

## **America's Next Step -- Where do We Go From Here?**

In a recent paper, we focused on the long-term implications of compounding rates of change for population growth and worldwide GDP. In this article, we look at the financial meltdown that is facing America and ask an obvious question: If the United States cannot get its own financial house in order, what hope is there for the world coming together to manage the devastating long-term consequences of compound growth that seems so benign in the short run?

Turning to the financial health of the United States the stock market is in the doldrums while inflation is running at 2.3% with 10 year Treasury notes yielding 1.8% and investment grade long- term corporate bonds yielding 3.3%. Meanwhile, unemployment is at 8% (or at 15% if under-employment is factored in) while robotic technology has pushed manufacturing employment off the cliff. Apple computer blithely assembles over a million iPhones a week in China in a factory that houses 120,000 highly trained workers -- with dormitories and movie theatres thrown in.

All the while, U.S corporations are sitting on \$2 trillion in cash (here and abroad) while they refuse to invest in plant and equipment that would boost employment. Finally, the Euro may be coming apart at the seams while a socialist mindset in Greece could easily bring that volatile country to its knees. It is suspected that Spain and France are not far behind.

Against this backdrop, America is steeped in political gridlock epitomized by the absurd debate over raising the debt ceiling to pay for things that have already been consumed -- as if becoming a deadbeat nation were our latest calling. Along these same lines, the Senate's rarely used tradition of the filibuster is being woefully abused. Last but not least, the national debt is overtaking the nation's Gross Domestic Product while the Federal deficit has soared to \$1.3 trillion.

Erskine Bowles summed the nation's financial outlook up in an April 24 speech to The Council on Foreign Relations as reported by William D. Cohen in Bloomberg news. Thus:

.....Bowles, a Democrat, laid on the crowd some pretty simple, but devastating, arithmetic. He explained that 100 percent of the tax revenue that entered the Treasury in 2011 went out the door to pay for mandatory spending -- such as Medicare, Medicaid and Social Security -- and to pay the interest on our staggering \$15.6 trillion national debt.

That means that every single dollar we spent on everything else, including two wars, national defense, homeland security, education, infrastructure, high-value-added research and the like, was borrowed. "And," he warned, "half of it was borrowed from foreign countries. And that is a formula for failure in anybody's

book.”

He said the U.S. is now paying \$250 billion a year in interest on the debt, and that is only because, mercifully, interest rates are at historic lows. That’s chiefly because investors are more worried about the risk of default by European nations, and because the Fed is doing everything in its power to keep interest rates low. “It’s because we’re the best-looking horse in the glue factory,” he said.

If interest rates were normalized, Bowles said, the annual bill would be \$600 billion a year. “We’ll be spending over \$1 trillion on interest alone before you know it,” he said....

It is every bit as criminally irresponsible for Congress to fail to address this looming crisis as it was for Jimmy Cayne at Bear Stearns, Dick Fuld at Lehman Brothers and Martin Sullivan at AIG to ignore the financial problems at their firms in 2008.

Interestingly, **Bowles remains optimistic that the circumstances are so dire that Congress will have to act**, although it probably won’t happen until the seven weeks between Election Day and the end of the year. “We have to,” he said. “We’ve simply made promises that we can’t keep.”

The big driver is clear, he said: “We have a health-care system that’s absolutely crazy. We spend twice as much as any other developed country in the world on health care, whether you talk about it as a percent of GDP or on a per-capita basis. And that might be OK if we could afford it, and it might be OK if the outcomes were any good. But if you look at most outcome measures, we rank somewhere between 25th and 50th in such important measures as infant mortality and preventable deaths and life expectancy....

Despite the March 28 defeat of a budget based on the Simpson-Bowles plan by a House vote of 382 to 38, Bowles believes a version will have to get adopted before we fall off the cliff at the end of year. He has spent much of the last year putting the plan into legislative language that has increased its page count to more than 800 pages, from 67, and has put real numbers to the various proposals.

“It’s a nightmare to do, but it absolutely is necessary,” he said. He added that Simpson-Bowles is the “gold standard” for figuring a way out of our fiscal mess, with its combination of revenue increases, spending cuts and tax reform. He allowed that “most people” think there will be agreement on reducing the deficit by \$4 trillion, the “minimum amount you need to reduce the deficit to stabilize the debt and get it on a downward path as a percent of GDP.”

Without serious debt reduction, it won’t take much of an increase in interest rates to create a fiscal crisis for the country the likes of which only those who lived through the Great Depression can recall. Once interest rates reach a level that

reflects the genuine risk inherent in our ongoing fiscal mismanagement, and debt-service eats up more and more of a shrinking pie, the financial crisis we just lived through (and are still living through) will seem like a sideshow.

“Deficits are truly like a cancer,” Bowles said, “and over time they are going to destroy our country from within.”

In addition to the above woes, America may be facing a secular decline as it inches its way toward European style socialism. Not to be an alarmist but consider the following warning about democratic states:

In 1887 Alexander Tyler, a Scottish history professor at the University of Edinburgh, had this to say about the fall of the Athenian Republic some 2,000 years prior: "A democracy is always temporary in nature; it simply cannot exist as a permanent form of government. A democracy will continue to exist up until the time that voters discover that they can vote themselves generous gifts from the public treasury. From that moment on, the majority always votes for the candidates who promise the most benefits from the public treasury, with the result that every democracy will finally collapse over loose fiscal policy.

Some readers may take the above remarks with several grains of salt, but there is a large block of the nation's citizenry that is in strong sympathy with them – and for good reason. Case in point: consider President Obama's renown “Julia commercial” that tracks a single woman's experience with government safety nets from cradle to grave. She is clearly very dependent on them. (In this regard see *Socialism in Perspective* which is included as an appendix to this article.)

As everyone knows, John Kennedy was right on the money when he uttered the phrase, “life is unfair.” What this means in broadest terms is that “elite” winners in the lottery of life (as Warren Buffett describes it) are born with high innate IQ's as well as many other forms of nascent intelligence just ready to pop out given the right conditions/environment. In short, these fortunate ones become the world's success stories amassing large fortunes, fame, glory and political power.

Most members of the Democratic party (e.g., Franklin Roosevelt, Harry Truman, Lyndon Johnson and Barack Obama) look upon this state of affairs as chronically unfair and want to mobilize the government (and society) to more “fairly” distribute material outcomes and political influence. In pursuit of such goals, Democrats had no problem with 91% marginal tax rates on “the elite” from 1950 until 1963. Indeed, Democrats have no problem with legislative remedies for these purposes or with taxing the upper class at sharply higher progressive rates to insure that basic needs of the less prosperous and/or productive class are provided for.

In pursuit these aims, we have such legislation/programs (primarily initiated, expanded and defended by Democrats) such as The National Labor Relations Act, Medicare, Medicaid, The Affordable Care Act, The Consumer Protection Act, minimum

wage, unemployment insurance, workman's compensation, job retraining, head start, special needs education, free school lunches, CHIP, student loans, food stamps, the auto union/industry bailout, the Earned Income Tax Credit, farm subsidies, payroll tax holidays, etc. In short, according to the Concord Coalition, federal transfer payments to individuals in 2010 totaled \$2.29 trillion compared to total government revenue of \$2.16 trillion. The difference was borrowed as was funding for all other activities of the federal government.

Republicans (e.g., Paul Ryan, Mitt Romney, Ronald Reagan, John McCain) on the other hand lean toward Ayn Rand's perspective and believe the wisest course is to let nature and the free market (not to mention luck and/or inherited wealth) determine outcomes based mainly on individual merit such as IQ, ambition, tenacity, talent, self-confidence, self esteem, curiosity, originality, insight, courage, integrity, entrepreneurial ability, managerial/leadership skills and, finally, that crown jewel of mental ability: superior judgment. (While it may be the mainstream Republican view, I certainly do not mean to imply that the Grand Old Party has a lockup on such desirable traits!)

In the broadest sense this is what a meritocracy -- as opposed to an aristocracy, at one extreme, or socialism at the other -- entails. Thus, the Republican view is that tax rates should be as low as possible on the wealthy (i.e., investors and "job creators") within whose ranks reside the most capable minds for creating profitable business enterprises and employment opportunities for the rest of us.

Voters in America are evenly divided along such philosophical lines (especially after religion, gay marriage, abortion and "judicial activism" get into the mix) and as a consequence gridlock (especially with elections on the horizon) prevails in Washington. Unfortunately, in such an environment, the Simpson-Bowles Commission, the Concord Coalition and Comeback America have about as much chance as a snail in a horse race to bring the United States back to its senses. Indeed, it will probably take a major catastrophe to do so.

### **Addendum - Socialism in Perspective**

#### **Overview**

There is an aphorism, popular among conservatives, to the effect that democracy is a better form of government than any alternative -- until the poor (who have the greatest number of votes) figure out that they can require the rich (who have far fewer votes) to take care of them.

#### **Introduction**

This essay, perhaps, teaches two lessons at once. First it makes clear that the U.S. has progressed far down the road toward embracing the core principles of socialism without going overboard as Greece, Spain, France and other European nations have done. Secondly, Einstein (1947) made a compelling case for the socialist approach at a time when *pure* capitalism held much stronger sway in the world, and especially the U.S., than

it does today. Thus, Einstein pointed out and predicted many of the difficulties, or shortcomings, that a state with a strong capitalist bias is prey to. Meanwhile, this essay attempts to put some of the tension between capitalism and socialism in better perspective than those who take extreme positions on one side of the issue(s) or the other.

### **Socialism in Perspective**

The simplest and clearest definition of socialism is that the state owns the means of production and determines how it is to be distributed according to the familiar maxim "from each according to his ability; to each according to his need." Meanwhile, there can be little doubt that the United States closely approximates the requirements of a socialist state in a number of ways.

For one thing, the ability to tax the means of production is almost as good as owning them -- some would say better than; no risk! Still, only those deemed to have the *ability to pay* (about 50% of the population) pay federal income taxes. And, of course, the "earned" income tax credit (or unearned rebate) is there for those who lack the wherewithal to pay income and Social Security taxes. But for those who do get caught in the snare, taxes are levied at progressive rates keyed to the *ability to pay* principle. Likewise, insofar as owning the means of production is concerned what are we to make of those confiscatory marginal tax rates of over 90% that lasted more than a decade (1950-1963)?

Meanwhile, massive outlays on k-12 education in the U.S. is largely funded by local property taxes keyed to the value of one's home (the *ability to pay* maxim) whether one has children in school or not. Likewise massive government sponsored student loans are available for those lacking the *ability to pay* for their college education.

Health care (around 1/6th of GDP) is under the sway of socialist influences to an astonishing degree. Thus, most citizens get their health care under the auspices of their employer and pay no taxes whatsoever on this hidden form of income. Meanwhile, the government controls and allocates massive expenditures for the health care of other citizens through Medicare, Medicaid and the Veterans Administration. And, naturally, emergency room care for the indigent (whether citizens of the U.S. or not) is "free" to those who benefit from it. And finally, The Affordable Care Act, which will benefit 33 million Americans, is keyed to the *ability to pay* principle (while presumably *saving* the country \$billions).

The Social Security system has a progressive (socialistic) element in the sense that the indigent collect more than they are entitled to by a strict accounting of their contributions while the wealthy collect less than they are due by the progressive mathematics of the new deal. Aid to dependent children and automatic access to Medicare for the disabled (at whatever age) is a nice piece of garnish. Food stamps (a massive program covering 43 million Americans in today's difficult economic times) and certain other forms of social welfare are entirely compatible with the aims of socialism. Meanwhile, state and local governments are awash in pension and health care obligations

they cannot possibly afford. Well, that about covers the list and it is a very pervasive one indeed.

Meanwhile, it is of considerable interest that arguably the greatest mind in physics, Albert Einstein, was also an advocate for socialism. Since the United States has adopted many programs compatible with a socialist agenda, it seems worthwhile to see what the case for such a system might be through the prism of one of the world's most lucid minds. In the interest of space and time, however, we have dropped much of the verbiage that isn't really necessary to see what Einstein (in somewhat turgid prose -- unlike his notations in math displacing Newton) was advocating and why. Thus, the following citations are from Einstein's 1947 essay entitled: "Why Socialism?"

It is "society" which provides man with food, clothing, a home, the tools of work, language, the forms of thought, and most of the content of thought; his life is made possible through the labor and the accomplishments of the many millions past and present who are all hidden behind the small word "society.".....

Human beings are not condemned, because of their biological constitution, to annihilate each other or to be at the mercy of a cruel, self-inflicted fate...Man can find meaning in life, short and perilous as it is, only through devoting himself to society.....

It is important to realize that the means of production -- that is to say, the entire productive capacity that is needed for producing consumer goods as well as additional capital goods -- may legally be, and for the most part are, the private property of individuals.....

The owner of the means of production is in a position to purchase the labor power of the worker. By using the means of production, the worker produces new goods which become the property of the capitalist... It is important to understand that even in theory the payment of the worker is not determined by the value of his product.

Private capital tends to become concentrated in few hands.....The result of this developments is an oligarchy of private capital the enormous power of which cannot be effectively checked even by a democratically organized political society..... Representatives of the people do not in fact sufficiently protect the interests of the underprivileged sections of the population. Taken as a whole, the present-day economy does not differ much from "pure" capitalism.....An "army of unemployed" almost always exists. The worker is constantly in fear of losing his job. Since unemployed and poorly paid workers do not provide a profitable market, the production of consumers' goods is restricted, and great hardship is the consequence.

The profit motive, in conjunction with competition among capitalists, is responsible for an instability in the accumulation and utilization of capital [*e.g., securitization of toxic assets and the financial wizardry at Lehman Brothers*] which leads to increasingly severe depressions.....This crippling of individuals [*e.g., under water mortgages and foreclosures*] I consider the

worst evil of capitalism. I am convinced there is only one way to eliminate these grave evils, namely through the establishment of a socialist economy...

Needless to say, America has embraced many reforms since this 1947 essay was written making a purely socialist economy out of the question. Indeed, enough half-steps have been taken to keep the wolves at bay.

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