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## THE UNITED STATES AT A CROSSROADS

### Introduction

The United States is experiencing a social and economic upheaval not encountered since the early 1970s. The validity of many fundamental functions the federal government has been performing for decades is being questioned. On the right, the Tea Party movement attacks the principles of the welfare state; and, on the left, the Occupy Wall Street movement doubts the state's impartiality in addressing the question of social justice. The Republicans feel great pressure to drastically limit the spending on programs benefiting primarily the less fortunate while the Democrats are being pushed to increase taxes on the wealthy. This tension translates into political paralysis.<sup>1</sup> For instance, Congress has failed to pass a budget for the past three years.<sup>2</sup>

### The rise of the Tea Party

The past few years have seen the rise of the "Tea Party." Despite its name, the Tea Party is a loose movement rather than a unified entity. "The Tea Party is a far-flung patchwork of organizations, some local and some national, with a related set of issue concerns and positions."<sup>3</sup>

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<sup>1</sup> T. Mann, N. Ornstein, *It's even worse than it looks: How the American Constitutional System Collided With the New Politics of Extremism*, New York 2012.

<sup>2</sup> J. Rubin, *Senate Democrats Won't Pass a Budget*, "The Washington Post", February 5, 2012, [www.washingtonpost.com/blogs/right-turn/post/senate-democrats-wont-pass-a-budget/2012/02/03/gIQAbLwfpQ\\_blog.html](http://www.washingtonpost.com/blogs/right-turn/post/senate-democrats-wont-pass-a-budget/2012/02/03/gIQAbLwfpQ_blog.html).

<sup>3</sup> Ch. Karpowitz, J. Quin Monson, K. D. Patterson, J. C. Pope, *Tea Time in America? The Impact of the Tea Party Movement on the 2010 Midterm Elections*, "PS: Political Science & Politics" 2011, Vol. 44, No. 2, pp. 303–309.

The movement has humble, if not inauspicious, roots. Ms. Kremer, a former flight attendant, and Ms. Martin, a former software manager, were two central figures in the movement's formation. Both were outraged by the government bail-out of financial institutions and fueled their frustration into their political blogs. On February 19, 2009, Rick Santelli, a financial market commentator on the television channel CNBC, had an on-air outburst regarding President Obama's \$75 billion assistance program for homeowners who could not pay their mortgages. In now-famous words, he exclaimed, "We're thinking of having a Chicago Tea Party in July."<sup>4</sup> Mr. Santelli's rant became an internet sensation.

A group of internet-linked political activists, including Ms. Martin and Ms. Kremer, decided to organize a host of simultaneous protests nationwide within a week. They succeeded in staging 50 protests all over the country. Another nationwide set of protests for the US deadline for filing taxes, April 15, exceeded all expectations and instead of the planned 40 cities as sites for protests, the organizers "lost track at 830" – the protests gathered hundreds of thousands of participants.<sup>5</sup> Three days before the protests, Ms. Kremer's husband came up with a name for the organization: the Tea Party Patriots. The Tea Party gained national prominence and recognition, and several conservative political analysts, such as Glenn Beck and Sean Hannity, started their own Tea Party organizations.<sup>6</sup>

### **"Contract from America"**

The Tea Party seeks a limited government, individual liberty, and economic freedom. These principles have been enshrined in a "Contract from America." It is reminiscent of the "Contract with America" that the Republicans, led by Newt Gingrich, propagated and used to take control of Congress in the mid-1990s. The contract contains ten main principles: "1) Protect the Constitution, 2) Reject cap and trade, 3) Demand a balanced budget, 4) Enact fundamental tax reform, 5) Restore fiscal responsibility and constitutionally limited government, 6) End runaway government spending, 7) Defund, repeal, and replace government-run health care, 8) Pass an 'all-of-the-above' energy policy, 9) Stop the pork, and 10) Stop the tax hikes."<sup>7</sup>

### **Special elections in Massachusetts**

In January of 2010, the Tea Party gained national recognition of its strength when Republican Scott Brown won the special election to fill the late Ted Kennedy's se-

<sup>4</sup> D. von Drehle, *Why the Tea Party Movement Matters*, "Time Magazine", February 18, 2010, [www.time.com/time/magazine/article/0,9171,1966475,00.html](http://www.time.com/time/magazine/article/0,9171,1966475,00.html).

<sup>5</sup> D. A. Blackmon, J. Levitz, A. Berzon, L. Etter, *Birth of a Movement: Tea Party Arose from Conservatives Steeped in Crisis*, "The Wall Street Journal", October 28, 2010, [www.online.wsj.com/article/SB10001424052702304173704575578332725182228.html](http://www.online.wsj.com/article/SB10001424052702304173704575578332725182228.html).

<sup>6</sup> *Ibidem*.

<sup>7</sup> Contract from America, [www.contractfromamerica.org](http://www.contractfromamerica.org).

nate seat in Massachusetts. Mr. Brown's win was quite the upset. In Massachusetts, registered Democrats outnumber Republicans by three to one and the state had not elected a Republican senator since 1972.<sup>8</sup>

The election had significant practical and symbolic implications. Mr. Kennedy considered health care reform (at the time not passed yet) the cause of his life. Mr. Brown's election not only signaled a rejection of the health care reform but also gave Republicans forty-one seats in the senate – the bare minimum necessary to prevent Democrats from overriding a filibuster. Buoyed by Tea Party energy, support, and volunteers pouring in from around the nation, Mr. Brown ended up winning handily with 52 percent of the votes to 47 percent for his opponent. Exemplifying his populist appeal and approach, Mr. Brown declared, “With all due respect, it's not the Kennedys' seat, it's not the Democrats' seat, it's the people's seat.”<sup>9</sup>

## 2010 midterm elections

The 2010 midterm elections marked the Tea Party's demonstration of strength. Forty percent of voters overall<sup>10</sup> and seventy-one percent of Republicans expressed support for the movement.<sup>11</sup> Energized by the Tea Party, the Republicans exceeded already high expectations and gained a significant majority in the House of Representatives. The GOP picked up sixty-three seats in the House, the largest midterm election swing since 1938.<sup>12</sup> Even President Obama described the results as a “shellacking” for the Democrats.<sup>13</sup>

However, during that election the Tea Party took on both parties. In terms of the GOP, the Tea Party exerted its influence in the primary contests. The Tea Party was not afraid to challenge Republicans who in the movement's mind did not have sufficient conservative credentials or had compromised by collaborating with the current administration. It was in the Republican primaries that the Tea Party was particularly strong. Statistical analysis of the Tea Party impact on the 2010 Republican

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<sup>8</sup> *The Unstoppable Truck: How Scott Brown Swept up the Bay State and Stymied Health Reform in Washington*, DC, “The Economist”, January 21, 2010, [www.economist.com/node/15330692](http://www.economist.com/node/15330692).

<sup>9</sup> *Ibidem*.

<sup>10</sup> G. Langer, *Exit Polls: Economy, Voter Anger Drive Republican Victory*, ABC News, November 2, 2010, [www.abcnews.go.com/Politics/vote-2010-elections-results-midterm-exit-poll-analysis/story?id=12003775&page=1](http://www.abcnews.go.com/Politics/vote-2010-elections-results-midterm-exit-poll-analysis/story?id=12003775&page=1).

<sup>11</sup> P. Wallsten, D. Yadron, *Tea-Party Movement Gathers Strength*, “The Wall Street Journal”, September 29, 2010, [www.online.wsj.com/article/SB10001424052748703882404575520252928390046.html](http://www.online.wsj.com/article/SB10001424052748703882404575520252928390046.html).

<sup>12</sup> C. Dodge, L. Lerner, *Democrats Face Biggest House Midterm Defeat Years*, Bloomberg, November, 2, 2010, [www.bloomberg.com/news/2010-11-02/republicans-approach-biggest-house-midterm-win-in-seven-decades.html](http://www.bloomberg.com/news/2010-11-02/republicans-approach-biggest-house-midterm-win-in-seven-decades.html).

<sup>13</sup> K. Rowland, *Obama Concedes 'Shellacking': Blames Process, not His Policies, for Democrats' Setback*, “The Washington Times”, November 3, 2010, [www.washingtontimes.com/news/2010/nov/3/obama-concedes-shellacking](http://www.washingtontimes.com/news/2010/nov/3/obama-concedes-shellacking).

primaries found that endorsement by the Tea Party increased a candidate's votes by eight to nine percentage and that signing on to the "Contract from America" increased votes by twenty percentage points. In sum, "either bearing a Tea Party stamp of approval or showing a willingness to affiliate with Tea Party principles clearly improved a candidate's electoral prospects."<sup>14</sup>

In Delaware, the Tea Party supported Christine O'Donnell to a shocking Republican primary upset over Mike Castle, former governor and the incumbent representative, who had been the presumptive nominee and winner. The Tea Party had similar success in Alaska, where the incumbent, Senator Lisa Murkowski lost the primary battle to the Tea Party candidate Joe Miller. At the time these two races were indicative of the Tea Party's strength. However, eventually they also exposed the Tea Party's weakness. Christine O'Donnell, with headline-grabbing views against pre-marital sex and masturbation, was simply too extreme a candidate and ended up losing the general election in a state that was thought to go Republican. In Alaska, Senator Murkowski ran independently and through her successful write-in campaign was re-elected.

### **The Tea Party loses momentum?**

According to some experts, the Tea Party seems to currently be in decline. Polling numbers for the movement have decreased. Virtually half of the population "say-[s] the more they hear about the Tea Party, the less they like it."<sup>15</sup> Tea Party candidates for the Republican presidential nominee, such as Michele Bachmann and Herman Cain, despite brief surges in popularity, ultimately performed poorly in the primaries. Nevertheless, in May of 2012 in a primary in Indiana, Richard Mourdock, the movement's candidate, managed to defeat by a shocking twenty-point margin a veteran Republican senator, Richard Lugar.<sup>16</sup>

Part of this is natural growing pains and the effect of a movement shifting from rhetoric to actually being in a position of responsibility. An example of such blowback was the negative response to the hard-line stance against raising the debt ceiling advocated by Tea Party members in the House. It is one thing to support the Tea Party principle of cutting government spending and another to realize that a possible result of their activities is government shut down and the US credit rating being downgraded. The Tea Party, perhaps in acknowledgment of its weakening national pull, is focusing its attention on local-level elections and fostering a new generation of political leadership rather than larger elections where candidates may be reluctant to alienate a variety of groups by siding with the Tea Party.<sup>17</sup>

<sup>14</sup> Ch. Karpowitz, J. Quin Monson, K. D. Patterson, J. C. Pope, *op. cit.*

<sup>15</sup> G. Langer, *Tea Party Movement Looks Stalled; Half Like It Less as They Hear More*, ABC News, Apr 15, 2012, [www.abcnews.go.com/blogs/politics/2012/04/tea-party-movement-looks-stalled-half-like-it-less-as-they-hear-more](http://www.abcnews.go.com/blogs/politics/2012/04/tea-party-movement-looks-stalled-half-like-it-less-as-they-hear-more).

<sup>16</sup> *The Tea Party: Another Moderate Shown the Door*, "The Economist", May 9, 2012, [www.economist.com/blogs/democracyinamerica/2012/05/tea-party](http://www.economist.com/blogs/democracyinamerica/2012/05/tea-party).

<sup>17</sup> R. W. Stevenson, *THE CAUCUS; Political Memo: For Tea Party, Priority Is an Enduring Future, Not Just a Candidacy*, "The New York Times", March 10, 2012, [www.query.nytimes.com/](http://www.query.nytimes.com/)

## The “Citizens United” Supreme Court decision

In 2010, the US Supreme Court handed down a decision with profound political impact. In *Citizens United v. Federal Election Commission*,<sup>18</sup> the Court eliminated restrictions on independent expenditures on political advertising. As a result, a new type of political advocacy emerged: organizations called super-PACs (Super Political Action Committees). Super-PACs face no limits on raising funds from citizens or corporations, including trade unions. As a consequence, they are able to spend unlimited funds to support or attack causes and individual candidates as long as they do not coordinate their activities with those of political parties and specific candidates. Prior to this Supreme Court ruling, only “regular” PACs were legal and significantly restricted in their fundraising capabilities. For instance, individuals and corporations can donate at most \$5,000 to PACs established by political parties and candidates.<sup>19</sup>

That decision elicited immediate public backlash and even prompted a much-ballyhooed silent “Not true” from Justice Samuel A. Alito, Jr. in response to President Obama’s criticism in his State of the Union Address on January 27, 2010.<sup>20</sup> The primary concern was that the decision would usher in an era where elections would be decided by massive corporate spending on candidates willing to follow corporate lobbying demands. The title of an article by regarded scholar Ronald Dworkin, *The Decision That Threatens Democracy*, captures the concern of many, particularly on the left.<sup>21</sup>

The experiences of the 2012 election cycle seem to confirm some of the fears. Wealthy individuals are in a position to influence outcomes of political races to a degree unknown before. The best example is the 2012 Republican presidential primary. Newt Gingrich, who had little success in raising money, received a \$10 million donation from Mr. and Mrs. Sheldon Adelson in January of 2012.<sup>22</sup> Thanks to this sudden change in fortune, Mr. Gingrich managed to win the South Carolina Republican primary.<sup>23</sup> This victory, although not decisive, allowed the former Speaker of the

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[gst/fullpage.html?res=9B04EEDF1138F933A25750C0A9649D8B63&ref=teapartymovement&pagewanted=1](http://gst/fullpage.html?res=9B04EEDF1138F933A25750C0A9649D8B63&ref=teapartymovement&pagewanted=1).

<sup>18</sup> Supreme Court of the United States, *Citizens United v. Federal Election Commission*, 130 S. Ct. 876 (2010), [www.supremecourt.gov/opinions/09pdf/08-205.pdf](http://www.supremecourt.gov/opinions/09pdf/08-205.pdf).

<sup>19</sup> Detailed information of campaign finance issues can be found in: The Federal Election Commission, “Federal Election Campaign Laws,” April 2008, [www.fec.gov/law/feca/feca.pdf](http://www.fec.gov/law/feca/feca.pdf). The Commission’s web page ([www.fec.gov](http://www.fec.gov)) also provides up to date information on changes in legislation concerning these matters.

<sup>20</sup> A. Liptak, *Supreme Court Gets a Rare Rebuke, in Front of a Nation*, “The New York Times”, January 28, 2010, [www.nytimes.com/2010/01/29/us/politics/29scotus.html?\\_r=1](http://www.nytimes.com/2010/01/29/us/politics/29scotus.html?_r=1).

<sup>21</sup> R. Dworkin, *The Decision That Threatens Democracy*, “The New York Review of Books”, May 13, 2010, [www.nybooks.com/articles/archives/2010/may/13/decision-threatens-democracy](http://www.nybooks.com/articles/archives/2010/may/13/decision-threatens-democracy).

<sup>22</sup> Ch. Palmeri, B. Jinks, *Adelson’s \$10 Million PAC Bet Gives Gingrich Boost for Southern Primaries*, Bloomberg, January 25, 2012, [www.bloomberg.com/news/2012-01-25/adelson-s-10-million-pac-bet-gives-gingrich-boost-for-southern-primaries.html](http://www.bloomberg.com/news/2012-01-25/adelson-s-10-million-pac-bet-gives-gingrich-boost-for-southern-primaries.html).

<sup>23</sup> K. Tumulty, *Newt Gingrich Wins South Carolina Primary*, “The Washington Post”, January 21, 2012, [www.washingtonpost.com/politics/newt-gingrich-wins-south-carolina-primary/2012/01/21/gIQAkTxBHQ\\_story.html](http://www.washingtonpost.com/politics/newt-gingrich-wins-south-carolina-primary/2012/01/21/gIQAkTxBHQ_story.html).

House to prolong his presidential run. The fact that Mr. Adelson gained his wealth from running huge casino operations, including establishments in China-controlled Macao, and that at the time he faced a federal investigation for a possible anti-bribery law violation brought particular attention to this case.<sup>24</sup>

However, not all join the chorus of democratic doom. Some scholars note that the decision implemented a relatively mild decrease – in comparison to previous decisions that did not garner such public attention – in restrictions on such political advertising.<sup>25</sup> More pertinently, there is a strong argument that such public participation, particularly support of political views, is simply too risky for large corporations due to potential repercussions from voters (citizens) or politicians (regulators).<sup>26</sup> However, it is undeniable that rich individuals, corporations, and trade unions have gained a potentially powerful political tool.

### **The growth of income and wealth disparity**

The Tea Party movement is often associated with the Occupy Wall Street protests. The Tea Party blames the federal government for the situation, whereas Occupy Wall Street blames the financial institutions. Nevertheless, both movements exemplify frustration with the political and financial situation of the United States. Their rise to influence is, to a large degree, the consequence of declining living standards that the majority of Americans is experiencing.

The Great Recession caused a drastic increase in unemployment and forced many to file for personal bankruptcy. These events came on the heels of the 2001–2008 period that saw a significant increase in inequality; incomes of a tiny fraction of the population – the super-rich – had been rising rapidly while those of the vast majority had been stagnating. Between 2000 and 2006 the median income (in 2006 dollars) declined from \$49,447 to \$48,233. Over this period of time, the bottom 90 percent of American households recorded a drop in real income of 4 percent, while the top 0.01 percent of families saw an increase of 22.3 percent.<sup>27</sup> In order to maintain their standard of living, Americans decreased the rate of savings; it dropped to 0.4 percent of personal income in 2006, from 2.3 percent in 2000.<sup>28</sup> The rise in inequality is not a new development. Economists at the Center on Budget and Policy Priorities

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<sup>24</sup> N. Confessore, E. Lipton, *A Big Check, and Gingrich Gets a Big Lift*, „New York Times”, January 9, 2012, [www.nytimes.com/2012/01/10/us/politics/sheldon-adelson-a-billionaire-gives-gingrich-a-big-lift.html?pagewanted=all](http://www.nytimes.com/2012/01/10/us/politics/sheldon-adelson-a-billionaire-gives-gingrich-a-big-lift.html?pagewanted=all).

<sup>25</sup> J. Levitt, *Confronting the Impact of Citizens United*, “Yale Law and Policy Review” 2010, Vol. 20, No. 1, p. 217.

<sup>26</sup> R. Epstein, *Citizens United v. FEC: The Constitutional Right that Big Corporations Should Have but Do Not Want*, “Harvard Journal of Law and Public Policy” 2011, Vol. 34, No. 2, p. 654.

<sup>27</sup> J. Jahart, K. Evans, *Trapped in the Middle, The Incomes of Most Americans Have Stalled: Tackling Voter Angst in Pennsylvania*, “The Wall Street Journal”, April 19, 2008.

<sup>28</sup> *Ibidem*.



calculate that between 1979 and 2007 the top 1 percent enjoyed a 277 percent increase in after-tax income, but the middle 60 percent and bottom 20 percent recorded a gain of only 38 percent and 18 percent, respectively.<sup>29</sup>

The stagnation in real incomes combined with rapidly growing health care expenditures resulted in a significant decrease in the standard of living. In 1980, Americans spent 8.5 percent of GDP on medical expenses, but by 2010 the share of health care outlays jumped to 17.6 percent of the GDP. In other countries, the rate of growth in health care costs has been much slower. For instance, over the same period in Switzerland the share of medical expenses in GDP rose from 7.2 percent to 11.4 percent and in the United Kingdom from 5.3 percent to 9.6 percent. But this excess spending on medical services does not translate into better health care; citizens of both Switzerland and the United Kingdom have a longer expected life at birth than Americans.<sup>30</sup>

This drastic growth in health care related costs has particularly negative implications for federal expenditures and, therefore, the size of budget deficits. The federal government runs two programs that cover medical costs: Medicare that pays for medical bills of the elderly and Medicaid, co-financed by states, that reimburses hospitals and doctors for the provision of services to the poor. A decrease in spending on Medicare and Medicaid would substantially add to the growing disparity in equality in the country.

For many Americans, the recent collapse of the real estate market was the death-knell, as the value of their most important asset, their homes, plummeted. Not surprisingly, the 2008 bank bail-out arranged by the Bush administration and an overwhelming majority of Democrats in Congress caused a popular outrage. Many on the right started to demand a radical decrease in the role of the federal government while many on the left demanded punishment of the “fat cats.” This upheaval contributed to a Democratic victory in 2008. But the policies adopted by the new President and Democrat-dominated Congress, the stimulus package (the American Recovery and Reinvestment Act – ARRA), “Obamacare,” and the bail-out of General Motors, gave the Republicans a new lease on political life as the budget deficit and national debt swelled. When the GOP won control over the lower House of Congress in 2010 an unprecedented stalemate set in. The divided government reflects a deeply divided society.<sup>31</sup>

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<sup>29</sup> Ch. Stone, H. Shaw, D. Trisi, A. Sherman, *A Guide to Statistics on Historical Trends in Income Inequality*, “Center on Budget and Policy Priorities”, March 5, 2012, [www.cbpp.org/cms/index.cfm?fa=view&id=3629](http://www.cbpp.org/cms/index.cfm?fa=view&id=3629).

<sup>30</sup> Organisation for Economic Co-operation and Development, OECD. Stat Extracts, [www.stats.oecd.org/index.aspx](http://www.stats.oecd.org/index.aspx).

<sup>31</sup> *Game on: The Campaign Looks Likely to Sharpen America's Divisions*, “The Economist”, April 14, 2012, p. 15.

## Macroeconomic imbalances

The political gridlock is a dangerous development as the economic picture is grim. Table 1 presents most important economic data for the past eleven years. The rate of economic growth is anemic, investment rate (real gross capital formation) mediocre, unemployment unusually high, budget deficit (general government net lending) at a record high, and the level of national debt (general government gross liabilities) approaching the level attained at the end of the Second World War. Projections of the federal government revenues and spending point to a long-term unsustainable path.<sup>32</sup> The nation needs bold fiscal reform.

The National Commission on Fiscal Responsibility and Reform (commonly known as the Simpson-Bowles Commission) and the Rivlin-Domenici Commission laid down a framework for such a change.<sup>33</sup> But President Obama missed this opportunity, even though the Simpson-Bowles Commission was his own creation.<sup>34</sup> The main reason for this failure was little interest among members of both parties in following its recommendations. The Democrats oppose a major weakening of welfare programs and the Republicans refuse to accept any increases in taxes.

This stance on taxes reflects a dramatic shift to the right among Republicans.<sup>35</sup> Chuck Hagel, a former senator from Nebraska and a seasoned Republican politician, goes even further and says that these days the Republican Party is so ideologically rigid that Ronald Reagan – who was a practical conservative and worked with the other party on many occasions – “wouldn’t even want to be a part of it.”<sup>36</sup> But a tax hike is unavoidable, because the level of discretionary spending is relatively small. In 2011, the expenditure on national defense, pensions, health care, and interest on national debt equaled, respectively, 25.3, 23.1, 20.8, and 5.4 percent of the total.<sup>37</sup> In sum, outlays on welfare, education, transportation, and all other federal programs were just a quarter of all federal spending. Contrary to popular opinion,

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<sup>32</sup> G. L. Dodaro, *Fiscal Year 2010 US Government Financial Statements*, Federal Government Continues to Face Financial Management and Long-Term Fiscal Challenges, United States Government Accountability Office, Testimony before the Subcommittee on Government Organization, Efficiency and Financial Management, Committee on Oversight and Government Reform, House of Representatives, March 9, 2011, [www.gao.gov/assets/130/125667.pdf](http://www.gao.gov/assets/130/125667.pdf).

<sup>33</sup> The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform*, Washington 2010; P. Domenici, A. Rivlin, *Restoring America's Future: Reviving the Economy, Cutting Spending and Debt, and Creating a Simple, Pro-growth Tax System*, Washington 2010.

<sup>34</sup> T. L. Friedman, *Go Big, Mr. Obama*, “New York Times”, November 22, 2011, [www.nytimes.com/2011/11/23/opinion/friedman-go-big-mr-obama.html](http://www.nytimes.com/2011/11/23/opinion/friedman-go-big-mr-obama.html).

<sup>35</sup> *The Republicans: A Dangerous Game*, “The Economist”, November 5, 2011, pp. 31–32.

<sup>36</sup> J. Rogin, *Hagel: Reagan Wouldn't Identify with Today's GOP*, “Foreign Policy Magazine”, May 11, 2012, [www.thecable.foreignpolicy.com/posts/2012/05/11/hagel\\_reagan\\_wouldn\\_t\\_identify\\_with\\_today\\_s\\_gop](http://www.thecable.foreignpolicy.com/posts/2012/05/11/hagel_reagan_wouldn_t_identify_with_today_s_gop).

<sup>37</sup> [usgovernmentspending.com](http://usgovernmentspending.com), FY12 Federal Budget Spending Estimates for Fiscal Years 2011–2016, compiled by Ch. Chantrill, [www.usgovernmentspending.com/federal\\_budget\\_detail\\_fy12bs1nnonen\\_1l1n\\_30](http://www.usgovernmentspending.com/federal_budget_detail_fy12bs1nnonen_1l1n_30).



there is simply not enough “government waste” that could be eliminated to make a significant dent in the size of future budget deficits.

Table. Macroeconomic data for the United States

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
GDP growth (annual rate, %)	1.1	1.8	2.5	3.5	3.1	2.7	1.9	-0.3	-3.5	3.0	1.7
Investment expend. (% change)	-1.0	-2.7	3.3	6.3	5.3	2.5	-1.4	-5.1	-15.2	2.0	3.7
Budget position (% GDP)	1.5	-0.6	-4.0	-5.0	-4.4	-3.3	-2.2	-2.9	-6.3	-11.3	-10.6
National debt (% GDP)	54.4	56.8	60.2	68.0	67.6	66.4	67.0	75.9	89.7	98.3	102.7
Unemployment rate (%)	4.7	5.8	6.0	5.5	5.1	4.6	4.6	5.8	9.3	9.6	9.0
China (GDP growth, annual rate, %)	8.3	9.1	10.0	10.1	11.3	12.7	14.2	9.6	9.1	10.3	N.a.

N.a. = data not available

Data: OECD, accessed on July 12, 2012.

Similarly, any potential savings resulting from the winding down of the war in Afghanistan are limited. In fact, the future spending on benefits to which veterans of the wars in Iraq and Afghanistan are entitled, especially for health care, will significantly exceed the direct costs related to the actual fighting. Linda J. Bilmes and Joseph E. Stiglitz assessed the total direct and indirect cost of the wars at three trillion dollars.<sup>38</sup> As the wars drag on the actual cost may substantially exceed that estimate.

The present tax code is inefficient and should be reformed regardless of the fiscal situation. For instance, the United States is one of the very few countries that use global assertion, which requires both corporations and individuals to pay taxes on their world-wide income. Since the early 1990s the federal and state combined statutory corporate tax rate has been kept at 39.2 percent. But over the past two decades many nations lowered their marginal rates and in 2010 the American rate was the second highest among the OECD countries.<sup>39</sup> Over time, as a result of lobbying, Congress adopted various tax-breaks, and many American multinational firms pay

<sup>38</sup> L. J. Bilmes, J. E. Stiglitz, *The Three Trillion Dollar War: The True Cost of the Iraq Conflict*, New York 2008.

<sup>39</sup> M. H. Moffett, A. I. Stonehill, D. K. Eiteman, *Fundamental of Multinational Finance*, Boston 2012, pp. 399–401.

much less than the statutory rate. For instance, in 2007–2009, General Electric, one of the largest transnational firms, paid an average effective rate of only 3.6 percent.<sup>40</sup>

The personal tax code is equally complex and distortionary. Tax on capital income is drastically lower than on labor income. For all practical purposes, top managers can transfer labor income into capital income. Consequently, in 2010 Warren E. Buffett, one of the wealthiest individuals in the United States, paid an effective tax rate of 17.4 percent, while his staff of twenty paid between 33 and 41 percent. The billionaire challenged Congress to change the tax code to make it more equitable.<sup>41</sup> So far, his call to increase taxes on the top 1 percent of Americans has been met, at best, with silence and, at worst, with ridicule.

The tax code is also full of exemptions (recently renamed tax expenditures). The Tax Policy Center estimates that in 2012 the breaks will cost the US Treasury at least \$1.1 trillion.<sup>42</sup> This is the equivalent of roughly 6 percent of GDP or the entire anticipated budget deficit. The elimination or reduction of some of the exemptions makes economic sense; however, for most Republicans this is synonymous with a tax increase and the entire party leadership and over 270 other members of Congress signed the Grover Norquist pledge not to raise taxes.<sup>43</sup>

They believe the deficit can be dealt with through economic growth and spending cuts only. This view is challenged by many economists, including former Treasury Secretary Lawrence Summers.<sup>44</sup> Bruce R. Bartlett, a Reagan Administration veteran, recently wrote in support of this position.<sup>45</sup>

## Economic challenges

The present stalemate has a clear economic dimension. On April 18, 2011, Standard and Poor's placed its rating of US Treasury debt on a negative outlook and on August 5, 2011 it followed through with a downgrade. In its justification for the government debt (rating), the agency stated that the "downgrade reflects our opinion that the fiscal consolidation plan that Congress and the Administration recently agreed to falls short of what, in our view, would be necessary to stabilize the government's medium-term

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<sup>40</sup> M. A. Sullivan, *Testimony before the Committee on Ways and Means*, US House of Representatives, January 20, 2011, p. 3, [www.waysandmeans.house.gov/UploadedFiles/sullivan\\_written\\_testimony\\_WM\\_Jan\\_20.pdf](http://www.waysandmeans.house.gov/UploadedFiles/sullivan_written_testimony_WM_Jan_20.pdf).

<sup>41</sup> W. E. Buffett, *Stop Coddling the Super-rich*, "The New York Times", August 14, 2011, [www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html](http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html).

<sup>42</sup> *The High Price of Tax Breaks: Not so Easy*, "The Economist", April 28, 2012, p. 32.

<sup>43</sup> CBS News, *60 Minutes: The Pledge: Grover Norquist's Hold on the GOP*, [www.cbsnews.com/8301-18560\\_162-57327816/the-pledge-grover-norquists-hold-on-the-gop](http://www.cbsnews.com/8301-18560_162-57327816/the-pledge-grover-norquists-hold-on-the-gop).

<sup>44</sup> R. Rubin, *Summers Says US Tax Overhaul Should Raise More Money*, Bloomberg, May 3, 2012, [www.bloomberg.com/news/2012-05-03/rubin-says-tax-overhaul-presents-difficult-substance-politics.html](http://www.bloomberg.com/news/2012-05-03/rubin-says-tax-overhaul-presents-difficult-substance-politics.html).

<sup>45</sup> B. R. Bartlett, *The Benefit and the Burden: Tax Reform – Why We Need It and What It Will Take*, New York 2012.

debt dynamics,” and that it also “reflects our view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened.”<sup>46</sup>

This judgment accurately reflects the political reality. Instead of tackling major issues, the President and the opposition at best make cosmetic changes to buy time. For instance, rather than follow the Simpson-Bowles recommendation to trim the deficit by at least \$4 trillion, in August of 2011 Congress barely managed to avoid a government shut-down with an agreement that, on one hand, increased the national debt limit by \$2.4 trillion and, on the other, mandated automatic spending cuts of only \$2.1 trillion over the following ten years.<sup>47</sup> Similarly, rather than reform the tax code, in December of 2010, President Obama and Speaker of the House John Boehner reached an agreement that extended the Bush tax-cuts for two years and decreased payroll taxes by 2 percent.<sup>48</sup>

The political stand-off threatens the fragile economic recovery. Unless there is new legislation, emergency unemployment benefits and the Bush-era tax cuts will expire at the end of 2012. This, together with the mandatory automatic spending cuts “might derail the recovery.”<sup>49</sup> The May 2012 OECD economic forecast stresses that fiscal consolidation should be implemented at “a steady, gradual pace consistent with a medium-term plan to restore fiscal stability” and that “restricting tax expenditures would lower the deficit while reducing market distortions and narrowing income inequality.”<sup>50</sup>

The above prescription is in line with mainstream economic views. An extensive analysis of fiscal retrenchments conducted by the International Monetary Fund shows that a 1 percent reduction in government expenditure has a significant negative impact on economic growth, employment, and equitable distribution of income. Therefore, the authors recommend the adoption of a plan to reign in the budget deficit that commences at a time when economic growth is robust.<sup>51</sup>

This finding is consistent with recent American experiences. The 2009 stimulus package absorbed a significant part of the shock that resulted from the collapse of the real estate market and the financial crisis. Blinder and Zandi estimate that in 2010 alone, the ARRA increased real GDP by 3.4 percent and employment by 2.7 mil-

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<sup>46</sup> J. Detrixhe, *US Loses AAA Credit Rating as S&P Slams Debt, Politics*, Bloomberg, August 6, 2011, [www.bloomberg.com/news/2011-08-06/u-s-credit-rating-cut-by-s-p-for-first-time-on-deficit-reduction-accord.html](http://www.bloomberg.com/news/2011-08-06/u-s-credit-rating-cut-by-s-p-for-first-time-on-deficit-reduction-accord.html).

<sup>47</sup> Congressional Budget Office, *CBO Analysis of August 1 Budget Control Act: Letter to the Honorable John Boehner and the Honorable Harry Reid*, August 1, 2011, [www.cbo.gov/sites/default/files/cbofiles/ftpdocs/123xx/doc12357/budgetcontrolactaug1.pdf](http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/123xx/doc12357/budgetcontrolactaug1.pdf).

<sup>48</sup> M. Spetalnick, P. Zengerle, *Obama Announces Tax Deal with Republicans* (Update 5), Reuters, December 6, 2010, [www.reuters.com/article/2010/12/07/usa-taxes-obama-idUSN0621134720101207](http://www.reuters.com/article/2010/12/07/usa-taxes-obama-idUSN0621134720101207).

<sup>49</sup> OECD, *United States – Economic Forecast Summary, May 2012*, [www.oecd.org/document/48/0,3746,en\\_2649\\_37443\\_45268528\\_1\\_1\\_1\\_37443,00.html](http://www.oecd.org/document/48/0,3746,en_2649_37443_45268528_1_1_1_37443,00.html).

<sup>50</sup> *Ibidem*.

<sup>51</sup> L. Ball, D. Leigh, P. Loungani, *Painful Medicine*, “Finance and Development”, September 2011, [www.imf.org/external/pubs/ft/fandd/2011/09/pdf/ball.pdf](http://www.imf.org/external/pubs/ft/fandd/2011/09/pdf/ball.pdf).

lion. The authors also believe that without the bail-out of General Motors the entire American auto industry could have perished.<sup>52</sup> A review of the impact of ARRA for the years 2009–2013 can be found on the Congressional Budget Office’s web page.<sup>53</sup> Similarly, estimates of the cost of the bank bail-out have been drastically reduced. In the summer of 2009, the projection was of a \$341 billion short-fall; a recent evaluation shows a loss of only \$60 billion.<sup>54</sup>

In sum, the United States needs to address some fundamental economic problems that hinder the nation’s economic progress. This is a pressing question because of the momentous shift in international relations developing before our eyes: the rise of China. This event, coupled with the rapid economic growth recorded in India and Latin America, poses a tremendous challenge to the economic and political supremacy of the United States.

### The rise of China

In a 2007 paper, Robert Fogel prophesized that China’s share in real world GDP would increase from 11 percent in 2000 to 40 percent in 2040, while over the same period that of the United States would shrink from 22 percent to 14 percent.<sup>55</sup> Overall, the balance of power, according to Fogel, would shift decisively to Asia, as India and a group of six South-east Asian nations (Singapore, Malaysia, Indonesia, Thailand, South Korea, and Taiwan) would account for 12 percent of the world output each (for a total of 24 percent). A prediction that reaches over thirty years into the future must be fraught with potential miscalculations; however, if anything the Great Recession has made it more probable. Table 1 presents the rate of economic growth in the United States and China over the 2001–2010 period.

“The Economist” presented an illuminating comparison of the two giants. In 2011 China consumed 6.6 times the amount of steel the United States did and had 3.3 times as many cell phones. The Asian nation also exported and invested, respectively, 30 percent and 40 percent more than the United States. In 2010, China bested America in terms of manufacturing output, car sales, and energy consumption. The United States still enjoys the largest GDP in the world, but this is going to change soon. Taking into account differences in prices, i.e. at purchasing power parity, China is expected to surpass the American output in 2016 and at market exchange rate just two years later.<sup>56</sup>

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<sup>52</sup> A. S. Blinder, M. Zandi, *How the Great Recession Was Brought to an End*, [www.economy.com/mark-zandi/documents/End-of-Great-Recession.pdf](http://www.economy.com/mark-zandi/documents/End-of-Great-Recession.pdf).

<sup>53</sup> Congressional Budget Office, *Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from October 2011 Through December 2011*, February 2012, [www.cbo.gov/sites/default/files/cbofiles/attachments/02-22-ARRA.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/02-22-ARRA.pdf).

<sup>54</sup> The United States Department of Treasury, *The Financial Crisis*.

<sup>55</sup> R. W. Fogel, *Capitalism and Democracy in 2040: Forecasts and Speculations*, “NBER Working Paper 13184”, National Bureau of Economic Research, Cambridge MA 2007.

<sup>56</sup> *Economics Focus: How to Get a Date*, “The Economist”, December 31, 2011, p. 61.

This could be a monumental shift in power, one that could also be very painful economically. The fact that the United States is the largest economic power makes US dollar denominated securities very attractive to international investors, including China. Consequently, the American government and private corporations are able to borrow at lower rates than would otherwise be possible. Additionally, American financial markets play a preeminent role in global finance and secure thousands of highly paid jobs for the nation. In the long-run, if the disparity in economic power between the two nations rises, this privileged situation could change. This change could happen faster if the present fiscal trends continue.

## **Conclusions**

The last four years witnessed exceptional political, social, and economic turmoil in the United States. Decades of stagnant or even declining standards of living that the majority of Americans has been experiencing culminated in an unprecedented economic crisis. This experience resulted in drastic polarization of political life and neither the left nor the right is willing to compromise any more. Each side holds a radically different view of the causes of the crisis and, consequently, proposes solutions that are polar opposites. The outcome of this struggle is unknown; but one is certain that whoever loses will not be easily reconciled with the end-result and will probably try to destroy the new order.

The necessary reforms include: a significant tax overhaul that, on one hand, makes it more equitable and efficient and, on the other, raises more revenue; a decrease in government spending on both civilian and military programs; and a re-vamping of welfare programs, especially government expenditures on health care and pensions. As of now, there is no consensus on how to accomplish these tasks. The 2010 Supreme Court *Citizens United v. Federal Election Commission* decision empowered the dominant special interests with a weapon to stall, if not defeat, any challenge to the present status quo. Therefore, the present political stalemate is likely to continue well beyond the upcoming 2012 presidential elections.

But, for the first time in over a century, the United States has precious little time to resolve the differences and return to normalcy. The rise of China poses an enormous challenge to American supremacy. China's population is over four times that of the United States and the nation is growing at a breath-taking pace. The next decade may be pivotal in deciding the outcome of this race. The longer the deadlock persists at home, the less likely it is the United States will be able to protect its dominant position abroad.

## **Stany Zjednoczone na rozdrożu**

Analiza współczesnego kryzysu ekonomicznego w kontekście szeroko pojętej wojny kultur. Autorzy ukazują, w jaki sposób procesy ekonomiczne są zależne od głębokich zjawisk kulturowych.