTON – I recently reported (see link above) that Peter Orszag, formerly Obama’s Budget Director and now with Citigroup, in a high profile Chicago speech strongly advocated more organic links between corporations, especially manufacturers, and Community Colleges, so that these vital education institutions will be able to give their students exactly the kind of skills that potential employers do need. This would be a good way to give people jobs, while helping corporations fill positions that will help their economic expansion.

Colleges and companies establish close cooperation

This need for “teaching customization”, for creating a good fit between instruction received and the actual jobs that are out there may seem self-evident, but apparently it is not yet the case, at least not nationwide. And this is why this emerging trend should be encouraged. In his speech, Orszag applauded an initiative under way in the greater Chicago region whereby companies are structuring a productive dialogue leading to closer relationships with area Community Colleges.

The formula works

And just today a very detailed Associated Press story (*Speed puts community colleges front and center*) illustrates concrete examples of very successful company-college partnerships, including close cooperation linking Fitzpatrick Manufacturing Co. in Sterling Heights, Michigan and Macomb Community College, just a few miles away.

These successful partnerships are possible, the AP reports, because Community Colleges are relatively small and have greater flexibility in adjusting instruction according to employers needs and –most importantly– they can do this adjusting very fast. The downside of custom tailored courses is that they are generally outside the established curriculum, and so they do not count towards a degree. And this may be a handicap for the student down the line.

But, all in all, the evidence so far suggest that these close ties between Community Colleges and companies are mutually advantageous. The students get the instruction they need to land a job, and the companies get the skilled people they want.

This approach should become standard

If this approach became dominant, then America could more easily cut down unemployment. In fact, the sad irony is that, even in this pretty bad jobs market with unemployment at 8.3%, there are tens of thousands of positions unfilled in America,

because companies cannot get the people with the specialized skills they need. Customized Community College curricula do help fill this large gap.

Time to go national on what seems to be a very successful formula.

America Hit By 2009 Recession As Wages Were Stagnant Due To Global Competition – Citigroup Peter Orszag Argues That US Should Invest Smartly In Education As A Way To Regain Strength

[the-subtitle]

By Paolo von Schirach

February 19, 2012

WASHINGTON – America is short of breath because we have to deal with the impact of two major issues. The first one is stagnant or declining wages, a global “*tectonic shift*” affecting most developed economies that started several years ago. The second one is the gigantic financial crisis that we are very slowly trying to emerge from. This is the analysis provided in a February 15 Chicago speech by Peter Orszag, Vice President of Global Banking at Citigroup and until July 2010

Director of Management and Budget in the Obama administration.

Crisis in the middle of a negative trend

If we accept this perspective of a crisis occurring in the middle of a long term negative economic trend, it becomes easier to understand why it is so difficult to get out of this slump. The 2008-2009 financial crisis hit a comparatively less vibrant America made relatively poorer by declining wages, a country in which family incomes can grow a bit only if both spouses are working. And this wage stagnation has been brought about by the massive addition to the global labor pool of hundreds of millions of mostly Asian workers, without any commensurate increase of invested capital.

To put it simple terms, in the context of a globalized world economy, we have many more workers competing for employment in economic sectors that have not grown in size at the same speed. And so American wages do not grow because US firms have to compete with mostly Asian counterparts employing very inexpensive workers. To stay competitive, American workers cannot demand higher wages.

Nobody understood how deep the recession would be

As America was still adjusting to this "tectonic shift" that caused stagnant wages and living standards, we had the 2008-2009 financial disaster. And financial crises, Orszag noted, are much tougher than recessions caused by the business cycle. The Typical "V" shaped curve of rapid decline followed by an equally rapid come back did not happen this time. If it is any consolation, as Orszag observed, nobody got the nature and magnitude of this recession right. And so there was a fundamental mismatch between the problem and the policies offered to fix it. The famous "Stimulus Package" passed at the very beginning of Obama's term did not work as intended because it could not work. It was designed to fix a temporary crisis, not a long drawn slump.

Unfortunately, it is going to take much longer to emerge from this crisis because millions of people have to climb up from very high levels of personal debt. All this debt prevents average Americans to consume, and without the pull of consumption there is not much demand and therefore not much additional employment.

Smart investments in education can provide a way out

So, what do we do about all this? We should increase America's skills level, argues Orszag. Indeed, along with the long term trend of wage stagnation, we have to consider that in recent decades there has been no growth in the number of Americans getting a college education.

So, one way out of this stagnation predicament is to get a better educated labor force, this way upgrading America's human capital pool. Of course, it would take years before we could see any tangible benefits from an increased number of skilled people. But one way to get faster results, says Orszag, is to establish direct and organic links between employers in a particular region and the Community Colleges that provide valuable education services to the local population.

If employers could supply reasonably accurate estimates of the types of skills they will need, then Community Colleges could steer an appropriate number of students towards those subjects, giving them a fairly good chance of getting a job upon completion of their studies. Orszag indicated that employers in the Chicago area have launched exactly this kind of structured dialogue with Community Colleges.

This could make a difference

This approach aimed at optimizing the value and cost effectiveness of investment in education may not be a panacea. But if it were adopted nation wide it would help lower unemployment levels, while giving US corporations the skills

levels they need in order to improve their competitiveness. Compared with populist nonsense about fixing unemployment by taxing the rich, something that would do nothing to create jobs, this would be a very good start.

Germany Reformed Labor Markets And Created A Pro-Growth Environment

WASHINGTON – In a [WSJ](#) op-ed piece, *Europe's Supply-Side Revolution*, by Donald L. Luskin and Lorcan Roche Kelly of Trend Macrolytics, (February 17, 2012), make predictions about the future of Europe so bright and so positive that they frankly border on absurdity.

Germany's example

As the writers put it, following Germany's example, Europe is bravely starting its own supply side revolution. Italy and Spain will turn into business friendly, market oriented countries. The discipline of debt is driving Europe to closer political integration. If Europe's countries could finally erase their political boundaries, their debt problems would also vanish. And so on.

Europe is stuck because there is no political will to reform

I must be looking at a different Europe. *I see a Europe that is not necessarily doomed; but a Continent that is stuck, precisely because there is no political will to do most of the things that the authors consider either a done deal, or so absolutely necessary that they become inevitable.* The implicit

assumption in this article is that Europe has had its moment of reckoning. Now it is “do or die”. And Europe chose to live –and live bravely, at that.

No “moment of truth” in Europe, just muddling through

But this is a major fallacy. This notion that Europe had only two choices: disaster and doom or vigorous renaissance, and that it (wisely) chose renaissance is just wrong.

The idea that at this juncture all the Europeans, having just stared into the abyss of the debt crisis, have irrevocably decided to finally do the right thing, is just fanciful. By the way, I really wish that it were so. But there is zero evidence to justify this optimism. My sense is instead that many European countries –and this would include all of Southern Europe– will just muddle through, with enough wisdom to avoid complete disaster, but insufficient political courage to really start the serious reforms the authors assume to be just behind the corner.

Political union a distant dream

As for this irresistible drive towards political unification starting with fiscal union, again, I must be looking at a different Continent. Political union is nobly advocated as a goal by many well-meaning Europeans. But it is a very, very distant goal, without any agreed upon road map and clear set of mile stones.

Sure enough, the Europeans recently agreed in principle to harmonize their fiscal policies in order to avoid a repeat of the debt crisis. But this is no done deal. And nobody has the foggiest idea as to how this generic agreement will become binding and, after that, how it will be implemented and monitored.

Germany succeeded, others will follow?

The op-ed authors premise is that since Germany could see the light at the turn of the millennium and embarked in serious labor market reform through which it regained economic vibrancy, it follows that the rest of Europe will see the value of such a historic change and follow suit.

Well, that would be wonderful. But it would entail a dramatic change of politics, psychology, ethics and business practices that, while possible in principle, cannot be taken for granted only on the basis that it would be the smart thing to do.

In Italy Monti wants reforms, but the country will not follow

Getting into specifics, to say that Italy's Mario Monti would like to liberalize and open the professions, introducing needed competition and that his heart is in the right place is not the same as saying that Italy is with him and that he will succeed. And, by the way, Monti's government plans to reform the "Workers Statute" caused the ire of the unions who are absolutely not on board on the critical issue of flexible contracts and more labor mobility –one of the key preconditions to attract investments and generate new enterprise.

Technocrat with no political base

And the authors should also know that Monti is an economics professor and not a politician with an organized following. He did not win any elections. He has no popular mandate. Late last year he was appointed as "chief rescuer", as a technocratic Prime Minister with the limited (and really unpleasant) job of extricating Italy from the pain of the debt crisis.

Monti came in as the trusted fire man with no political agenda of his own. He has done a good job regarding the stabilization of Italian debt. But, so far, he has done nothing to bring the national debt (now at 120% of GDP) down to the agreed Maastricht levels of 60% of GDP .

Besides, he has a limited mandate. Any serious reform aimed at making Italy a lot more like Germany would require broad and durable political agreement binding the left, the right and the powerful trade unions. Nothing like this ever happened in Italy. That does not make it impossible; but it makes it unlikely.

Corruption

And let me add that other factors do not inspire confidence. Italy has third world level scores regarding corruption, (according to Transparency International) and “easiness of doing business”, (according to the World Bank). Just days ago, Italy’s “Corte dei Conti”, something like a General Accountability Office, issued a scathing report regarding corruption and lack of ethics throughout Italy’s public administration. According to the report, this creates an environment that discourages investments, enterprise and therefore new growth. (Italy is now in a recession).

Demographic crisis

Add to all this a serious, systemic demographic crisis. Italy has one of the lowest fertility levels among developed countries, (1.38 children per woman). While the Italians stopped having children, there is the steady arrival of difficult to assimilate, poor and mostly illiterate immigrants from Africa.

Sure enough, all this can and, in fact should, change. But let’s not mix wishful thinking and reality. Monti may like to modernize Italy; but I am not sure that the country’s mood and long-term systemic trends support optimism about success.

If Southern Europe changed its values...

If the Southern Europeans –and that includes Italy, Spain, Portugal Greece and even France– really changed their values, their ethics and their business sense, this revolution

envisaged by the op-ed piece authors would take place.

But this is the same as saying that if the Indians were more organized and less corrupt, and if they put together a credible national infrastructure master plan, all kinds of good things would happen to India.

By the same token, if Angola's leaders were not corrupt, the vast oil and mineral riches of the country could do wonders to finance sustainable development, thereby lifting millions out of poverty.

And we could add that, if the Arab countries would finally understand that they should adopt modern, pro-growth economic policies, this would unleash new economic growth. And so on.

Good outlook for Northern Europe

Yes, Germany reformed labor markets years ago and we can safely assume that the countries of Northern Europe that have a stronger cultural affinity with Germany have already been positively influenced by this pro-business climate.

So we can expect Germany, The Netherlands, Austria, Sweden, Denmark and Finland, and may be a few others to do well. (I am not so sure about France, flirting with the idea of electing a Socialist President).

Southern Europe a different story

But I would not bet on these wise choices to be embraced by the rest of the EU members, whatever Britain may or may not do as the perennial dissenter among the 27 EU members.

Do not count on Southern Europe getting the medicine. And do not tell me that this going go down well in far less developed Romania, Bulgaria or Hungary.

Political union a distant dream

As for Europe finally becoming a federation, with one government, one army, and one foreign policy, this is not impossible; but it is so unlikely that it is indeed peculiar to read in this article that it is sort of a “done deal”, with only a few details to be ironed out.

Confused Republicans Will Have A Weak Candidate – Four More Years For Obama – Bad for America, As This President Has No Convincing Pro-Growth Plan

[the-subtitle]

By Paolo von Schirach

February 9, 2012

WASHINGTON – The confused and fractious Republicans appear terminally incapable of getting their act together, as the latest contests in Colorado, Minnesota and Missouri won by comfortable margins by conservative Rick Santorum show. By now it is pretty obvious: a large chunk of the rank and file GOP activists really do not like nor trust centrist Mitt Romney, while they foolishly look for a real conservative that would incarnate every possible sacrosanct principle and ideological bias they hold. In the end they may find one. Right now it looks that this champion may be previously overlooked Rick

Santorum.

Santorum will never get elected

But, while I find it hard to believe that Santorum will be nominated, I can be bold enough to state that he will never get elected. I just do not see millions of independents going for someone who seems to be better versed at preaching than at dealing with public policy. The believers may indeed like both the righteousness and the delivery. But, as they are a minority even within the relatively small universe of Republican activists, I doubt that there are enough of them in America to propel former Senator Santorum into the White House.

Romney is a weak candidate

But if Santorum does not get the nomination and bruised Mitt Romney is after all the man, he is looking weaker every day. How can a candidate with such lukewarm support within his own party have the aura of inevitability that will get millions of people, including many who voted for Obama in 2008, vote for him? Of course, as always, much will depend on the mood of the nation in the crucial two or three months preceding the elections. And, if something real bad happens and Obama becomes vulnerable, Romney may get lucky.

Four more years for Obama

Still, barring unforeseen events, as the pitiful economy slowly improves and with the enormous power and prestige of incumbency working for him, at this stage I would say that we should expect four more years of Barack Obama. And this will not be good for America. I say this without any partisan animosity. *It is just that Obama is not capable of fashioning a new national consensus around what America desperately needs, and that is vigorous and convincing pro-growth economic policies.*

Republicans: no deal with Obama

This may not be entirely his fault. I suspect that a large segment of the Congressional Republicans would rather see America sink than do a deal with Obama that might benefit him politically. And I also believe that this Republican animosity against this president is so visceral and so irrational, in part I suspect based on non confessed racist prejudice, that it cannot be watered down. (Remember that there is a sizable minority of Americans who really believe that Obama should not be president because he was not born here, while many others truly believe that he is a Muslim, and therefore "illegitimate" as a Christian nation could not possibly have a non believer as president).

Fairness is the wrong theme

On the other side of the divide, Obama is now locked in as the president who will fight for the struggling middle class and for the poor. He has firmly embraced and has been indulging in truly anti-rich populism. Bad enough if this is were just a gimmick to get him re-elected. But I suspect he believes what he says and this is truly unhelpful. By saying that America's main problem is "fairness" Obama shapes the national debate around the wrong theme.

Don't get me wrong, fairness is a real issue, just like the need to extend health care insurance a couple of years ago was a real issue. But as much as health care should not have been picked as "*the*" national priority, while the US economy was in a real mess, fairness is not the dominant issue when we need to kick start America's engine.

Picking the wrong priorities

True leadership is about identifying the most important thing and running with it. I am afraid that this president lacks this quality. The most important challenge facing America today is lack of growth and losing the innovation battle. And

I do not hear any of this from the White House. We hear a lot about caring for the poor and the unemployed. However, the fact is that the best cure for unemployment is not extending the safety nets but promoting vigorous growth.

Looking at a country still struggling to get out of a historically bad recession, facing an unprecedented growth of the national debt, while million of children get a truly bad public education, condemning them to menial jobs, I would say that economic revitalization, while going all out on public education reform, should be priority one and two and three.

Inability to create a coalition around economic growth policies

But this president, while saying a few good things here and there, has not managed to create the proper atmosphere leading to a grand bargain with the opposition that might have led to the creation of a better base for growth. In fact he has failed to the make the case even within his own party, now dominated by nervous law makers whose priority is the preservation of the welfare state with all the entitlements, while selling the silly notion that it will all be fine if the rich paid for it. Look, if we squeezed the rich we may get a few hundred extra billion in tax revenue. But you tell me if that alone would make a serious dent into a 15 trillion national debt that keeps growing.

Imagine a different scenario

But think instead of a different scenario. Roll back to December 2010 when the Bowles Simpson Report came out. Imagine that Obama had fully endorsed it, promoting it vigorously in Congress. Imagine if today we had in place a simplified flat tax system that would have eliminated loopholes and preferential treatment for special interests. Imagine if had in place a substantive deal about fair but meaningful entitlement reform affecting not the current retirees but

those still active, so that the whole world would know that America is serious about bending the cost curve, reducing the deficit and thus the national debt.

Imagine if had an agreement about energy and about a credible national infrastructure plan that could not be politically manipulated, whereby all the good projects would go to the districts of the most powerful law makers. Imagine if we had created a national consensus about public education reform. Imagine the impact of a credible national effort, based on smart public private partnerships to boost R&D across the board. This would be an entirely different country.

Public policy alone not a cure all

Look, good public policy would not be a cure all. But it would help set the tone and the national mood. If all these (sadly) imaginary reforms had been agreed to in a climate of genuine cooperation, this would have helped to create optimism and hope.

But instead we have nothing done and the prospect of more stalemate ahead, unless the Democrats win everything in November: the White House, the Senate and the House. Former governor Mitt Romney had tried to say that he really knows this stuff and that he would fix the economy. He's got the credentials. He can do it, or so he says. And, for all I know, he may have the instincts, the capabilities and the smarts to do it. But a president also needs to inspire and unite. And in the confidence department accident prone Romney does not appear able to do well.

Believing in "American exceptionalism"

And so, as I said, expect four more years of Obama, a president who once waffled when asked about his belief in "*American exceptionalism*". Corny as it may sound, genuine belief in "*American exceptionalism*" is an essential leadership quality. Exceptionalism is the distilled essence of America.

Belief in it provides the extra energy to defeat the odds and to come back from behind. Yes, I know, this is Hollywood stuff. But this is also the soul of America.

When Ronald Reagan talked about it it was contagious, because he believed in it. Whatever his shortcomings, and they were many, Reagan's contagious optimism, based on a sincere belief in America's resilience and energy, was probably the best policy ingredient he had. And it worked.

Is America In Decline? It Will Be Unless We Reform Entitlements, Education and Energy – Time To Reaffirm Faith In US As An Opportunity Society That Nurtures Innovators

[the-subtitle]

By Paolo von Schirach

February 6, 2012

WASHINGTON – Remember Yale historian Paul Kennedy and his 1987 tome *“The Rise and Fall of the Great Powers”*? At that time there was a lot of interest in, and indeed concern about his fairly comprehensive narrative focusing on how all major Western Powers, primarily because of the huge cost of

maintaining their Empires, suffered progressive economic decline and eventual decay. This had been Spain's fate, and Britain's –in Kennedy's argument– and this is where America was headed.

Spirited debate

The book sparked a spirited debate about the future of the US as the leading power of the last century. The combination of a sputtering economy, structural budget deficits, (compared to what we have today, then they were only "*200 billion a year deficits, as far as the eye can see*"), relentless Japanese competition and rising security expenditures necessary to maintain the American Empire would lead to national ruin, perhaps bankruptcy and thus to the inevitable –if sad–retreat from global ambitions.

The competitiveness issue

At the time, Kennedy's work contributed to a new self-reflective atmosphere that gave rise, among other things, to efforts aimed at investigating the soundness of the main pillars that sustain the edifice of America's might: a sound economy, high education standards, innovation and good governance. Think tanks, the Congress, and the Federal Government launched studies, initiatives and task forces on "*US Competitiveness*" –or lack thereof. The newly formed bipartisan Concord Coalition started warning Americans as to the structural damage caused by runaway deficits due in large part to the unstoppable growth of spending on entitlement programs.

Imperial overstretch

So, according to the conventional wisdom of the late 1980s, we were overstretched militarily because of Cold War security commitments, highlighted by the 300,000 troops permanently stationed in Europe as our most visible contribution to NATO, and by the questionable idea of spending billions of dollars

on the *Star Wars program*, the most unfortunate nickname attached to research in space based ballistic missile defenses, a concept that had its strong moment during the Reagan administration. Besides, we had lost our edge in economic innovation. We were assaulted by the Japanese bulldozer from the East. Most ominously, it seemed that we were becoming dependent on Japan for the supply of critical electronic components absolutely vital for our new weapon systems.

Japanese economic onslaught

This was the time, we should remember, in which the trade deficit was about Japan, not China; while Japanese conglomerates had started a buying spree in America that, according to many, including serious observers, had all the markings of a progressive take over of our economy.

Meanwhile, the "*Europe 1992*" agenda, the solemn commitment on the part of the then European Community to pull down residual internal barriers and create a brand new, vibrant market protected by an external tariff seemed to foretell a new era of economic primacy for the Old Continent, engineered behind the walls of a "*Fortress Europe*" that –it was feared– would exclude Americans.

Too much spending

Here at home, because of misguided fiscal policies and unhealthy personal spending habits, we –the Government and the citizens– were slowly but surely drowning in debt. (Nothing like today's debt. But this does not mean that, at the time, it was not serious. It only means that today we are totally unserious about the size of our much worse fiscal predicament. More on this later). That was the picture then. Indeed, it was the widely shared notion that the economy was on the verge of collapse, especially after the mild recession of 1991 that propelled technocrat Bill Clinton and his panoply of new,

original economic ideas, (never really implemented, by the way), to the White House.

Unexpected developments

But, in the meantime, the unexpected happened –on many fronts. November 1989 did not just give us the promise of eventual German reunification. It was the first shock wave that signaled the collapse of the Soviet Empire and thus the end of the only existential threat to US and European security. The final demise of the USSR was the justification to significantly cut defense spending and international commitments in the 1990s. This dramatic change, combined with a resurgent faith in small government, especially after the Republican revolution of 1994 masterminded by Georgia Congressman and then House Speaker Newt Gingrich, meant that runaway federal spending could be contained. In fact, the US enjoyed budget surpluses for a few years.

The IT revolution to the rescue

At the same time, without the support of any particular blueprint devised in Washington, the information revolution was unfolding. Rather than creating a *new economy*, as people were predicting, the massive adoption of IT by all businesses meant a massive leap forward for US productivity and competitiveness. With Bill Clinton in the White House and Robert Rubin at Treasury we had spectacular growth, year after year, record low unemployment and high tax receipts that combined with spending cuts gave us for the first time in decades a federal budget surplus.

Japan imploded, Europe lost steam

At the same time, without the US lifting a finger, most feared Japan, because of its social, rather than economic contradictions, fizzled. Europe also lost its luster. The predictions of the rise of a robust, innovative and economically powerful Europe proved to be quite wrong. And so,

we had the American roaring '90s: a prolonged period of US unchallenged economic primacy. Under president Bill Clinton the US was first in everything: innovation in high tech, creation of new employment, record productivity increases.

US glory days also faded

But it all seemed to have ended somewhat ignominiously with the beginning of the new millennium. Just as Clinton had left the scene, we had the dot.com bust, (do you remember when the NASDAQ was at 5,000?), accompanied by the Enron, WorldCom, Adelphia and other well known gigantic corporate scandals which ushered the Wall Street contraction and the ensuing long bear market. The 9/11 attacks, occurring during this downward spiral, certainly did not help, nor did the enormously costly military actions taken as a response to terrorism.

And then we had the horrible 2008-2009 recession from which we are still slowly emerging. While the combination of a real estate bubble and financial markets madness cannot be considered a systemic problem, the magnitude of this downturn has been so huge that it contributed to sink a country already weakened by high spending, growing debt and the considerable cost of the wars first in Afghanistan and then in Iraq.

Fast forward to 2012

And now, where are we now? There are disturbing signs that would indicate that Paul Kennedy and others were after all right in predicting decline. Only they were incorrect as to how close it was and what would trigger it. The root cause is not *"Imperial Overstretch"*, and not even the 2009 recession, bad as it was. ***It was and is the erosion of US competitiveness due to lack of investments in both human capital and needed infrastructure, accompanied by the unstoppable growth of entitlement programs.***

Sure enough, at this time we also have the cumulative cost of long conflicts. The prolonged Iraqi campaign just concluded at

the end of 2011 had become stupendously expensive. Afghanistan, whatever the final disengagement calendar, drags on. But, regardless as to one's own political opinion about the wisdom of both wars, these commitments would be economically affordable, provided a healthy US economy.

Wars, entitlements, low education standards

Indeed, while wars and years of increased Pentagon budgets are a drain on public finances at the expense of productive investments, by historic standards defense spending as a percentage of GDP is not high, in fact it is lower than what we had during the Cold War.

The real systemic problems are in the same factors that were identified 25 years ago, at the time of the "*competitiveness debate*", by most sensible analysts: a more and more expensive welfare state that cannot sustain itself financially, and the progressive erosion of the education advantage that had made America the principal player in yesterday high tech environment, now morphed into today's knowledge economy.

The large entitlement programs, especially Medicare, need to be reconfigured. If not, if we continue to affirm that large segments of the American society, mostly the elderly, have an inherent right to subsidized benefits that represent an excessive drainage of diminished US national resources, the federal government, assuming its continued commitment to finance these obligations at current levels, not only will have nothing left for productive investments, it will go bankrupt.

The secondary public education system, in turn, provides mediocre graduates, while the poor and minorities, on balance, do a lot worse than the already low average. It is impossible to sustain this increasingly complex economy without a dramatic improvement in the quality of the labor force. It is important to note that this problem was already identified as

a national crisis by the seminal 1993 Report "*A Nation at Risk*". Perhaps with some hyperbole, the authors argued that, if a foreign power had tried to impose on the United States the inferior public education system that we had chosen, we would have rightfully "*viewed it as an act of war*". Well, bad as the system was then, it has not improved much. The OECD sponsored comparative tests under the Program for International Student Assessment, (PISA), show US high schools students doing poorly in most areas and leading in none. Sadly, the Nation is still at risk.

Trade deficits

The fantastic explosion of the trade deficit is the manifestation of eroded competitiveness. The 40 billion dollar deficits that scared us about Japan in the 1980s are pocket change compared to the 220 plus billion that we have nowadays with China alone, (not to mention the increased cost of our energy habits: at 360 billion in 2010, higher than the trade imbalance with China).

Unfortunately, the argument on how best to rebalance our trade accounts has been successfully framed by a strange medley of simplistic romantics and demagogues who point the finger at the combined perils of free trade and outsourcing. By opening ourselves to foreign producers –so the refrain goes– we allow cheaper goods to come in. This means that US companies that have much higher costs go out of business or move overseas. Good American jobs go abroad because greedy corporations want to save money by having cheaper foreigners perform jobs previously held by higher paid Americans.

The solutions advocated? Essentially close our borders, so that the jobs stay in and the foreign goods out. In this new era of global and irreversible interdependencies, the notion that this way we shall be able to regain, maintain and for ever keep our supposedly God given infinite prosperity is bizarre; but, nonetheless, it has strong emotional appeal.

The bad side of globalization

However, if it is clearly futile to try and close our borders to keep cheap goods out or to prevent businesses from outsourcing, we still have a huge problem which is indeed caused by globalization. But not the globalization demonized by the protectionists. ***It is caused by the global spreading of the knowledge economy model developed first in America whose successful exploitation gave the US the edge for a number of years.***

The formula for US innovation may be replicated

We have to come to terms with the fact that the genie of IT innovation has been out of the Silicon Valley bottle for a long, long time. We cannot restrict inventiveness and entrepreneurship –the key components of the American success story– to the American soil. At least some of the key ingredients of a knowledge based economy are transferable and so, (despite many copy cat failures and other clumsy attempts), they are transferred elsewhere today and more so in the intervening years.

True, the 1990s triumph of America's reacquired competitiveness was due to a truly American innovation ecosystem that cannot all be easily reproduced. The lively, free wheeling, almost chaotic mixture of entrepreneurs, academics, venture capitalists and their interactions with established corporate entities that buy, absorb and invest in new ventures, as yet has no equivalent elsewhere around the world, in terms of depth and scope. But some of its elements can and will be replicated. No doubt, by trial and error, in time others will manage to produce adequately funded innovative clusters that will be able to quickly direct new discoveries to a hungry global marketplace.

Bangalore and more

The celebrated Bangalore example in India is illustrative. The

Indians have managed to create and aggregate in productive clusters world class human capital, (scientists, engineers, software programmers), and harness it effectively to competitive IT enterprises. To keep things in perspective, we should remind ourselves that Bangalore is still mostly about outsourcing and not much about innovation. Moreover, the whole Indian high tech phenomenon is only a small speck within a still primitive Indian economy which is constrained by horribly inefficient public administration, corruption and crumbling infrastructures. India has an enormous population that is still largely poor or very poor. So, the days of Indian high tech supremacy in the context of a nimble knowledge economy are still in the distant future.

High tech in poor countries

But Bangalore, Hyderabad, Chennai and other such examples in India and around the world will multiply, as more and more people gain access to higher education, IT literacy and other skills that cannot be kept within the West and America. The very information revolution unleashed by the American genius becomes the vessel that greatly expedites the transfer of knowledge that will create new centers of excellence where none existed before and thus the new challenge to America's leadership in innovation.

Furthermore, India illustrates how centers of competitive high tech can be established even without the fertile ground of an already developed economy that has already successfully dealt with creating a favorable macroeconomic environment. The Indian example proves that emerging economies can create islands of modernity that can compete on many levels with counterparts in advanced economies.

Eventually these new high tech enterprises, especially those established in business friendly developing countries where the cost of professional for many years to come will continue to be much lower than America's, are bound to gain world

market share, inevitably at our expense. If even a small fraction (as a percentage of the total population) of Indians and Chinese become good scientists, their absolute numbers will be sufficient to tip the balance.

US: stay innovative, move up the value chain

Our only hope to stay competitive is in continuing to invest in new technologies and new ideas so that superior innovative products and services will continue to be created in America.

But here we have a serious problem. Americans are so used to primacy that they do not believe that the ingredients that make it possible need to be nurtured, refined and upgraded, especially now that we are confronted with new, capable competitors that have the added edge of a lower cost structure.

For instance, it took the specter of bankruptcy for the ossified and slow moving, (no pun intended), US automobile industry to have a collective awakening. It took the prospect of extinction to get corporate managers and the unions to buy into a massive Washington funded and led rescue plan.

And remember that previous turnaround strategies announced by Detroit's managers were only partial and half-hearted. It took this near death experience to get people focused and moving.

Simplistic remedies for lost competitiveness

But for the rest of the economy we are still in the dark. While discussions about the negative impact of globalization abound, for the time being, not much in term of workable national policies aimed at strengthening US competitiveness. Unfortunately, to the extent that the general public has been brought into the conversation, it is fed gross distortions and oversimplifications.

The simple explanation is that we are losing ground because the others (read China) cheat and Washington does nothing to stop this. The conversation is mostly on allegedly bad trade policies and greedy corporations that outsource good American jobs. If we could only change Washington's direction on trade, policy all will be well. Indeed, the debate is mostly about identifying culprits and quick fixes. So, according to these critics, beyond Washington's international trade policy incompetence, (close to treasonous behavior), the enemies are the Asians, (yesterday Japan, today China), who do not play by the rules, and the illegal and legal immigrants who steal our jobs while depressing US wages. This sort of populism may work with many constituencies in hard economic times; but it explains nothing about the causes of our ailments and its remedies would cure nothing.

Systemic problems

The reality is that we have structural, systemic problems of our making that need to be addressed now, so that we can begin to change course and hopefully improve our conditions for the long term. While the misbehavior of others is real, (think of Chinese exploitative low wages, their undervalued currency and their disregard for intellectual property rights; think of the Mexican government actively encouraging the emigration to America of the their country's surplus labor), there are inherently domestic structural deficiencies that slow down America and that have eroded its ability to compete. ***To name a few critical ones: a deteriorating education system, the unsustainable cost of the welfare state and the lack of a serious energy strategy.***

Attracting talent: Europeans

Clearly America's soft underbelly is a mediocre to bad secondary public education system right at the time when others are improving their own standards. For a long time America's high quality public education had nurtured domestic

talent while, by design or by default, the US was able to attract first class minds from around the world. Think about the massive intellectual migration to America from Nazi occupied Europe. After all, Albert Einstein, Enrico Fermi and Edward Teller were not Americans. But they were welcomed in America, and the American intellectual and scientific environment was able to absorb their uncommon talent and greatly benefit from it. Hard to think of the Manhattan Project and the US Atom bomb without the intellectual contribution of all these high quality immigrant.

Attracting talent: gifted Asians

In more recent years there has been a significant influx of gifted Asians. More than 50% of the prestigious Ph.D degrees in science and technology are now earned by foreigners. A vast percentage of high tech start ups are led by foreign born, mostly Asian, entrepreneurs. But now the pull of America is not as compelling as it used to be, in the light of the fact that good opportunities are developing elsewhere in Asia. And this is a problem. America used to be "*the magnet*". Reclaiming that status should be a primary objective of public policy at all levels.

Low education standards

At the same time, it is now apparent that the American public education system, the incubator that should nurture the future scientists, engineers and entrepreneurs, is at best mediocre, deeply flawed in its worst components and certainly inadequate to create the world class work force that will have to compete on quality, as we operate in a high cost economy. The existence of several world class American universities is not sufficient to guarantee that the broader US workforce will be able to compete with increasingly more sophisticated foreigners. A sub par work force will make it difficult to compete, let alone strengthen, our positions in high value, strategic areas.

Of course, America is far from being finished. American resilience if not always primacy in high value, technologically complex industries, (think of Intel, Apple, Microsoft, IBM, HP, GE, 3M, Monsanto, United Technologies, Caterpillar, Boeing among many others), show that, despite higher labor cost, superior quality, when it can be reinforced by constant refinement, still counts.

By the same token, we still have an edge in services, (FedEx and UPS, come to mind). But this is entirely dependent on the continuous waves of IT innovation. The day we can no longer be at the forefront of IT, because we can no longer compete with increasingly more competent but much cheaper Indians and Chinese, we shall have lost the competitiveness contest. And it would be unwise to count on the narrow edge provided by a few great schools fed by a relatively small pool of quality US students coming from private schools. America needs to restore high quality public education so that we can broaden the base and nurture human capital.

Entitlement reform

Much has been said about the increased welfare costs due to the demographic changes that America is experiencing, along with most other developed countries. The core question is whether it is smart public policy, in the long run, to have a central government whose main function is to distribute benefits, at the cost of everything else.

Even now, while immediate solvency is not an issue, the federal government devotes smaller and smaller portions of its resources to productive investments, given the overwhelming weight of the entitlement obligations that represent about 60% of overall federal spending. All projections indicate that, if do not bend the cost curve, in the future this is only going to get worse.

Serious reform deemed politically explosive

That said, as the current political debate shows, it is clear that trying to take something away from people who believe that they have “*earned*” subsidized health care and subsidized Social Security in their old age is extremely hard. But there is an opportunity cost in spending most of our revenues on welfare and little on competitiveness enhancing investments. Unfortunately, nobody really tries to show the thousands of research projects or new infrastructure that could be financed by the federal government, with long term broad based gains for America, assuming a substantial reduction of entitlement programs costs.

No energy strategy

The energy picture is also bad, even though somewhat improving, given increased fossil fuels discoveries in the last few years. The shale gas revolution, with massive amounts of new natural gas coming on line, (Marcellus shale, among other places), is a real game changer. Likewise, shale oil production in places like the Bakken basin in North Dakota will contribute to a larger domestic production that will help cut imports. And then, of course there is renewable energy.

But with all that, the US still lacks a comprehensive energy strategy that would encourage oil and gas production, conservation and higher efficiencies, especially in the transportation sector, in the near and medium term, while boosting R&D in renewable technologies for the longer term.

If we look at oil, despite increased domestic production, we still have excessive consumption, and a huge dependence on oil imports that is financially burdensome, (bigger than our trade deficit with China), while it creates a constant and worrisome strategic vulnerability. (In this respect it is important to note the Navy Department ongoing effort to develop reliable renewable energy supplies for all its needs. This is all about diminishing a well known strategic vulnerability).

America needs more than the tinkering provided by this or that pork laden energy bill. It needs a bold new *energy strategy* that would set realistic goals regarding long term alternatives to hydrocarbons. For the short and medium term, we need a good balance between encouraging US hydrocarbon production and increased imports from Canada, while actively discouraging consumption through revenue neutral gasoline taxes stay could be progressively phased in. For the long term, we must have cost effective renewable energy sources that will eventually replace hydrocarbons. In doing so, America would free itself from the straightjacket of imported oil, while possibly becoming the world leader in key new technologies related to alternative energy.

No political consensus

But in all these areas: education, welfare reform and energy, while there is a debate and many have offered sensible solutions, we are far from having reached the deep shared understanding that is the prelude to decisive action. In fact in Washington, while experts may discuss, policy makers are not involved. At this time, there is no productive debate on any of this. Potential platforms for credible bipartisan solutions, such as the Bowles-Simpson "*Debt Commission*" December 2010 Report, have been abandoned because of lack of political support.

Toxic political climate

Unfortunately, the now unfolding national political campaign is fiercely adversarial and this a bad omen for finding the bipartisan common ground that historically is always needed to engage in major reforms. Besides, while many are really worried, many others are led to believe that things are more or less fine and that we have enough slack to muddle through. And so, we hail 8.3% unemployment rates as great news, while we dismiss a 15 trillion national debt, since for the time being the US has no problem finding lenders that will gladly

finance this debt at historically low interest rates.

None of this looks good. Even if we want to assume that soon we shall be past the nasty consequences of the *Big Recession* of 2009 and that we shall be back to where we were in 2008, before anybody had heard of sub-prime mortgages, let's keep in mind that that was not a particularly good place to be. ***The real point is that America's overall dynamism had already been eroded before the recession hit us so hard.***

Coming defense cuts

Overspending in entitlements with consequent cash shortages for everything else has already forced the Pentagon to plan significant defense spending cuts. Some of them are on the table. More details will follow with the new federal budget that will be presented in just a few days. These defense cuts will inevitably translate into reduced operational capabilities and eventually into reduced American influence. Defense cuts, combined with social programs as the bulk of US federal spending, less money for innovation and lower education standards taken together do not paint a pretty picture for the country that only 20 years ago, after the demise of the USSR, was the unchallenged superpower.

Passive attitude

In hindsight, similar historic circumstances, characterized by a passive attitude that in effect allows the almost mindless sliding into national decay are ascribed to a state of mind of myopic denial and complacency affecting people who have lost their way. But this is usually the verdict of historians. And, when they pronounce it, it is too late to change anything. Among historians, important to single out Arnold Toynbee. Having studied human developments all his life, his observation was that civilizations do not die because of foreign invasions, famine or natural catastrophes. They end because they lose their sense of purpose and the will to go

on. In a word, *they commit suicide.*

Reaffirming America as Opportunity Society

This is the bad news. The good news is that, since much of America's unpromising predicament depends on our state of mind, it is obvious that our minds can be changed. But for that to happen, we should need a believable, collective reaffirmation of America's unique brand of dynamism. Unique brand because it is grounded in a genuine *Opportunity Society*. This is what differentiated the American Republic from socially stratified Europe.

And opportunity is what made America immensely attractive to all who wanted to try something new. Reaffirming an *Opportunity Society* means recreating at a national level truly pro-innovation and pro-enterprise public policy, with good quality public education and basic services for all as the foundation on which to build it. Time to unleash American ingenuity, and time to work on non ideological, fact based, sound public policies that will sustain it.

The Greek Crisis Drags On – Europe Should Cancel Most Of Athens' Debt – An Insolvent Country Cannot Pay Back A Crushing Debt And Have A Hope

To Grow Again

[the-subtitle]

By Paolo von Schirach

February 5, 2012

WASHINGTON – What is most amazing about the Greek debt crisis is that more than two years into it, (it all started in the Fall of 2009), the European Union has not managed to take care of it. True enough, the Greeks bear full responsibility for getting themselves into this financial abyss and for being recalcitrant counterparts, largely incapable of understanding that the old ways of not working much, not paying taxes and still expecting public services and a good standard of living are gone. Still, it is inconceivable that the other 26 members of the European Union, a grouping of nations with a combined GDP larger than America's, have been unable to resolve, once and for all, the troubles, deep as they are, of one of its middling to small members.

How big a hair cut?

The issue at hand today is the inability to impose a dramatic loss to private holders of Greek debt. While everybody agrees that there must be a "hair cut", the sticky issue is how big a hair cut. And this matter that is both financial and political drags on and on. And it is not that everything else is settled. The Greek economy, while benefiting from a variety of lines of credit, is on respirator, while it keeps shrinking, year after year. To get out of this horrible mess, the Greeks need not just some cash to stay afloat. They need some kind of credible pathway to new economic growth. And it is not clear that one has been delineated. Certainly not by the wobbly coalition supporting the recently installed technocratic government headed by Lucas Papademos, himself an economist and a former Central Banker. And the EU partners are not doing any

better. They should recognize that the people of a virtually bankrupt country committed to more and more austerity have neither the resources nor the will to go back to work.

Why so difficult for a 15 trillion EU to deal with tiny Greece?

But let's look at the actual dimension of the problem by considering the larger context. The EU of which Greece is still a proud member has a combined GDP of about 15 trillion dollars, just about the size of the USA. Sure enough the parallel ends here. The EU is not "A Country". It is an arrangement among many countries. Their combined wealth, while the largest in the world, cannot be mobilized that easily. Still, in comparison, Greece has a GDP of only 300 billion dollars, smaller than Singapore, a tiny city state. And if we look at the EU leading countries, Germany, The United Kingdom and France have respectively the 6th, 9th and 10th largest GDP in the world. Greece is number 41 in the world rankings.

Is it really possible that the EU as an institution and within it its most formidable members, (the UK is not part of the Eurozone, but surely it must have an interest in its stability), have not yet managed to close a two year old problem affecting a relatively minor EU member? Well, yes, it is possible; because the EU has weak institutions, while its key members are not unanimous on anything.

Greece both insolvent and declining. The GM analogy

In the end the Europeans will have to recognize that Greece is an insolvent country trapped in an uncompetitive economy that simply cannot be re-energized while at the same time servicing a gigantic (even if now diluted) debt. As nobody wants to see a Greek bankruptcy, fearing that a disorderly solution would have unpredictable ripple effects, then what do you do? Well, you force all creditors to take a big hit, *I mean a really big hit*. Forgive me an analogy that may be questionable, but this

is what the US Government did with General Motors. Sure enough, in 2009 Uncle Sam stepped in with big money, but the key point here is that a *de facto* bankruptcy allowed GM to get out of most of its pre-existing obligations, financial, contractual, with the unions, and so on. And so, with Washington's critically important help, a leaner and unburdened new GM could come to life. And now it seems that a reborn GM will be quite capable to function without government crutches.

EU weakness worse than the Greek crisis

We need the GM equivalent for Greece. Right now, all creditors and most of all all key EU policy makers have to realize that Greece is both insolvent and declining. If bankruptcy is unacceptable because of its messy consequences, then the only hope is to give Greece a truly fresh start. And this means debt forgiveness, just like we used to do with messed up third world countries. No use demanding money that cannot be produced. The never ending negotiations between Greece and its private creditors unfortunately indicate that we are not yet at the point of a realistic political consensus on any of this.

At some point some deal will be struck, I suppose. But the way the never ending Greek Tragedy has been handled is an indication of Europe's internal confusion and consequent lack of resolve. And this inherent EU weakness may be even worse than Greece's problems. Europe revealed itself to be nothing more than a turbo-charged Chamber of Commerce, with no idea of how to deal with crises.

Panetta Announced Early End Of US Combat Mission In Afghanistan, And the Strategic Rationale Is...? Not Clear At All – It Looks As If It Is Driven By The US Political Calendar: Better To Go Into A National Election With A Promise To End A War

[the-subtitle]

By Paolo von Schirach

February 4, 2012

WASHINGTON – What a mess in Afghanistan. Given the high cost of what very charitably could be called an expensive and inconclusive stalemate, it is really surprising that president Obama has not been damaged politically by a war effort with no focus and no end game, except for a politically driven withdrawal schedule, (now moved up), that may have very little to do with conditions on the ground.

No political damage from Afghanistan

May be Obama is relatively unscathed because the US is not suffering the heavy casualties that killed political support for George Bush's war in Iraq. Besides, unlike the Democrats regarding Iraq, the Republicans in general support the war in Afghanistan. And so this conflict, unlike domestic issues, has

not been politicized. Even right, now, as the Republican primaries progress, no one has openly attacked Obama on Afghanistan, except for Texas Congressman Ron Paul, whose isolationism while popular among Libertarians is certainly not main stream among Republicans.

Huntsman: Us focus should be on counter terrorism

There was of course former Utah Governor and former US Envoy to Beijing Jon Huntsman. He did say that we had precisely the wrong strategy in Afghanistan. He did argue that our large and expensive deployments have very little to do with our primary objective of degrading international terrorism capabilities. But, of course, Huntsman candidacy for the GOP nomination went nowhere and he is now a distant memory.

Surge, McChrystal, Petraeus

So, what is the stay of play in Afghanistan? Just a few facts. Obama ordered a surge of about 30,000 US troops at the end of 2009 to turn things around and crush the reborn Taliban insurgency. Pentagon chief Bob Gates fired the previous Commander and sent in General Stanley McChrystal to lead the effort. But then Obama had to fire McChrystal because of very inappropriate and offensive remarks made by the General about administration policy-makers in the course of interviews that ended up in a Rolling Stone article in June 2010.

So, out goes McChrystal and in come Petraeus, the anointed hero of the Iraq surge. And what did Petraeus accomplish? Not much. And now Petraeus is gone. He retired and left the Army. He went on to be CIA Director when Leon Panetta conveniently vacated the post to go run the Pentagon after Robert Gates left the job.

SecDef Panetta: withdrawing combat troops sooner?

And now it comes out that Panetta, in a sort of "by the way" fashion, semi-announced that the US heavy military involvement

in Afghanistan may end in 2013 and not in 2014, as officially stated. And this is because...? *Because we are winning? Not by a long shot.* Because the European Allies will be doing more? Not even the slightest chance. The French just got 4 unexpected casualties and used this bad news to announce that they may leave early. (Yes, you read that right. It is 4 French soldiers killed. Tragic as this is, it is not 400. And not even 40. These days 4 dead soldiers can force governments to rethink security policies. Think of that.)

Special Ops will take over?

So, what is America's new approach to the war? Anonymous Pentagon sources fed stories whereby conventional US forces would leave Afghanistan earlier than planned, while Special Forces, perhaps beefed up some, will carry on with search and destroy missions against the Taliban, while training the Afghan Army. Interesting. Isn't this what Huntsman had recommended? Well, close. The difference is that Huntsman was talking about policy clarity, the Pentagon seems to be acting under political pressure.

Is this about the presidential elections?

This is largely guess work. But it may very well be that Obama would like to go into the November 2012 general election with a cooked up plan for early withdrawal from Afghanistan. So, just like he did regarding the US leaving Iraq, he will be able to claim that it is good news that US forces leave distant lands, so that we can get on with "nation-building" here at home. On the campaign trail, this may have a good ring. But it really makes one wonder as to what these people have been doing all this time regarding this most critical war and with what ends in mind. (For whatever it may worth, please remember that then candidate Obama in 2008 chastised George Bush for the Iraq war, a costly distraction that made the US lose sight of Afghanistan, where, according to Obama, we had a real strategic interest).

US should have had a counter terror goal from day one

I have said this before. A large US involvement in Afghanistan is a losing proposition on any good day. The country is too poor, too rugged, and too large. Afghanistan cannot "be fixed", and it cannot even be managed, short of a massive occupation force and a grand plan to redo the whole country over decades. The US never had the resources or the stamina to do any of this. The US key national security objective should be to make sure that Afghanistan will not be used again as a terrorists sanctuary and as a staging ground for terrorist operations against the US homeland and/or against key strategic targets around the world.

In an ideal world it would be nice to place counter terror operations within a broader, comprehensive approach aimed at reforming and modernizing Afghanistan. But the fact is that this way too complicated, given the country's extreme backwardness.

Rationale behind the policy shift?

So, now it seems as if the Pentagon may finally pursue a more targeted campaign, based on Special Operations forces. But one wonders how they got to this point, and why it took so long. Has there been serious rethinking about tools available and objectives? Or is it that, after all these years, it is..well, you know...just time to go?

Do we go to war, (with all the immense costs associated with such an undertaking), to accomplish anything, or is it just a mindless undertaking that at some point ends because we lost interest, or because the president does not how to explain our goals to a worried public? Is this confused reshuffling about a 10 year war the best that the country that spends more than any other than in the world on national security can produce?