

# No Serious Discussion About Entitlement Reform In The U.S.

WASHINGTON – Much has been said about the first Trump budget recently released. The expected partisan critiques –in fact outcry– focus on proposed cuts in Medicaid and disability benefits. Therefore, this becomes a “cruel budget”, an open attack against weak, low income Americans, and so forth.

## No discussion about Entitlement Reform

Well, this may be true. However, the biggest problem with this proposed federal budget, (and with many budgets that preceded it, coming from both Democratic and Republican Presidents), is that –leaving aside symbolic fights– it is a reflection of an unchanged (unchangeable?) fiscal *status quo* that will stay pretty much the same until the American political leadership –Democrats and Republicans acting together– will finally address its **Number One Policy Priority: Entitlement Reform.**

## Symbolic cuts

The Trump Budget, even assuming that it will be passed by Congress as is, (it will not), will never “solve” the structural fiscal imbalance –namely: permanent high deficits– that has regrettably become the norm in America. You may indeed cut spending for the State Department, the Education and Energy Departments, and more. You may reduce Medicaid and the Food Stamps Programs. But none of this would really “bend” the overall spending curve. Hence the deficits and a growing national debt, soon to be out of control.

How so? Very simple. Anybody who has given even a mildly serious look at U.S. Federal Budgets notices a trend. The main drivers of (over) spending are large and growing federal

entitlement programs that are not even voted on. They are on automatic pilot.

### **Social Security and Medicare bigger than ever**

The fact is that these programs (first and foremost Social Security and Medicare, accompanied by many other smaller federal assistance program), have become so large that now they comprise almost 2/3 of total federal spending. If you add to this colossal total another 16% of overall federal spending devoted to national defense (sounds like a lot; but in relation to GDP defense spending is historically quite low), plus about 6% of total outlays that have to be set aside for debt service, (this is about paying interest on all the debt we have accumulated until now), and you realize that there is almost nothing left to squabble about.

Indeed, “the rest” –what the budget professionals call “non defense discretionary spending”– is less than 15% of the total. Since the bulk of all spending (with the exception of defense) is essentially off-limits, all the budget battles are fought on this residual 15%.

Which is to say that, unless we want to entirely abolish most of the U.S. Government, (Agriculture, Justice, Transportation, money for NIH and medical research, NASA, and more), we cannot possibly change the present pattern of spending without seriously looking at entitlement reform, with the goal of reducing future outlays. Since most of the real money goes to these programs, they should be reformed so that there will still be benefits for seniors in the future, but sustainable benefits. Simply stated, for social programs to work in a sustainable way, in the future most Americans will get less.

### **Everybody knows this**

Again, every student of US public policy, beginning with House Speaker Paul Ryan, (He used to be Chairman of both the Budget and later on the Ways and Means Committees), knows all this.

***And yet, for fear of causing massive social unrest, nobody –Republicans and Democrats– want to go even near the entitlement reform issue. The topic is worse than a non starter. It is almost unanimously viewed as political suicide.***

Not straying from the conventional wisdom, as a candidate, Donald Trump promised that he would leave all key federal entitlements untouched, claiming that these benefits have been earned by individual Americans, and therefore they should not be messed with. A very conventional approach.

### **“The Moment of Truth”**

A few years back, (2010), President Barack Obama convened a special bipartisan commission (it became known as the “Debt Commission”) that was chaired by Erskine Bowles (Democrat) and Alan Simpson (Republican) in order to give a serious look at the issues of taxation and spending.

These two elder statesmen took the lead and eventually issued a powerful report in December 2010 aptly titled “*The Moment of Truth*”. They, and most of the members of their Debt Commission, argued convincingly about the need to seek and find broad bipartisan support for a thoughtful plan aimed at reforming entitlement programs that had been designed in another era with different demographics (starting with life expectancy, much shorter at that time), and much lower health care costs. They pointed out that, if we change nothing, we are headed towards financial ruin.

They argued intelligently and convincingly. But nothing, absolutely nothing happened.

### **No action**

As it turned out, President Obama (even though he created the Commission) did not want to tinker with issues viewed by most political insiders as “radioactive”.

The Tea Party Movement, at that time growing in national popularity, was led by amateurs who understood practically nothing about the real dynamics of public spending. Their home spun wisdom was that America's run away public spending and ensuing annual deficits, were all due to "fraud, waste and abuse". As simple as that. Their remedy? Eliminate silly programs and politically motivated earmarks, tighten the system, punish a few offenders who get benefits via false claims, and all would be fine.

Well, it would not be.

Given the overwhelming and growing weight of federal entitlements benefiting mostly senior Americans, you could abolish the entire Defense Department and you would still not be able to alter the overall pattern characterized by over spending and perennial budget deficits.

### **Spending favors senior citizens**

Simply stated, in America, just like in most other rich democratic countries, there is now an unwritten social contract whereby large and increasing amounts of national resources are devoted to assistance to the sick and to the elderly.

***The problem is not that the priorities are wrong. The problem is that this level of assistance has become unaffordable, because it is no longer matched by revenue. Hence our annual deficits that add to the already exploded national debt. Of course, we could raise taxes in order to rebalance the federal deficit. But this would mean significantly "higher taxes", another radioactive issue that no mainstream politician wants to address.***

### **More debt is the path of least resistance**

So, here is the thing. Politicians want to keep doling out large entitlement benefits. But they do not want to tell the

country that there is not enough money to pay for them. Instead, they have chosen the path of least resistance: use most of the federal revenue to pay for the entitlements, this way starving the rest, and borrow the balance.

This may look clever in the short run. But this approach means that we are well on our way to becoming Europe or Japan: societies with enormous public spending and huge national debts that simply do not have any resources to invest in their own future.

Let me say this clearly: these are societies headed towards decline. In fact, some of them are already beyond repair, mostly due to the impossible fiscal burdens represented by gigantic national debts.

### **Where are we headed?**

Well, unless we want to become the next Italy or Japan, we need a serious conversation about the level of future federal benefits. This does mean *"throwing sick grandma in the snow, in the middle of winter"*. But it surely means readjusting benefits so that, going forward, we take care of the neediest first, while all the others will get smaller benefits, and later in life.

Anyway, all this is purely theoretical. The current budget debate, with all its theater of partisan acrimony, posturing and grand standing, does not even begin to address entitlement reform. And this means that what we are having is not a serious, adult debate. This is mostly rubbish.

### **We need a serious debate**

The American people deserve national leaders –in both parties– who will tell them the truth about what we can afford going forward, and how we can and must share sacrifice, (fewer benefits, higher taxes, at least for some), in a fair and equitable manner.

This is what mature political discourse in a republic should be about. But nobody wants to even think about it.

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# America Needs Good Pro-Growth Structural Reforms

**WASHINGTON** – After the August 24 sell off, there was no real bounce back. The US stock market regained some ground, but only some. Still too many uncertainties for investors, I guess, from the Fed and its decisions on interest rates to the real global ramifications of the Chinese sudden and somewhat mysterious convulsions.

## **Put our house in order**

Alright, enough of that. Forget about markets. The smart thing for America would be to begin –right now– to put our own house in order. In order to do so, we need to focus on at least three major areas:

### ***1) Fiscal and Tax Reform***

### ***2) Deregulation***

### ***3) Public Education Reform***

## **Fiscal reform**

On fiscal and tax reform, Washington had a great opportunity to start the process back in December 2010, after the release of the final Report by the **National Commission on Fiscal Responsibility and Reform** headed by Erskine Bowles and Alan Simpson, (it was also known as the “Debt Commission”). The bipartisan Report, (endorsed by the majority of the Commission

members), was aptly titled *"The Moment of Truth"*. It provides a good start on a process eventually leading to entitlement and fiscal reform. It is a genuine bipartisan effort led by two credible, experienced national leaders, a Democrat and a Republican. Granted, it is not comprehensive. It does not seriously address health care policies. But, there again, it was a good faith attempt to get things moving. It was a very good start.

Well, President Obama looked at the Report, thanked the co-chairmen and essentially discarded it. Notwithstanding subsequent political upheavals, Tea Party activism, Republican congressional victories and more, we have made zero progress to reach the needed political agreement on reform. And yet real fiscal reform that would have to include a major overhaul of the large and soon unsustainable entitlement programs (Social Security, Medicare and Medicaid) is essential.

### **Necessary**

Let's be clear. This reform is no guarantee of long term economic growth. But it is hard to believe that we are going to go very far while America will carry the weight of an enormous debt burden. Look at anemic Japan. Is this where we want to go?

Same for tax reform. America has an absurdly long and complicated federal tax code. We have the highest corporate tax rate in the developed world. This is not good for business.

(It would be nice to see some serious discussion about these issues in the unfolding campaign. This would be more substantive than stupid polemics about "anchor babies").

### **Deregulation**

Ditto for deregulation. When concerns about regulatory compliance become the overriding daily preoccupation of

business owners, we have a real problem.

Regulations should be about establishing and enforcing reasonable environmental, work safety and public health standards. But now we have gone way beyond that. The attempt by the US Environmental Protection Agency, EPA, to essentially outlaw coal-fired power plants (and more) by regulatory fiat, on questionable legal grounds, is just the latest illustration of this.

### **Education reform**

And finally public education. This is after all and will be the *"Knowledge Economy"*. In this new world, If you do not have a good education, you are done. If you do not know much, if you do not master sophisticated skills, you simply do not have the entry ticket. Period. No way to have access to good jobs. You will be relegated to the lower echelons of society. No prayer to become "upwardly mobile", as we used to say.

Slice it the way you want, but if we do not get serious about drastically improving American public educations standards, at least half the country, the half that cannot afford private education and live in poor neighborhoods, will be left behind.

### **We need an action plan**

This is what needs to be done –today. Forget about Wall Street gyrations. Let's get busy and rebuild the solid fundamentals of a world-class, truly competitive US economy.

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**Senate      Finance      Committee**

# Chairman Ron Wyden Proposes Corporate Tax Reform

WASHINGTON – In a clear and totally non-partisan WSJ op-ed piece, (*We Must Stop Driving Businesses Out of the Country*, May 9, 2014), Senator Ron Wyden, a Democrat from Oregon, and Chairman of the Senate Finance Committee, makes a case for comprehensive corporate tax reform.

## **Tax avoidance drives business decisions**

In his piece he points out that many large US corporations make significant foreign acquisitions mostly for tax avoidance (better to say tax evasion?) purposes. The latest headline is about the US pharmaceutical giant Pfizer buying UK-based AstraZeneca, so that it can “relocate” to the United Kingdom for tax purposes.

Indeed, if a US corporation can legitimately claim that 20% or more of its stock “is owned by their new, foreign partner” the same corporation can shift its tax domicile to the country where the new subsidiary is located, usually a country with a lower corporate tax rate. This way, in a totally legal way, a large US corporation can cut its tax bill.

Of course, this should not happen. And Wyden pledges his intention to introduce legislation that would close this loophole.

## **US corporate tax rates are too high**

However, at the same time, Wyden recognizes that US corporations are exploiting every possible “legal” avenue to escape from a very heavy US tax burden.

Yes, America, the cradle of capitalism, has one of the highest corporate tax rates in the world: 35%. We know that in many

cases this is largely theoretical. Many companies pay much less, or (in some instances) very little, or nothing at all. And this “magic” of a low tax bill despite a high tax rate is due to a jungle of special provisions, tax credits, dispensations and loopholes, incomprehensible to most, that allow many corporations, depending on the sectors they operate in, to pay less.

### **Lower rates, no loopholes**

Without getting into the impossible details of the monstrosity of the US tax code, Wyden proposes a simple, common sensical, approach. Let’s lower the US corporate tax rate, while at the same time eliminating all the loopholes and special treatments for this or that sector.

This way US corporate taxation will be more in line with prevailing rates applied by other developed countries, (about 25%). And this would mean that US corporations would not be incentivized to pursue business strategies that are in fact mostly, in certain cases entirely, tax avoidance strategies.

Indeed, in an ideal world, the allocation of scarce capital should be driven by business factors and not by calculations of tax advantages. I fully agree.

### **“Debt Commission” had a similar approach**

Going back just a few years, (2010), the “Debt Commission” co-chaired by Republican Alan Simpson and Democrat Erskine Bowles had the political courage to come up with a decent federal spending reduction program matched by a comprehensive tax reform plan. It all made perfect sense. It was a good starting point, that had at least some measure of bipartisan support.

But nothing, absolutely nothing happened, in large part because President Obama essentially distanced himself from the findings and recommendations of the Simpson-Bowles Commission.

What Senate Finance Committee Chairman Wyden suggests now is more limited in scope but essentially in line with the approach that inspired Simpson-Bowles: lower the tax rates, broaden the tax base and eliminate all tax favors to this or that sector. This would be good for the economy, good for the US Treasury and good for individual businesses, especially small and medium-sized companies that would no longer have to spend inordinate amounts of time and resources on tax issues. Everybody would pay, but not too much.

### **Good idea, (whose time has not come)**

All this makes perfect sense. Wyden is not in the pocket of this or that interest group, nor is he trying to mount a populist anti-business crusade that may resonate with the ideological left.

He is proposing common sense. Well, you would think that the traditionally pro-business Republicans would respond enthusiastically. But I doubt it.

### **Special interests dominate US politics**

And sadly this is because behind the *"We-are-the-fearless-defenders-of-free-market-capitalism"* label, many Republicans (and Democrats too) are subservient to the wishes of the armies of lobbyists permanently encamped in Washington DC.

The lobbies and the powerful economic interests they represent are largely responsible for the grotesque US tax code, with all its ultra-complex and in fact impenetrable layers of special provisions. They are experts at pushing this or that "provision" (often worth hundreds of millions of dollars) at critical times, in sometimes obscure pieces of legislation nobody really understands.

### **Corporations, lobbies and campaign finance**

The ugly truth is that, while the US economy as a whole

suffers because of this ghastly hodgepodge of dispensations and special credits, many economic sectors benefit from it. And so they will fight tooth and nail to keep things as they are. And, of course, at election time, money talks. Elected representatives need vast and always larger sums of money to finance their re-election campaigns. Directly and indirectly, corporations are a major source of those needed finances.

### **Dysfunction is now system**

So, here we are. In large part because of our dysfunctional politics, we have elevated tax dysfunctionality to system. We say that America is the best place in the world to do business, while in fact we have created a tax and regulatory environment that pushes US corporations to relocate their headquarters and/or key operations abroad.

### **Sensible ideas will be ignored**

Ron Wyden, a fair-minded Democrat, proposes sensible reforms. But I doubt that he will find enough allies –Republicans and Democrats– to make something happen. In order to cut the Gordian knot of the absurd US tax system, we need a new political consensus.

Yes, we need to rediscover the simple truth that the job of people sent to Washington is to pursue the “common good”, as opposed to electing Representatives and Senators who will respond mostly to the demands of special interests.

Sadly, I do not see this “back to basics” (but in essence revolutionary) transformation coming along.

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# **America Stagnates – Global Competition And Lack Of Pro-Growth Tax Policies Stifle The Economy – Urgent Need Of Policy Changes; Will The President Lead?**

[the-subtitle ]

**By Paolo von Schirach**

February 7, 2013

**WASHINGTON** – The American economy has yet to recover from the spending binge that led to the 2008-2009 financial collapse. Simply stated, most American households are spending less as they are trying to pay back the debt they accumulated during the go-go years. And they are doing so while their homes (housing recovery notwithstanding) are worth much less.

## **Painful de-leveraging**

As US GDP is driven mostly by consumer spending, thrifty consumers are bad news for the economy. Hard to say how long it will take for this painful de-leveraging process to lead to more acceptable levels of household debt, an essential precondition for higher level of consumer spending in the future.

## **Competition from low cost Asian workers**

But this is not all. As the financial and housing debacle destroyed the value of real estate, while everybody got into debt, America was also hit badly by systemic global labor

market changes whose net effect has been and will be to eliminate many jobs while hurting the earning power of the US middle class.

Whatever the at times grotesque demonization of "outsourcing" as a sinister plot hatched by evil US corporate leaders, the truth is that in the global market place there are now hundreds of million of new, able bodied Asians workers. Most of them are reasonably skilled and willing to do the very same jobs Americans do at a fraction of the cost. This is a fact. While cheap labor advantages are not for ever, (indeed we already see wages moving up in parts of China), for the moment they determine the location of many labor intensive economic activities.

Low labor costs, combined with "hyper-connectivity" provided by inexpensive communications, plus reliable and lean supply chains made transferring manufacturing to Asia possible. As a result of this gigantic change, many US middle class jobs have disappeared, while there is no chance for wage increases for employed US workers who have to compete with cheaper Asians.

### **More US manufacturing**

As for the hopes of a US manufacturing renaissance, they may actually be real, at least in energy intensive sectors. Some corporations want to relocate to the USA in order to take advantage of low electricity prices due to abundant and cheap American natural gas. However, a few more factories do not translate into more jobs. IT systems, automation and more robots are actually eliminating factory jobs at a fast pace.

### **No innovation, mediocre education**

To add more misery to the picture, the American marvelous technology/innovation engine has stopped. At the moment, we have no great breakthroughs opening up entirely new fields, just as it happened with the IT revolution in the 1980s and 1990s.

And if you really want to be pessimistic, you have to add a mediocre to bad public education system that produces sub par high school graduates, many of whom end up getting a semi-worthless college degree.

### **Disappointing public policy**

In order to reverse this economic stagnation, we need better education, more private and public resources devoted to R&D and a tax system that encourages business creation.

But instead we have a semi-broken Washington government machine that is not even capable of passing budgets, let alone frame new pro-growth policies. Due to bitter ideological feuds, the President and the Congress are able at the very best to pass short term stop gap measures, so that America will not go into default and so that we do not need to shut down the Federal Government. And these band aid deals last for just a few months.

Indeed, today's "policy debate" is about the short term and long term consequences of the "sequester", an emergency, across the board spending cut provision encompassing all discretionary spending (defense and non defense) that will soon kick in lacking broader agreements on spending and taxes between Democrats and Republicans. And we call this governing?

### **We know what needs to be done: tax and entitlement reform**

And yet, all the centrists and all the smart economic and fiscal policies experts in Washington know exactly what needs to be done. There are Blue Ribbon Commissions Reports and plenty of studies generated by think tanks that provide the basis for substantive reforms.

In brief: America badly needs tax reform based on simplification and the closing of loopholes designed to protect special interests. A modern tax code will create incentives to create new enterprises and to invest in future

technologies. At the same time, America needs a long term, bipartisan agreement on entitlement reform that will take into account the growing number of seniors (and therefore the cost of programs dedicated to them), while trying to reform health care, so that its costs will stop growing at a faster pace than the economy. Entitlement reform can and should be phased in gradually, without hurting current recipients. But it needs to be done.

## **Confidence**

A new, credible and sustainable tax and fiscal reform package that will encourage economic activities, while signaling the beginning of a real inflection in America's public spending, over time would do wonders to re-inject confidence in the system.

Confidence, in turn, will stimulate investments and business growth. All this has been said by wise people many times. Remember Simpson-Bowles and their "Debt Commission" December 2010 Report? It's all in there. It is time for Washington, starting with the White House, to lead and take action.

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# **An Urgent Appeal By Elder Statesmen: Out Of Control US Federal Debt Will Undermine American National Security**

[the-subtitle Put country first and fix fiscal policies]

*U.S. national security in the 21st century rests on both*

*economic and military strength, for our military might and diplomatic muscle ultimately depend on a vibrant economy. Unless we change course, our huge and growing debt will undermine our economic growth, our military strength, and our global leadership.*

*Our leaders should use the consensus against going over the fiscal cliff as an opportunity to agree now on a framework for significant fiscal reform in 2013. Another “kicking of the can” – the lowest common denominator of what both parties can currently accept, without any structural reforms that truly address the nation’s problems – is not acceptable. We must reassure our own citizens and businesses, the international financial markets, and the greater global community that America will address its fundamental challenges and maintain its leadership role in the world.*

*At a minimum, the resolution of the fiscal cliff by the end of the year should have the following components:*

- *The Objective: Our fiscal goal must be to stabilize the debt as a share of the economy, and put it on a downward path for the longer term. We cannot continue to grow our national debt faster than our economy if we want to maintain our global leadership. Any solution which does not meet this simple test is insufficient.*
- *The Framework: To achieve this objective, our leaders should decide on a fiscal framework that results in substantial deficit reduction over the next 10 years and structural changes to our fiscal policies that eventually balance the budget over the long term, including:*
  - ◇ *Specific levels of revenue, spending and deficits over the next 10 years, and parameters for longer-term fiscal reform, including future levels of debt as a share of the economy, and a date by which the budget must balance.*

◇ Tax reforms to raise more revenues, encourage growth and enhance progressivity – and it must be decided how much should be done through eliminating deductions, increasing rates and/or more fundamental changes to our tax code.

◇ Changes to entitlements to put them on a sustainable long-term path, as well as changes to defense and other discretionary spending, while protecting the most vulnerable and preserving sufficient resources to invest in the future.

◆ In our judgment, advances in technological capabilities and the changing nature of threats make it possible, if properly done, to spend less on a more intelligent, efficient and contemporary defense strategy that maintains our military superiority and national security.

- *The Process: Congress and the President should agree on an expedited process to enact legislation reflecting this framework in 2013, including appropriate default and enforcement mechanisms that ensure we will achieve the targeted result.*

*In a time of division and drift, the true test for America is neither military nor economic – it is political. We ask our elected officials from both parties to assert genuine leadership, communicate to the American people what needs to be done, and make pragmatic policy decisions to power our nation's economy, democracy, and role in the world. It will require courage, shared sacrifice and a willingness to compromise and make the tough choices essential to setting a new course for our nation. It summons the truest form of patriotism – putting our country first.*

(Signatures)

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# **To Save America Democrats And Republicans Should Reject All Extreme Positions, Find Agreement On the Fundamentals Of Democratic Capitalism – Erskine Bowles And Alan Simpson, Co-Chairs Of The Debt Commission, Did That**

[the-subtitle ]

**By Paolo von Schirach**

September 29, 2012

**WASHINGTON** – America is a democratic and capitalistic society that lost its bearings in on an orgy of stupid ideology fueled by ignorant ideologues. This toxic concoction is fanned out daily by outrageously partisan media that treat politics as entertainment that has to be dished out to aficionados who want to hear their silly biases repeated again and again.

**Democratic capitalism is complicated**

In fairness, to create and sustain a modern society based on democratic capitalism is a really complicated matter, in fact

an almost impossible undertaking. The enterprise is premised on ample doses of vision, intelligence, maturity, self-restraint and on the ability to constantly balance the promotion of private interests and the need to uphold the public good.

### **Balance between private and public**

Indeed, democratic capitalism is about building a robust consensus on the proper mix between private and public –in everything.

To begin with, there should be a shared understanding that democracy does not mean much without sustained economic growth. Therefore democratic capitalism has to include every possible incentive to free enterprise, along with sensible regulations that will prevent capitalists to become exploiters or rent seeking monopolists.

### **Opportunity**

The mix has to include basic regulations, some functions performed by public entities that will include the provision of some basic services. A democratic capitalism formula has to include a broadly shared understanding of what it takes to create the foundations for a *real* equal opportunity society in which all children, irrespective of socio-economic background, can acquire the tools that will give them a truly fair shot at excellent education and therefore personal growth.

By the same token, there should be a widely shared consensus as to how all citizens and corporations contribute financially, via the tax system, to the general welfare.

### **Growth and the environment**

By the same token, it should be obvious to all that there must be a good balance between economic development and protection of the physical world in which we all live. There should be no

built in contradiction between sustainable growth and sound measures to safeguard the environment.

### **All in agreement?**

In theory, all this sounds simple and self-evident. Of course, we are for economic growth. Who isn't? Of course, we all believe in equal opportunity. Of course we think that there should be a balance between markets and regulations as well as between development and environmental protection. Yes, we all agree, in theory.

### **The triumph of ideology**

In practice, though, in recent years intense ideological bias and the desire to cultivate selected special interests and voting blocks created a huge mess that now risks to derail proper US governance, any residual social consensus about taxes and public services, and the entire American economy. The goal of optimal balance goes out the window when we have opposing sides vociferously advocating their own self serving reformulations of what a "fair balance" should be.

### **Demonizing opponents**

Forgive the over simplification, but this is the nasty predicament in which America finds itself today. On the eve of a critical presidential election, the two parties have managed to create an absurd scenario of mutually exclusive, extreme visions. Obama presents himself as moderate and socially inclusive. Romney calls his plans disastrous socialism that will kill enterprise while causing financial ruin. Romney claims that he knows how to manage public policy and how to restart the economy. Obama calls him a vulture capitalist bent on destroying social programs in order to benefit the rich.

Both candidates are right in some measure, and both are guilty of indulging in crazy hyperbole and willful slander.

No, Mr. Romney, markets are not self-regulating, as a history of boom, bust and bubbles, culminating in the 2008 disaster that almost sunk the entire US economy, shows. And no, Mr. Obama, regulation and public contracts are hardly a formula for optimizing outcomes, witness the historic disaster of the American public education system and the unsustainable debt burden caused by overgenerous benefits granted to public sector employees by politicians who want votes more than good governance.

### **Reject ideologies**

Many say that the only way to get out of this mess is finding an honorable “compromise” between diametrically opposing visions –all for the good of America. I disagree. The healthy way out is for both parties to grow up, sober up and reject as silly and foolish their most extreme positions. As long as these ridiculous positions, (“tax the rich to redistribute wealth”, “no new taxes under any circumstances”, and so on), have legitimate standing, compromise will be extremely difficult or impossible, as the recent history of major failures attests.

As a nation, we could not have broad based agreement on sound health care reforms, on financial regulations, on air quality regulation, on a public schools reform agenda. Most notably, as the failure of the 2010 Debt Commission and subsequent efforts proves, we cannot agree on the really big ticket item of federal spending reform which has to include entitlement and tax reform.

### **Deadlocked America**

While the picture may be very different at the state and local level, when it comes to national policies, America is deadlocked. For a constitutional system based on the separation of powers whose success is therefore predicated on the ability to reach agreements between different factions,

this perpetual deadlock is the kiss of death.

In this respect, we are not faring better than any tired and litigious Southern European parliamentary system and no better than perennially blocked India.

### **True statesmen: Bowles and Simpson**

The reasonably good debt reduction formula provided in December 2010 by the Debt Commission was based on a broad policy agreement between the two elder statesmen who served as co-chairs. Republican Alan Simpson and Democrat Erskine Bowles set ideology aside and put together a decent proposal that should have been the basis for crafting a national plan that both parties could sign on without suffering any political consequences.

But it did not work out that way because active duty political leaders are sensitive only to immediate political pressure. In so doing, they show that they do not care that much about national priorities and even less about the price of inaction in terms of missed growth and impending fiscal disaster. Nothing was done about the Bowles-Simpson plan. Absolutely nothing.

Erskine Bowles and Alan Simpson are rare examples of genuine statesmen who put together a proposal for the common good. (Of course it helps that they are both out of the active politics arena and therefore with no concern about defending their agreement at the next election). The others, and that includes Obama and Romney, are not real statesmen. They are just myopic politicians.

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# **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 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.

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# 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 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.

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# **No Common Ground Between Obama And The Republicans on Debt, Spending and Taxes**

[the-subtitle ]

**By Paolo von Schirach**

July 15, 2011

**WASHINGTON** – Watching President Obama today during another press conference on the negotiations that should lead to an agreement on raising the debt ceiling and spending cuts was a bit unreal. The President sounded reasonable, quite conciliatory. “Look – he almost said– this is not that difficult. We all want to see a lower debt. But we also need a bit more revenue. If the Republicans would just stop listening to their anti tax hard core ideologues, we could do this fast. Americans want this and it is our responsibility”. How very reasonable.

## **What about entitlements?**

Except that I did not hear President Obama squarely say in that press conference that he is committed to serious entitlement reform. And, without that, the rest is literally smoke and mirrors. And he knows that. Which makes me think that this TV exercise is not about pleading for an agreement but about posturing so that when failure to get a deal becomes obvious, he can start apportioning blame from a high moral ground. "I really wanted this deal. But they just wouldn't listen to reason".

## **Republicans: "No" to any and all taxes**

On the other side of the fence the Republicans are equally disingenuous. Their total opposition to all "jobs killing tax hikes" is also posturing. It is all about keeping ideological purity on the part of many who got elected having made solemn pledges that they would never, never vote for a tax hike. While one could agree with House Speaker John Boehner that America has a spending problem and not a revenue problem, and while we can also agree that tax hikes in a weak economy can be counter productive, it is unwise to rule out any and all revenue increases as a matter of principle. Some revenue increases would help reducing the deficit. Most serious plans, starting with the Bowles-Simpson December 2010 debt commission report, include them.

## **No more borrowing**

Further down the line, there are those (the Tea Party Movement vanguards) who oppose raising the debt ceiling also as a matter of principle. I share their frustration. America has gotten used to over spending, followed by more borrowing, followed by more over spending. At some point, this has to stop. I agree with the principle. However, this is hardly the right time. To say that now is the moment to halt all this and deny any additional borrowing ability is insane.

## **Bachmann: not to worry, we have enough money left**

It is plain obvious that there are just too many policies and programs in place predicated on a certain level of funding. The idea that cutting all new borrowing today is no big deal is astonishing and completely crazy. And yet I heard Congresswoman Michele Bachmann say exactly that, with conviction, in a TV interview. Washington gets money from general revenue, said presidential contender Bachmann more or less. So, you simply use this money to take care of the most important issues.

And how do you do that? Simple. Being responsible Americans, we make sure that the interest on the debt is paid, and there is money for that. Then you make sure that you pay the soldiers in Afghanistan, Iraq, etc. And, I presume, we also pay for the entire supply chain that keeps the war effort going. May be there is some more left for Social Security checks and Medicare/Medicaid payments. Fine, We do that. At that point we have finished all the money. Which means that the rest of the US Government essentially will close down. No more Departments of Agriculture, Energy, Transportation, Education. No more Securities and Exchange Commission, no more Federal Communications Commission, no more National Institutes of Health. How do you like that? But, according to Ms. Bachmann this is not an issue. And this lady wants to be President? Of what?

## **Sarah Palin: "you got to prioritise"**

And conservative movement leader and rumored presidential candidate Sarah Palin said more or less the same in another TV interview. She repeated the same nonsense that, even with no new borrowing, Washington would still get revenue. So, she argued, the point is that, if you have less, you just have to "prioritise". Easy, no? You keep Health and Human Services, but you cut Homeland Security by –say– 50%. You fire every other FBI agent, close down the National Security Agency and

you send the Coast Guard home. Now, this is what seasoned executives like the sturdy former Alaska Governor would do. But Obama, the poor fellow, he does not know how to prioritise, you see. With less money to play with, he would get all confused.

### **No consensus on anything**

So, let's take it altogether. The president talks for an hour, saying that we can get an agreement that would get America out of the woods, without seriously addressing entitlement reform. The Republicans say "No" to any new taxes. A presidential contender and an anointed national conservative leader say that default is perfectly manageable, if you only know how to "prioritise". So, you have the clever, the ideologues and the nutty in the same room. And you want an agreement? On this basis?

### **There was merit in a comprehensive agreement**

In principle, the basic idea about having a comprehensive deal that would authorise more federal borrowing and significant spending cuts at the same time seemed good. In one move, Washington would signal that it can act to make sure that it will have enough cash to pay for its current obligations, while it would say to everybody that the era of gigantic spending increases is over and that the Federal Government is now on a serious diet. As I said, nice idea. Except that is premised on political agreement on appropriate levels of cutting and spending that is just not there. (See above).

### **No deal**

As things stand, there may some twisted gimmick (Senator McConnell's idea) that will allow the dreaded debt ceiling to be raised, but without the Republicans in Congress leaving any fingerprints on this dreadful action. This way America will not default, there will be more (borrowed) money to pay the bills and the big debate on taxing and spending will move on

to the 2012 electoral campaigns now beginning to unfold. Fine? Not really. While it is alright in a democracy to settle big issues through a national political vote, it is by no means clear that the 2012 elections outcome will provide the needed clarity.

### **We need serious entitlement reform**

Remember what is at stake here. All major entitlement programs, tax reform, the future of a variety of discretionary programs and myriad of subsidies: to agriculture, ethanol, renewable energy, oil and gas, you name it. Entitlements are the real big ticket item. Remember that they alone already absorb more than 60% of federal spending. The growth dynamics of Medicare indicate that, without significant changes, it will eat up most federal revenue in a few more years. The program needs serious overhaul. As currently structured, since it is a pass through for bills generated by doctors who have every interest to over prescribe, Medicare has no internal check mechanisms. And so, higher costs keep barreling ahead. And, while this is the biggest issue, it is not the only one. There is Medicaid and Social Security. Perhaps a bit less complicated, but thorny nonetheless. And then everything else.

### **Reform ideas are politicised**

But the problem about putting on the table any serious entitlement reform plan is that it immediately turns into a carnival of shameless demagoguery. Easy to accuse any attempt at restructuring programs as a mean spirited conspiracy aimed at depriving America's seniors of their hard earned benefits. The whole thing turns immediately political and the objective is only to score points. Any serious reform proposal that –by definition– has to entail reducing benefits is presented as a calamity to be fought against at all costs.

**Americans do not get that the debt is largely about money they get**

On top of that, most Americans are genuinely confused about what it would take to really cut spending, thus reducing deficits and reversing the national debt growth trend. Inordinately large numbers of Americans believe that the debt is mostly about “fraud, waste and abuse”, or “foreign aid”, or about that particularly egregious earmark. This is all fantasy.

*People do not want all this debt; but they cannot yet digest the fact that most of it is due to benefits they get.*

And so we have a huge disconnect here. There cannot be any serious discussion about spending reductions without a real entitlement overhaul. And yet, somehow, the elected leaders have been vague about this “detail”. And so they have no idea how to sell entitlement reform without angering too many voters.

### **In this atmosphere, serious debate is impossible**

From the above it is obvious that a serious debate is almost impossible, as the fruitless negotiations between the White House and Congressional leaders carried out until now amply demonstrate. Lacking honest dialogue, then there are only attempts at manipulating public opinion.

Again, at its core, the issue is rather simple. America wants public services, including entitlements. Yet, all serious people know that, in order to preserve entitlement programs designed in a different era, we need fundamental changes regarding their scope and cost. And finally, we need to agree on who pays for what.

As the President smilingly said on TV, it should be simple. But it is not.