TIMES THAT TRY MEN'S SOULS

The failure of America's political leaders across the spectrum to explain to the public the serious long term, intermediate and short term challenges we face has caused unnecessary pain, turmoil and widespread loss of public confidence in government. Their failure to deal effectively with those challenges has put our national well-being in jeopardy. Widespread protests from left and right may lack a coherent agenda, but the public knows that something is wrong and they demand the truth.

Liberals refuse to acknowledge that we must live within our means; conservatives refuse to acknowledge the economic and social imbalances that threaten to strangle our society. Both confuse symptoms with causes and the cyclical with the structural; both use the current turmoil to further their ideological goals. As a result, both give the impression of being long on cleverness and short on integrity. Neither faces the long term ramifications of an economy shifting from industrial production to services and information, or the emergence of a single global market for goods, labor and capital, or growing intergenerational economic tensions. Neither encourages the deferred gratification and future-mindedness that underlie all successful societies.

America's declining rate of social mobility, our diminishing ability to influence the world beyond our borders, the relative shabbiness of our national physical facilities, the deteriorating quality of life—none is pre-ordained, none is inevitable. All are the result of bad governmental decisions and a public demanding much, but willing to pay for little—'self-inflicted wounds' that can be reversed.

When we deal effectively with the problems of education, infrastructure, foreign trade, industrial policy and social mobility, we will regain the forward momentum we had before this lost decade, and our government will regain the public trust it has lost.

Subtle changes in the American psyche, influenced by European thinking, have caused our public to focus on today vs. tomorrow, on rights vs. obligations, on entitlements vs. their financing. All spell trouble, as does the Left's demand for equality of result rather than equality of opportunity or the Right's belief in 'everyone for himself and the Devil take the hindmost.'

Our common goals—a fair and just society, with opportunities for advancement for talent and effort, with a balance between public and private amenities, with the rewards and obligations of citizenship rationally apportioned— are achievable over time; but current realities are discouraging, and public expectations are unrealistic.

Aristotle might cite the 'efficient cause' of our current predicament as our dysfunctional mechanics of government— electoral gerrymandering, arm-twisting political lobbyists, the legalized bribery we call 'campaign contributions.' The 'formal cause' he might cite as the preposterous cost of political campaigning. Until we address these causes, we are unlikely to get the kind of responsible legislative bodies—and responsible legislation—our Founding Fathers envisioned.

The coming American "new normal," a society stratified along educational lines, with growing numbers of the under-educated having no economically-productive role, is rapidly becoming a fact of life. The wage premium of intellectual over manual labor continues to surge, even as recent college graduates find jobs scarce. How we increase the size of our national economic pie and how we divide it appropriately are challenges we must face; the sooner the better.

We have seen middle class wages stagnate so that workers can no longer afford the goods and services whose purchase the economy requires to keep growing. The top one per cent of our public receives one quarter of our national income, the top five per cent receive 37%;

and 95% of the public must limit their expenditures. The last time we had similar numbers was in 1928.

The national macro-numbers today are frightening. With a GDP of $15 trillion, U.S. public debt to others is now $10 trillion and intergovernmental debt is over $4.5 trillion, with the total growing at the rate of $1.5 trillion a year. The present value of our existing unfunded domestic entitlements is huge; common estimates put them at $66 trillion: $35 trillion for Medicaid, $23 trillion for Medicare and $8 trillion for Social Security. Of 51 million private homes with mortgages, 15 million are worth less than their debt. Three million homes were foreclosed last year; another six million are in arrears. Our national unemployment rate is over 9%, and millions of workers have given up looking for work. The unemployment benefits of some four million may expire this year. Student loans total over a trillion dollars, and the rising default numbers are ominous. Opinion polls show a public anxious and pessimistic, pleading for government's pragmatic compromise on vital issues.

We must consider—calmly and rationally—where our economy is and where it is heading. We can no longer afford the luxury of allowing political polemic to drive reasoned argument from the stage nor permit political candidates to see no further than the next election.

Just as our political parties cooperated in the national interest during the crises of WWI and WWII, they must cooperate in the current economic crisis. 'Loyal opposition' is one thing; 'rule or ruin' political maneuvering is another, and the climate in polarized Washington today is rightly called 'obsessive obstructionism.'

In light of the international embarrassment of Standard and Poor's credit downgrade, history will deal harshly with our Congressional leaders, and those like Grover Norquist, leader of the "No Tax Increase—of any kind, at any time, for any reason" movement and his efforts to demand No Tax pledges from all Republican candidates (with the threat of running further-to-the- right primary opponents against them).

The Left must face the ramifications of an aging and longer- living population, of a public education system falling seriously behind global standards, of government employee benefits out of sync with those of the rest of society.

Grover Norquist may wish government reduced to "the size where I can drag it into the bathroom and drown it in the bathtub (sic)," but most of us do not. We want government services and we must pay for them by taxation. Edmund Burke, the father of modern conservatism, put it succinctly—"To tax and to please is not given to men." Europe has found that Value Added Taxes, although regressive, are the least objectionable way to raise revenue. If we cannot face other forms of taxation, we, too, must consider them. (A 5% VAT would raise some $500 billion in annual revenue.) One way or another, cutting expenditures and increasing revenues lie ahead of us.

Few observers would disagree that free market economies are more productive than rigidly controlled ones—leading to what Winston Churchill called "the unequal sharing of blessings vs. the equal sharing of miseries." Few would disagree that to achieve optimum productivity and socio-economic stability, free market economies require some degree of government regulation. What that degree should be is the question.

John Maynard Keynes' 'interventionist' followers and Frederick von Hayek's 'hands off' supporters will always battle, but neither Keynes nor Hayek approved of swollen government, and both agreed that over-indebtedness leads to financial nightmares. Short term 'stimulus,' (preferably on desirable repairs to our deteriorating and inadequate infrastructure) to provide immediate employment, and longer term 'austerity' (with renewed savings and investment for continuous growth) reflect the best thinking of both. The two trillion dollars respected engineers tell us we must spend on infrastructure—for repairs, upgrades and expansions— will provide short term jobs and long term economic and social benefits. Had we created an infrastructure bank (with an accelerated review process) three years ago, the results would already be apparent. Short term fears of deflation, long term fears of inflation and recurring fears of stagflation must be dealt with realistically and prudently.

A healthy economy requires a sensible balance between consumption and saving/investment. In America today consumption is tilted in favor of private consumer goods and against public goods such as airports, parks, highways, mass transit, etc. We mistakenly consider expenditure on education and scientific research as personal consumption rather than as national investment for the future. We are heavily over-invested in housing, which is not productive of future wealth.

Other countries do not share our fetish of home ownership nor our conventional wisdom that house prices must rise more than inflation.

Our financial services industry, whose function should be to oil the wheels of society and to channel savings into productive enterprise, has become a world of its own, skimming a disproportionate share of the national income. In 2008, for example, the country's top 25 hedge fund managers personally received $25 billion among them, largely through the legal scam of low tax "carried interest"; corporate CEOs receive huge bonuses even as their companies post major losses. Rewards for risks on the upside have not been balanced by penalties for bad guesses on the downside. No wonder our best and brightest are seduced by financial paper-shuffling rather than careers in the productive world. Eventually, even the investment world will realize that a smaller share of a growing economy is better for them than a larger share of a stagnant one.

National wealth cannot be distributed (or redistributed) until it is produced; we must focus as much on wealth production as on its division. Albert Einstein noted that, "In the real world, there are neither rewards nor punishments—only consequences." We must act so that the consequences of our actions take us where we want to go.

Our economic problems are remediable— but not in the immediate future. America is a resilient society and we will muddle through, but we must modify our expectations for the short run and again think long run. As Adam Smith wrote, "There is a lot of ruin in a country," and we have great strengths. To regain our national momentum—to refute those who speak of "American decline"—we must act vigorously and wisely. Three specific areas cry out for governmental attention: infrastructure, foreign trade and industrial policy. Our public intellectuals are remiss in not demanding that we address them.

Finally, and most importantly, we must address the long term challenge of providing productive employment for all those ready, able and willing to work. Today, one quarter of our young people drop out of high school before graduation, and we have no economic role for them. Those with college degrees do somewhat better, but not really well. Graduate degrees or specialized skills are increasingly required for success in this information-fueled, high-tech world. Our workers are in competition with those of the rest of the world who are becoming better educated and vocationally-trained than U.S. workers. We either raise our educational and skill levels in STEM fields (Science, Technology, Engineering, Mathematics) or suffer accordingly. Increasing poverty, downward mobility and social turmoil are not impossible.

That is a worst case. A best case could occur if our disadvantaged poor—whether whites in the rural South or minorities in the inner cities— develop the attributes demanded by a high tech, globalized, competitive world. Future-mindedness, self-discipline, the capacity for sustained hard work and a passion for education are the underpinnings of the self-confidence and high aspirations that lead to economic productivity and personal fulfillment.

Skin color, religion and ethnicity are fading rapidly as major factors in American life. Social culture (as reflected in attitudes, values and mindset) is paramount today, regardless of the fulminations of demagogues. Entrepreneurship, for example (which we need to encourage), requires a mindset of risk-taking, thinking outside the box, the ability to rebound from failure with vigor and the tenacity to hold fast to a creative vision, all of which are cultural, not ethnic. Jesse Jackson's 'perpetual victim' view of life should give way to W.E.B. DuBois' call for the minority Talented Tenth to lead the way to the promised land.

Continuing economic growth is the answer to our employment problem, but such growth requires a revival of what Keynes called our "animal spirits," confidence in prospects for the future. That confidence must be based on real world factors, and only political and legislative leadership can create those factors: improved education and vocational training, improved infrastructure, more astute foreign trade policy, a rethought national industrial policy and a more balanced national distribution of income and wealth.

Lowering the cost of political campaigning (by some form of public financing, or free access to TV) and tightening—not loosening—the regulation of political contributions (thereby lessening the influence of lobbyists), are important first steps, along with an end to political gerrymandering. Undue influence—whether of 'fat cats' or of labor leaders—must be lessened. Political term limits and specific steps to increase transparency and accountability to voters should follow. In the meantime, we need more politicians like Teddy Roosevelt, of whom the bosses complained, "We bought him but he didn't stay bought!"

"Let no good crisis go to waste" is a useful thought; but we must be sure that Schumpeter's "creative destruction" is indeed creative. It will be worth our present pain and sacrifice if a healthier, more responsive political and legislative system results from it.

This past decade has been a difficult one for us, but we can snap back. "American exceptionalism," in which I believe, has traditionally been based on underlying premises of "can do" pragmatism, fair-mindedness, generosity and optimism. We must not forget that.

Sheer demographics and economic projections indicate that with a global population of 7 billion people, America's position in the world must in time change relatively. In absolute terms, great days can still lie ahead for our country.

The following points would speed our recovery:

- Budget deficits should be recognized as short term expedients to "tide us over" cyclical downturns, and our debts must be paid down significantly as soon as budget surpluses from a growing economy permit.

- Health care costs must be financed by actuarially-sound measures that are transparent and understood by all. In 2010 the U.S. spent 17.6% of its GDP on healthcare vs. an average of 9% for European countries, yet their life expectancies are higher than ours. We need better value for our health dollars. "Defined benefits" as a concept should yield to some form of a "defined contribution" approach because we can no longer afford the former today, much less when the WWII baby boomers retire.
- Our system of taxation must be considered afresh, to promote investment and to raise future revenue. Eliminating many deductions and credits (e.g. from eliminating $150 billion a year to stimulate race horse breeding, whale hunting, etc., to re-thinking deductibility of interest on home mortgages) in favor of lower marginal tax rates will provide a simpler and more efficient system. The byzantine U.S. Tax Code, thousands of pages written in technical jargon beyond the ken of a typical small businessman without expensive lawyers and accountants, is a national embarrassment without parallel in the developed world.
- Lower taxes on U.S. corporations' foreign earnings would encourage them to repatriate the cash (tax revenues for us, domestic investment money for them). Tax havens (such as the Cayman Islands or the Faroes), that serve no role other than tax evasion and money- laundering, should be subject to public scrutiny and international regulation.
- Legislation which protects the banking system by distinguishing "depository" (savings/lending) banks from riskier "investment" banks (that trade for their own account) should be reinstituted, as advocated by the wise Paul Volcker. The capital requirements of all banks (large and small, savings or investment) should be examined carefully. Protection of savers and

investors and encouragement of lending are the goals. Private entities "too big to fail" are too big.

- Unfunded, unaffordable pension programs of federal, state and municipal employees should be re-examined and discussed publicly. Logic calls for them to be brought into line with those in the private sector, regardless of the short term political battles that will cause.
- Legal tort reform, regulatory reform and entitlement reform should be reviewed periodically for costs and benefits, goals and actual effects. There should be full and frank discussions before an informed public on these sensitive issues. Frivolous law suits should be discouraged by using the British practice of having losers pay court costs and legal fees.
- Foreign trade should be encouraged, not discouraged, with the informed cooperation of business, labor and government, all concerned with the national interest. A clearly-enunciated national trade policy is long overdue. We must again become a successful trading nation, with high-wage, high-productivity jobs located in the United States profitably providing goods and services for the growing middle classes of the BRICs (Brazil, Russia, India, China). Trade policy should be all-encompassing; for example, tariffs on industrial production "inputs" should be eliminated so that U.S. producers are more competitive in the global economy.
- Charges of growth-strangling costs of counter-productive federal regulations (especially on small business) must be investigated and, where justified, modified. Sarbanes-Oxley and Dodd-Frank legislation should be treated as 'living documents' whose consequences and unintended consequences are reviewed periodically. Necessary environmental controls (which some business groups fight even in good times) must be differentiated from excessive controls (which ideologues support regardless of cost vs. benefits).
- Our housing problem must be faced realistically. Americans

have lost $7 trillion in home equity, and necessary "de-leveraging" will be slow and painful. It requires orderly debt restructuring, debt reduction and conversion of debt into equity, until normal market forces again bring equilibrium. Permitting fore closed home owners to remain in residence as tenants, with modest rents and an option to repurchase, will prevent vandalism to the house and homelessness for the occupant. (The mortgagee will receive some income and some "shared appreciation" on the property's eventual sale but would face some write down in the short run.) Enabling non-profit groups to own—and to rent out— foreclosed single family homes is another approach; private investors can be encouraged to buy and rent out distressed single family houses. With housing production less than family formation, markets will stabilize in time, but in the meantime, first-time home buyers should be helped to absorb the current surplus of available houses; and existing home owners should be able to avail themselves of current low interest rates.

Those fortunate countries without a 'sub prime' problem either required a significant down payment on home mortgages and borrower incomes sufficient to pay debt service or did not let mortgage originators bundle and sell loans.

- Visas and 'green cards' for post-graduate students, high tech practitioners and others who help our economy should be expedited, not only for their benefit but for ours. A remarkably high percentage of our innovative practices have come from immigrants or their children who have started 40% of our Fortune 500 corporations.
- "Prevailing wage" laws have had a distorting impact on employment. General Motors, for example, has been able to hire thousands of workers recently when unions agreed to permit some "below-prevailing wages."
- Legitimate charitable contributions should be encouraged, not discouraged. The suggestion that they be taxed is the most

counter-productive idea recently proposed, since a thriving philanthropic sector is now more important than ever. $300 billion in annual contributions employing 9% of the U.S. work force should not be diminished.

- The multi-trillion dollar long term reductions in government expenditures being proposed are necessary, but some proposed cuts (such as Pell scholarship grants) are ill-advised, and our public universities must be maintained.
- The successful industrial policies of Germany, whose high-wage manufacturing sector is flourishing, should be an example for America. The manufacturing economic 'multiplier effect' is much greater than that of the service sector.

Other questions to be pondered:

- Why should "second home" owners receive interest deductions on their mortgages?
- What inheritance should heirs receive free of all taxes, and what should graduated taxes be on larger estates?
- Should seniors, regardless of their ability to pay, receive medications free?
- Should Social Security be "means tested?"
- How should Internet purchases and services be taxed?
- Is it psychologically sound for one half the public to pay no federal income taxes at all?
- Why should tax rates on short term capital gains (less than one year) not be raised, while those on longer term (over a year) not be lowered? And how about a zero tax rate on newly-issued securities which fund growth?
- How should 'short selling' be regulated, taxed and reported, and what are appropriate regulations and taxation for the $600 trillion derivative market? (Yes, the $600 trillion figure is "notional," with much double- counting, but what a number!)
- Given our conflicting desires for energy independence and for a green world, how should oil and gas companies be taxed? Would not higher taxes at the gas pump curtail consumption

as well as provide revenues?

- America's great days may lie ahead, but "the mode by which the inevitable comes to pass is called effort," said Oliver Wendell Holmes.

It remains to be seen if the American public will make the effort.

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