

2012 Election: Show Down at OK Corral*

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The recent debate generated by Warren Buffet's call for billionaires to pay more taxes is really about what kind of society we want. The debate has been going on since the founding of our country. Comments on the fairness of taxes are interesting, but it seems to me that we need to put the discussion in a broader context.

I recently saw an analysis of income distribution around the world based on the Lorenz Curve and the Gini coefficient. Tony Spiva, an economics professor at the University of Tennessee, reports in his latest semi-monthly commentary that between 1950 and 1990, the Gini coefficient in the U.S. went from .35 to .40 and by 2007, to .45. This can be compared to figures reported in a Recent Times magazine article focusing on inequality as one of the causes of the riots in England. The Times article reports a Gini coefficient for several European countries: Portugal .36; U.K. .34; Germany .30; France .29; Austria .26; and Sweden .26. The Times article went on to describe England and the U.S. as two of the worst nations in terms of upward social mobility.

Dr. Spiva went on to summarize the trend of income distribution:

"1929-1947 is called by many the period of great compression as the real wages of American workers rose by 67% and the real incomes of the richest 1% of Americans fell by 17%.

1947-1973 is the era of shared growth when real wages rose by 81% and the incomes of the richest 1% rose by 38%.

1973-1980 is the OPEC period when everybody lost with real wages falling 3% and real incomes of the richest 1% falling by 4%.

1980-2004 is the period of rapid gap widening with real wages falling by 1% and incomes of the richest 1% rising by 135%."

Spiva quoted one study as follows:

"The data are stark and go some way towards explaining why so many Americans felt so disaffected even during the most robust years of growth under the Bush administration. Between 2000 and 2006, the U.S. economy expanded by 18 per cent, whereas real income for the median working household dropped by 1.1 per cent in real terms or about \$2000. Meanwhile, the top tenth saw an improvement of 32 per cent in their incomes, the top 1 per cent a rise of 203 per cent and the top 0.1 per cent a gain of 425 per cent."

Views on what is fair and equitable vary widely; some see these data as evidence of an unfair society and others believe allowing the wealthy to accumulate wealth is good for all. The rich will use this wealth to create jobs and all boats will rise. We have lived with this rhetoric for many decades, especially since Ronald Reagan charmed the nation with his "supply-side" theory

of tax cuts. The voters will be faced with the conflicting philosophies next year, but it is uncertain that they have any clue as to whom is at fault. The election debate appears to be coming to a shootout at the OK Corral during the next election cycle—if the voters have enough judgment to know what the stark choices are.

How did we arrive at this situation? This is my personal memory of what happened, so excuse me if personal bias gets some figures wrong.

Back in the 1980s, I recall that some proponents of deep tax cuts argued that the only way to stop government spending and reduce the size of “big government” was to “starve the beast.” Since a series of progressive administrations starting with FDR (including Eisenhower and Nixon among Republicans) had expanded the role of government in domestic areas, the way to walk the cat back was to run up huge deficits so Congress would have no other alternative but to cut spending and eliminate many government activities.

It took 28 years to accomplish that goal. Reagan tripled the debt (\$1T to \$3T). Bush I increased the debt to \$4.3T (But brought sanity back by raising taxes, probably costing him a second term). Clinton added \$1.4T by a combination of spending cuts and tax increases, but reversed the trend and was running surpluses by the end of his term. Bush II opted to go back to deep tax cuts. Testifying before the Senate Budget Committee on Jan. 25, 2001, Alan Greenspan *warned* that we faced a \$5.6T budget surplus over the next decade and said we needed a tax cut to prevent Congress from creating new spending programs. Members from both parties jumped at the chance to cut taxes and please the masses. Everyone loves small government and low taxes—in theory.

But the people eager to satisfy the thirst for tax cuts didn’t hear the second part of Greenspan’s message: In essence, he said that economic relationships are different from anything we have considered in recent decades, and the projections could be wrong. He advised Congress to include a provision for the tax cuts to expire if targets in the surplus trajectory weren’t hit (Greenspan later argued to let the cuts expire in December 2010). After two wars and expanded Medicare drug benefits (all unfunded), Bush II handed Obama a \$10.2T debt—and a deep recession. Low taxes became the 11th Commandment that was somehow left off the tablet that Moses brought down from Mt. Sinai.

We had two ideologies competing for how to handle the recession that began in December 2007: 1) Leave it to the markets to be self-correcting, or 2) use a stimulus package to jump-start a recovery. We made a feeble try at the Keynesian model, and while we avoided the catastrophe of another “great depression,” we are treading water while the gap between revenue for federal programs (15% of GDP) and spending (24% of GDP) has led to huge deficits. While some argued that we needed to stay focus on the recovery of the economy, the political agenda became focused on the need to bring the deficit under control. The debacle created by the threat to force the government into default is well known to all but the most ignorant elements of the public.

The battle lines have been drawn. Do we focus on short-term reduction of the deficit, or do we focus on long-term structural changes to our spending? Most economists I follow argue that we must do both, but avoid taking whatever wind we have out of the recovery.

It appears to me that the Republicans chose to focus on the short-term and saw the debt ceiling as an opportunity to force the issue of how much we want to fund the federal government in the future. After the plan to privatize Medicare ran into a political buzz saw, the Republicans abandoned any notion of including structural changes to entitlement programs. In order to avoid a default, the budget must be balanced on the back of domestic discretionary spending. Of course, once again, defense was off the table. In effect, by refusing to put taxes on the table continues the plan to starve the beast. Raising the debt ceiling was an ideal political hostage to force the issue.

But something funny happened on the way to the Forum. While the first round of cuts was largely domestic programs, the next \$1.5T will come from...? Only the most optimistic believe the so-called committee of twelve will come to any agreement. Failure to do so will result in across-the-board cuts of 15% of both domestic and defense spending. The specific cuts will become apparent to even the most casual observer when they occur in 2013. Will the consequences be apparent by the 2012 election? From my observation of voter behavior, I wouldn't bet on it. Conservatives may scream about undermining our security by cutting defense and liberals may scream about cutting domestic programs that have developed over the last eight decades, but will reality hit home?

We have come to crunch time in deciding what kind of society we want. This is the real issue over the debt ceiling. If we want to limit the federal government to 18% of GDP, what programs will get that money? Obama has been accused by his liberal base of "giving away the store" in order to avoid a default on the debt. Perhaps he did, but there will be one new factor in the calculus next year: the Bush tax cuts, which will expire at the end of 2012. If Obama chooses, he can hold the extension hostage; he will certainly campaign on that issue. It will be interesting to see how voters choose next November. Do they want to give the federal government 18% of GDP and make the tough choices, or do they want to provide 21% (Bowles/Simpson) or 23% (Rivlin/Dominici).

I just read that Americans pay 24% of GDP in taxes; Brits pay 34%; Germans pay about 40%; and the French 43% (if my memory is correct). There is no question that the American ethos is small government and low taxes. The next election will be very interesting. It has the potential of being a show down at the OK Corral.

In an article in the Post on 11 August discussing the rioting in England, the Guardian editor had this to say:

"Most controversial is the suggestion that the riots might have even a tenuous link to the government's austerity program, aimed at reducing the deficit. Funding for youth services — clubs and outreach workers — in the Tottenham area [has just been cut by 75 percent](#). Those schemes used to keep some of the toughest kids off the streets, but no longer.

“It’s too early to know whether spending cuts played any part in England’s burning. But as the United States embarks on its own retrenchment, it should beware — this is an argument that could soon be coming your way.”

Margaret Thatcher attempted to reduce the role of government in England; she managed to reduce the share of GDP from 49% to 47%. The Cameron administration has set a goal of 39%. Most of those cuts are yet to be implemented. Is this austerity policy unrelated to the riots? A few, including the Pope, have suggested that there are lessons to be learned from what is happening in England, but that doesn’t seem to be getting much traction in the media.

None of us who has been engaged in the political debate about what kind of society we want should be surprised by the ideological views being expressed, and the conflicting ideas of what is a just society should look like. I hope we can watch the coming election play out and have a dispassionate exchange about what the real issues are. I doubt many will change his or her mind as a result of the exchange, but I would hope we don’t impugn the motives and integrity of those who disagree with us.

John Johns

*This is a posting on the War Lord Loop, a blog of about 500 people.

Addendum, 12/14/11.

Since I wrote this, the Occupy Wall Street (OWS) movement has spread around the world. In a recent article in the Washington Post, the Ombudsman interviewed a number of protesters and concluded that, while they varied in their specific aims, they coalesced around the resentment of the growing gap between the top 1% and the 99%, which is their rallying cry. This finding correlates with a number of observations by the OECD, IMF, and Financial Times (FT) articles focusing on the growing gap between haves and have nots.

In a recent article “U.S. Heads for Class Warfare Election”, the FT cited Obama’s recent speech at Osawatomie, Ks., where Obama cited Teddy Roosevelt’s similar speech there in 1910. The FT editorial said: “and thus are the 2012 battle lines being drawn.” It went on to say the Republicans have adopted the Tea Party’s anti-tax, small government, laissez-faire ideology, while Obama is adopting the 99% slogan of the OWS with a large government role. The FT argues that there needs to be a consensus that recognizes the need for taxes, spending cuts, and government regulations. (I would like to distribute the FT articles, but they do not permit it).

There is nothing new in these additions to my original August essay, but it seems to me that the battle lines are being sharpened, as the FT says. I suspect the game of brinksmanship we will see for the next year will be focused around this divide. The game of chicken is for the soul of the country, and there are two competing ideologies that seem to be beyond compromise.

JJ

