

R704: Ramifications of the 2012 Election
Session 1: The Size and Role of Government

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In the January/February 2010 edition of Atlantic Monthly, James Fallows declared that the U.S. political system is dysfunctional. He cited the gridlock over confronting our economic problems. Unless we fix it, he said, we will either have a new Constitution, or a coup. He ruled out both as unthinkable, and argued that we will fix the system. The past two elections brought many new members to Congress who are dedicated to returning “power to the people” and “constitutional government.” The coming months will reveal what the fix is to be. What was the signal sent by “We the People” in the last two elections?

There are several issues that divide the two parties regarding the proper role of government, to include individual privacy, gun rights, and freedom of diverse lifestyles. But central to the current gridlock is the proper role of government in economic activities, and in order to manage the discussion, this paper will be restricted to that area.

The role of government, especially at the Federal level, has been controversial since the founding of our republic. The Constitution, which lays out the framework for this role, was the result of compromises between those who wanted a strong national government (perhaps represented best by Hamilton) and a weak national government (Jefferson, though he was not present at the drafting). This issue is at the heart of the gridlock which Fallows describes. The current economic debate promises to bring this controversy to a head. In my opinion, the 2012 election results did not resolve the question of what “We the People” want that role to be. It seems to me that the issue is too complex for voters to understand. When they give congress an 11% favorable rating, they don’t know which of the two ideologies to blame for the gridlock.

In simplistic terms, there are two competing ideologies that provide the framework for policies related to government intervention in economic activities. It is useful to define the terms I will be using. Classical economic theory is concerned with economic activities in an unfettered, laissez-faire market place, that is, a “free market.” Many of the analytical tools used in classical theory are econometric models designed to explain supply and demand, propensities to save and spend, etc. While these mathematical models may strive for scientific respectability, research has shown that they do not reflect actual human behavior. The main

limitation is that some of the basic assumptions, principally “rational economic man,” are unfounded. In the last few years, a new area of economics, behavioral economics, has accumulated empirical data to support common-sense observations that people do not behave rationally in their economic behavior.

Based on the econometric models, classical economists search for the most “efficient” means of production free of contaminating variables such as government regulations. Political boundaries, economic “justice,” and other externalities are considered irrelevant, or assumed away. On the other hand, “political economy” involves the intervention of government to take into account those externalities. More than economic efficiency is considered; rather, Economic “effectiveness” is the desired outcome of political economic theories. “Effectiveness” is defined in terms of what a particular government deems to be desired outcomes. As we shall see, this might include home ownership as a national goal. Tax policies, e.g., deduction for interest on mortgages, may be used to encourage such outcomes. This particular policy can be very complicated. Should it be extended to beach homes, homes in flood-prone areas, etc.? What is politically desirable may or may not be in the “national interest.” Ultimately, this will be decided by the voters.

The United States has never had an economy based on pure laissez-faire economics, but our policies have increasingly moved toward a greater role for government, that is, a political economy. This movement toward an economy based in large measure on ensuring economic justice for the public in general is commonly referred to as the “progressive movement.” If one wishes to describe it in derogatory terms, it is “socialism.” In the United States political arena, “socialism” is one of the political third rails. As I will outline, the current political gridlock is centered on the attempt to not only stop the progressive movement, but to walk the cat back to a pre-New Deal era.

History of Progressive Movement.

In op-ed article on 16 January 2011 of the Washington Post, “A Congress that reasserts its power,” George Will, provides a good summary of the essence of this divide. Will asserts that Conservatives believe in small government, which, in his opinion, the Founders intended. Liberal Courts have allowed executive aggrandizement, first by FDR and then by his “acolyte, LBJ.” Will says to ignore the intent of those Founders is to turn the Constitution on its head. He argues that the current conservative movement is a reaction to those liberal policies. Will referred to the 1905 Court decision, *Lochner v. New York*, as an example of the

proper role of the judiciary. In that case, the Court decided that government had no authority to regulate business and cited a book (1853) by Herbert Spencer, which advocated “Social Darwinism.” (Ayn Rand was a 20th Century advocate of this ideology for those who want a short summary of her philosophy, read her Novelette, Anthem. I believe you can get this on You Tube). The last two paragraphs of Will’s article sum the Conservative ideology:

“Two years into Barack Obama's presidency, we now know what he meant about ‘hope’ and ‘change’ - he and other progressives hope to change our national character. Three weeks into his presidency, Newsweek, unhinged by adoration of him and allowing its wishes to father its thoughts, announced that ‘we are all socialists now’ and that America ‘is moving toward a modern European state.’ The electorate emphatically disagreed and created the 112th Congress, with its exceptionally important agenda.”

It should be clear that the Democratic Party has, since the FDR era, pursued a more “Progressive” and active role for government. I don’t need to summarize the New Deal agenda, which was a social revolution. LBJ and his “Great Society” agenda were captured by this statement in one of his speeches:

“I see a day ahead with a united nation, divided neither by class nor by section nor by color, knowing no South or north, no East or West, but just one great America, free of malice and free of hate, and loving thy neighbor as thyself. I see America as a family that takes care of all of its members in time of adversity ... I see our national as a free and generous land with its people bound together by common ties of confidence and affection, and common aspirations toward duty and purpose.”

The degree to which one leaves it to the “market place” to correct economic problems is critical in identifying where one falls on conservative/ liberal continuum. The history of “progressive government” has been one of finding the role of government in providing an economic “safety net” for the disadvantaged. Conservatives have argued for a “free market” as the best approach to ensure justice while liberals have argued for government intervention. Social Security, Medicare, Minimum Wage laws, workplace safety, and the 2010 Health Reform Act are examples of such intervention. Most these policies have been under Democratic Presidents.

Politicians are sensitive to the danger of being labeled as callous toward the unfortunate; hence the claim to be a “compassionate conservative.” Likewise, one must not be labeled a “bleeding heart liberal,” as in the case of Dukakis. Bill Clinton fought the label by declaring “the era of big government is over,” and later, “welfare as we know it is over.” In the 22 October 2012 edition of The Week, this was the Quote of the week:

“In American politics, Republicans routinely speak in broad themes and tend to blur the details, while Democrats typically ignore broad themes and focus on details. Republicans, for example, speak constantly of ‘liberty’ and ‘freedom’ and couch practically all their initiatives—tax cuts, deregulation, and so forth—within these large categories. Democrats, on the other hand, talk more about specific programs and policies and steer clear of big themes. There is a reason for this: Republican themes, like ‘liberty’, are popular, while Republican policies often are not; and Democratic themes (‘community,’ ‘compassion,’ ‘justice’) are less popular, while many specific Democratic programs—Social Security, Medicare, even (in many polls) putting a price on carbon emissions—have majority support.”

Michael Tomasky in The New York Review of Books

A survey by the Washington Post during the 2010 election reported that the top five words used by Tea Party members to describe themselves were: patriotism, constitutionalism, freedom, liberty, and grass roots. (24 October 2010, p. A9). This reminds me of the advice given in a textbook I used in a 1948 class “Public Opinion and Propaganda,” to wit, “to win an election, wrap yourself in the American Flag, stand on the Constitution, and quote the Bible” (Public Opinion and Propaganda, Leonard Doob, 1948).

Distributive Justice.

There are fundamental differences in how the two competing ideologies view the best way to provide “justice for all.” Basically, neoconservatives believe the market place can do this best. Government attempts to do it result in the creation of a welfare class of moochers and takers and erosion of the work ethic. They believe that free markets are the basic element of a system that is an “opportunity” society. I have cited some of the oracles of this view. Their ideal ethical theory of distributive justice would be something like that advocated by Ayn Rand:

Distributive Justice Based on Contributions. Benefits should be based strictly on one's contribution to the goals of her/his group (the firm, society, humanity, etc.). Pay and benefits measure contributions. These are used in turn to obtain society's benefits. If one does not have the means to pay for such benefits, he/she goes without them. The "free market" of economic activities determines who gets what and the government has no obligation, or right, to interfere as long as everyone has a legal opportunity to gain employment (this is usually called "the opportunity society").

Liberals, on the other hand, believe that in a complex economic system the government must intervene to provide a safety net. There are variables beyond the control of individuals that leave some people in a disadvantageous position. There are certain basic entitlements for all citizens, to include education and health care. These make up the so-called "safety net." Their concept of an ideal ethical theory of distributive justice would be that advocated by John Rawls:

Distributive Justice as *Fairness/Equity*. Each person has a moral right to a *fair* distribution of benefits of a society. This includes, as a minimum, the essentials of food, clothing, shelter, and medical care. The higher expectations of those better situated are just/fair if, and only if, they work as part of a scheme that improves the expectations of the least advantaged members of society. There must be *fair*, not just *legal*, opportunity to attain advantaged status.

It is interesting to note that when someone suggested to Ayn Rand that she read John Rawls' theory, she dismissed it as not worth reading. Not all conservatives accept the radical extremes of Ayn Rand's rugged individualism, but economic plans such as Paul Ryan's first budget introduced in the 2011 House comes close. Dominated by Tea Party insistence on immediate austerity measures in spite of being in the midst of a recession, the budget was draconian in its attack on the safety net.

Current Status of Economic Justice in the United States.

Advocates of a free-market, "opportunity society," supply-side tax structure often boast of the American economic system compared to that of the "socialistic" European countries. It is useful to look at some empirical data.

In December 2011, about the time Ryan was developing his draconian budget to cut the safety net, international studies were focusing on the growing economic inequality around the world, especially in the United States.

According to a report released in December 2011 by the Organization for Economic Cooperation and Development (OECD), income inequality is increasing across much of the developed world, a trend that will continue unless governments move aggressively to arrest it. The mission of the Paris-based OECD, whose members include 34 developed countries, is to promote policies for improving economic and social well-being.

The OECD report cited rising dissatisfaction with economic inequality that has spilled over into street protests in dozens of cities around the world. “The social contract is starting to unravel in many countries,” OECD Secretary General Angel Gurría said in a statement. “This study dispels the assumptions that the benefits of economic growth will automatically trickle down to the disadvantaged and that the greater inequality fosters greater social mobility. Without a comprehensive strategy for inclusive growth, inequality will continue to rise.”

The average income of the richest tenth of the population in OECD countries is about nine times that of the poorest tenth, the report said. The United States, Turkey and Israel have among the largest ratios between the incomes of those at the top and the bottom, roughly 14 to 1. Germany, Denmark and Sweden have among the lowest — 6 to 1 — but the ratios are up from the 1980s.

Overall, inequality among working Americans has risen 25 percent since 1980, the report said. In 2008, the average annual income of the top 10 percent of Americans was \$114,000, nearly 15 times higher than that of the bottom 10 percent.

Supporting those findings, Tony Spiva, an economics professor at the University of Tennessee, reported in his semi-monthly commentary that economic mathematical models (the Lorenz curve and Gini coefficient) showed a sharp rise in inequality around the world, especially in the United States. He cited a New York Times article that described 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."

The top 1% in the U.S. was initially hit hard by the global economic crisis that began in December 2007, accounting for 50% of the income loss. Their share of income dropped from 23.5% (up from 10% in 1980 before the Reagan tax cuts) to 18.1%. In the sluggish recovery, however, top incomes have also rebounded much more strongly. The top 1% captured 93% of the income gains in the first year of recovery.

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. Voters will be faced with the conflicting philosophies during the next few years as we debate how to solve our economic crisis, but it is uncertain that they have any clue as to who is at fault. But let me give you a quote from the guru of many conservatives:

*“The necessities of life occasion the great expense of the poor. They find it difficult to get food, and the greater part of their little revenue is spent in getting it. The luxuries and vanities of life occasion the principal expense of the rich, and a magnificent house embellishes and sets off to the best advantage all the other luxuries and vanities which they possess. A tax upon house-rents, therefore, would in general fall heaviest upon the rich; and in this sort of inequality there would not, perhaps, be anything very unreasonable. It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion.” Adam Smith. *The Wealth of Nations**

Back in the 1980s when I was teaching political economy at the National Defense University, 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. When I showed the above quote, students erroneously identified it as a quote from Karl Marx.

It took over 30 years to accomplish that goal. Reagan tripled the debt (\$930B to \$2.7T). 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 (a disciple of Ayn Rand) *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. (Even now, a recent poll shows that only 27% favor cutting the deficit by tax increases beyond those just enacted for the top .8%)

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 have 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 (16% 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 in 2011 is well known to all but the most ignorant elements of the public. Will we face the same tactic in the next two months?

Summary:

I have described what I believe we can draw from the recent election in regard to the role of government in economic activities. I believe it continues to be a “Show Down at the OK Corral. While there is no danger in going back to the pre-New Deal role of the 1920s, there is a danger of “starving the beast” (Federal Government) so that it cannot fund the safety net programs that are now in place. Both Reagan and Bush attempted to privatize Medicare and Social Security. Both failed and it is unlikely that the Republicans have the political clout to resurrect those efforts. However, there are ways to whittle away at the “socialist” programs by pushing through measures that will force the Democrats to reduce the safety net considerably. The recent “deal” to make the Bush tax cuts for all but the top 1% permanent may have ensured that revenue will never be adequate to fund the safety net now in place. Who will dare raise the taxes on the bottom 99%, even when our economy is strong?

With long-term global economic trends aligned against the American “middle class,” social unrest will be probable. Whether this results in political instability is to be seen. The unions are no longer able to protect the ordinary private-sector worker, leaving the government as the last resort to maintain the basic elements of an economic safety net. Only 11% of our workforce is employed in non-agriculture manufacturing; we are a “service” economy. This part of our economy has a wide range of wages. The financial sector pays well—very well for many at the top.

Those who serve us at restaurants and shopping malls have a hard time surviving. We are reluctant to give them health care and free college education, which are essential basic needs. We don't want to keep the minimum wage to keep up with inflation. Above all, we don't want to raise taxes!

The gerrymandering of congressional districts after the 2010 election (both parties are equally guilty) ensures that the Republicans will likely retain the House majority until at least 2020. If they are able to maintain party discipline dominated by the Tea Party, that will result in continued gridlock. We will know how serious this is for the welfare of our country during the next two years. I would hope the voters understand the stark choice and vote in people who stand for what the voters want our society to be—either continue the communitarian/progressive model, or return to the individualistic model. The result will be some compromise, but we cannot prosper if we maintain gridlock.

I have attached an enclosure, *Dominant Values in American Society*, that illustrates the rugged individualistic culture that makes it difficult to create a communitarian society. In theory, the deck is stacked against the “progressive” movement.

Enclosure 1
Dominant Values in American Society

Let me summarize what I see as some of the dominant values in American society that impact on different ideologies. Research indicates that while people espouse these values in theory, they value specific programs that often conflict with theory. As you read through this list, you can identify how conservatives (the new variety) and liberals differ in their ideologies.

- A. **Rugged individualism.** The country was born in an environment—physical and culturally—that emphasized self-reliance and individual initiative. Missing was the role of government in assisting in distributive justice. In a sense, everyone was on her/his own. While circumstances have changed considerably as the society has become more interdependent, the culture, at least in theory, has endured. A survey in the sixties of fifty countries measured the individualistic-communitarian continuum. At the head of the list of individualism was the United States, with England second. Large urban areas, where life is more interdependent, reflects a more communitarian culture, while rural areas and sparsely populated areas, remain highly individualistic. It should not come as a surprise that “Red” and “Blue” states reflect these differences.
- B. **Belief in American Exceptionalism.** The belief that America is an exceptional country that is destined to lead the world in the march toward enlightened political, economic, and human justice is deeply engrained in our psyche. Any suggestion that our foreign policy is flawed is quickly denounced as a “blame America first” attitude bordering on treason. Some argue that this leads us to pursue a “Pax Americana” foreign policy that attempts to make the world over in our image. In a recent op-ed piece, Henry Kissinger argued that the belief in “American exceptionalism” is an obstacle to world peace. In his book, *Washington Rules*, Andrew Bacevich argues that this attitude condemns us to endless wars such as Vietnam, Iraq, and Afghanistan. This demands increasingly large military forces and spending. Economic and political correlates are discussed below.
- C. **Small Government.** Another feature of our early history and a rugged individualism was the innate fear of a powerful government. Settlers had lived under oppressive governments in Europe and were distrustful of any attempt to create similar institutions here. The “Bill of Rights” was designed to ensure individual freedom and privacy. Conservatives argue for a narrow interpretation of the tenth amendment. The demand for “States’ Rights” is a manifestation of the disdain for the national government. This battle still rages. Governor Rick Perry is perhaps the

- most vocal Republican leader on this issue. “Small government” is especially aimed at the national government.
- D. Distrust of government.** Consider the current polls regarding trust and confidence in our government institutions. If we have no trust in our government, can we endure? If we do not trust the judgment of our elected officials, where do we turn for guidance? “Throwing the bums out” every two or four years doesn’t seem to solve the problem. More on this below.
- E. Free markets.** “Free enterprise” is next to godliness in our society. Although we have not had laissez-faire capitalism for nearly a century, the concept still has political appeal. This element of conservative ideology carries over into our foreign policy, which leads to our goal of forcing it on the rest of the world.
- F. Democracy.** Our political form of government, along with free markets, is undoubtedly the “end of history” as far as debate about ideology goes—according to some neo-conservatives.
- G. Authoritarian.** In spite of our claim to be a culture that encourages individuals to “think for themselves,” we derive most of our opinions from opinion formers who may or may not be either informed or honest.
- H. Religion.** While fundamentalists more often vote on single issues, the mainstream religions promote diversity of thought. Catholics are generally conservative on social issues, but liberal on economic matters. Protestant Fundamentalists tend to be conservative on both social and economic issues and represent a powerful voting bloc for Republicans.
- I. Guns.** I simply don’t know how to discuss this issue.
- J. Low taxes.** Raising taxes is the third rail of politics; candidates recommend tax increases at their peril. The average European country levies taxes to provide their governments (All levels) the ability to provide 49% of the GDP. We have provided revenues to all levels (County, State, and Federal) for 35-38% of our GDP. For the last three decades, we have allowed the Federal government to spend about 20.7% of GDP; but revenues have been limited to about 18%. The gap has been through deficit spending and accumulated debt. Dealing with this gap is at the heart of the political debate. Republicans argue that the solution lies in reducing spending (to 18% of GDP), not raising taxes, while Democrats argue for raising taxes rather than cutting spending.
- K. Rational Man.** It seems to me that much of our belief on rugged individualism, democracy, and free markets is based on the assumption that people are rational beings and that they will make rational choices regarding their welfare. This leads to the belief that if given the choice,

they will plan for their old age, health care, etc. In fact, this concept is the basic principle of classical economics. It is closely related to the concept of “free will,” which assumes individuals are captain of their own ship, masters of their own fate. The belief in rugged individualism and free will were at the heart of Ayn Rand’s economic philosophy. I point this out because among her followers are Alan Greenspan and many of the Republican congressional leaders, e.g., Ryan and Boehner.