



## FRIENDS OF THE MIDDLE NEWSLETTER #49 — JAN. 11, 2012

*Welcome to always lively political discussion and whatever else comes up.*  
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**[INDEX: Click here.](#)**

### **Capitalism and Good Government**

(posted by Pam McRae, Jan. 11, 2012)

I like Paul Krugman, and I like Robert Reich. They are my go-to economists. But I take exception to the point in this article (see below) that our nation's debt is not unimportant. (I doubt that Krugman believes that either.) I hate to say it--patriotic American that I am--but I wonder why no one seems to question the whole idea of capitalism. It's not as if it were the perfect system that will solve all problems, any more than communism, mercantilism, feudalism, or raid your enemy and steal all their stuff--ism were. I know Marx is anathema to many, but I believe he was right about capitalism being a stage on the way to something else. I have no idea what that will be, and I doubt very much that I will be around to see whatever it turns out to be, but despite what Francis Fukuyama said, we are not at the end of history. We cling so tenaciously to our precious capitalism, without allowing ourselves to imagine another way. We are so bound up with ideology that our politics, our morals, and our laws are hobbled by preconceptions and unexamined principles.

I heard a young woman on the radio tonight talking about how she likes Rick Santorum because he stands for THE FAMILY. I think I know why she said that. I'm guessing that she is between 26 and 40, is married, and has at least two children. I'm guessing that she trusts her husband but worries about his fidelity--though she would never admit it. She is a mama wolf guarding her cubs, and there is nothing fiercer. It's the same phenomenon as the good women of old Salem condemning Hester Prynne. Living outside the law--or custom, or tradition--threatens those cubs, and Mama wolf can't have that. The young are strict because they fear anarchy, the old because habit is comfortable. But clinging to the status quo is never a way to the future. We must make room for creativity--in industry, in education, in family structure, in economics and politics.

I am a believer in the good government can do. Good government can protect individual autonomy and assure equity and fairness (at least in theory). But I'm not so sure government is ever creative. Maybe FDR showed creativity and daring, but most of our leaders are like pit bulls that won't let go, even the Democrats. They say the army is always fighting the last war. I think politics is always a few steps behind where history is already taking us. In a hundred years Gingrich and Obama will seem as archaic as Jefferson and Madison. Differences will fade, and everything will be subsumed into one gray fog of nostalgia. However we find our way out of the morass we're in, we'll be seen as heroes, just as Lincoln is for getting us through the Civil War or Roosevelt and Truman (two VERY different men) are for getting us through WW II. It will all be turned into myth, and nothing will seem quite so serious to our descendants as it does to us today. Either that, or our progeny will rain curses on our heads.

If we don't destroy the planet--and I really don't know how that will go--I believe solutions will be found that will carry the human species into the future. A remnant (at the very least) will remain. What troubles me is the terrible cost to those who just happen to be in the wrong time or the wrong country and die of untreated AIDS, starvation, genocide, or simple neglect. I'm optimistic about the survival of the species, even of the planet. Nothing will be

the same in a hundred years, that's for sure. But each individual casualty matters. People are always more important than ideas. The danger is that so many allow loyalty to cause, ideology, religion, ethnicity, tribe, or leader to override simple human fellow-feeling. There are no simple answers, but I sure wish I could find just one before I shuffle off this mortal coil.

"Paul Krugman is Dead Wrong: Debt Matters" by Shah Gilani, Capital Waves Strategist, Money Morning

Jan. 9, 2012 (<http://moneymorning.com/2012/01/09/paul-krugman-is-dead-wrong-debt-matters/>)

Paul Krugman, the Princeton University economics professor, Nobel Prize winner, and regular New York Times op-ed contributor says, "Debt matters, but not that much."

Not only is he off the reservation on this one, but he's completely fallen off his high horse.

In the real world, debt actually matters a lot.

In a Houston Chronicle opinion piece last week, Krugman, riding his horse - whose name might as well be Liberal Conscience - trampled conservatives under the guise of an economics lesson that derided "deficit-worriers" for wrongly seeing "America as being like a family that took out too large a mortgage, and will have a hard time making the monthly payments."

According to Krugman, that's a bad analogy and "the way our politicians think about debt is all wrong, and exaggerates the problem's size."

Decide for yourself. Either debt matters a lot, or not that much...

### The World According to Paul Krugman

Professor Krugman calls all the conversation in Washington about debt and deficits a "misplaced focus" and says all of the economic experts "on whom much of Congress relies have been repeatedly wrong about the short-run effects of budget deficits."

He derides the fears that deficits will cause interest rates to soar by pointing out that they haven't moved.

What he doesn't say is that they haven't moved because they're not free to move.

The fact is that the U.S. Federal Reserve has corralled the free market in interest rates by knocking short-term rates to almost zero through successive open market operations and extraordinary quantitative easing measures.

Mr. Krugman mocks those waiting for rates to rise and notes that while they wait "rates have dropped to historical lows."

Maybe what he doesn't realize is that the Fed's actions themselves have been nothing short of historical.

The crux of Mr. Krugman's supposition that debt doesn't matter much is based on his bashing of the popular analogy comparing America's debt problems to those of a mortgaged homeowner.

All of which Krugman claims is "a really bad analogy in at least two ways."

He says, "First, families have to pay back their debt. Governments don't - all they need to do is ensure that debt grows more slowly than their tax base."

"Second," he says, "an over-borrowed family owes the money to someone else; U.S. debt is, to a large extent, money we owe ourselves."

He goes on to say that the debt from World War II was never repaid and didn't make postwar America poorer.

In fact, the Professor points out, "the debt didn't prevent the postwar generation from experiencing the biggest rise in incomes and living standards in our nation's history."

### Krugman is Flat Out Wrong

First off, the homeowner analogy is excellent--not irrelevant.

Mr. Krugman is wrong when he says that homeowners have to pay back their debt. The truth is they don't have to.

Just like the government, as long as their creditworthiness is intact and money is available, at whatever cost, homeowners can refinance their mortgages over and over. That's no different than how the government rolls over its own debts.

We saw this phenomenon play out in stark reality during the housing bubble.

Not only were homeowners refinancing their homes to take out money for consumption purposes, they leveraged themselves to buy more homes to multiply the wealth effect they were already experiencing.

In the case of the housing crash, borrowers were counting on rising property values to finance their expanding debts. That's the same as what Krugman says governments should do: make sure debt expansion doesn't outpace revenue growth, in this case taxes.

In the end, though, didn't the bursting of the housing bubble prove that debt eventually matters?

To me, the housing bubble was a pretty darn good analogy as to what happens when mounting debts aren't repaid. When it happens on a systemic basis, the entire economy suffers.

Doesn't our nation's expanding debt and deficit in the face of falling tax revenues and worse, a lower base, portend similar problems on an even larger scale?

Of course, Krugman has it all figured out.

We just have to grow our debt at a slower pace than our tax base grows. Who knew the answer was so simple...

We'll just meet our expanding debt obligations by raising taxes faster. Perfect!

Second, to claim that U.S. debt doesn't matter because we owe it to ourselves, and that homeowners' debts do matter because they owe them to someone else, is absurd.

It is as if we are all going to say to the government, "It's okay you took all of those taxes from us and spent them on stuff we'll mostly never see, wipe the slate clean, we're good. And all the stuff you promised us that you didn't budget for, or worse, those set aside budgets you stole from, it's okay, we're good, we relieve you of what you owe us." It's just stupid.

Also, if you are a homeowner you are paying yourself too, in a sense.

While you are paying the mortgage to your bank you are also paying into a capital asset known as your home. You end up with something of fairly equal value, or more when home prices appreciate.

### The Truth about Debt

But we screwed that all up because debts do matter.

Too much debt leads to depreciation and deleveraging, which leads to lower demand, lower production, fewer jobs and a lower tax base.

The last piece of Krugman's argument that our World War II debts were never repaid and that the huge deficits to pay for the war effort led to an extraordinary peacetime expansion is also frighteningly off the mark.

Of course, the savings bonds issued to fund the War have matured and been paid off. And the portion of our national debt brought on by the War was paid off a long time ago.

Just because the U.S. continues to add to its deficit and has to continually rollover debts doesn't mean that we're rolling over debts from 70 years ago.

Mr. Krugman's own argument even addresses that. Rising incomes and our rapidly expanding economy in the postwar period generated a vastly rising tax base and led to prosperity.

But, that had nothing to do with deficits not mattering.

That had everything to do with soldiers returning home and being educated under the G.I. bill, being able to find work in revved-up manufacturing facilities, and the ensuing baby boom that would lead to a substantial increase in the population and tax base.

### A Political Axe to Grind

There are a lot of problems with Professor Krugman's argument that deficits don't matter.

But, the biggest problem I have is that instead of addressing deficits in an organic, holistic and objective way, Mr. Krugman addresses these important issues from his political perspective rather than a purely economic perspective.

Bashing conservatives who say deficits matter and spending cuts along with a smaller government are the best way to solve our long-term fiscal problems, and arguing that "responsible governments -- that is governments that are willing to impose modestly higher taxes when the situation warrants it" are the answer to deficits that don't matter much, is polarizing at best and dangerous at worst.

What economists should be advocating is an apolitical approach to both our short-term and long-term problems.

We need smaller deficits over time and a smaller, more responsive government in the long-term.

In the short-term, we need real infrastructure spending, not quantitative easing for banks to increase their bonus pools. We need a massive investment in education and we need an industrial policy that promotes manufacturing and job growth - not the exportation of our capital to less developed countries where labor cost advantages fatten up public corporations that don't pay enough U.S. taxes and hide the money from Uncle Sam in the loopholes Congress digs for them.

Both deficits and politics matter.

And if we don't figure out how to bridle both we are all going to end up in the dirt being trampled by stampeding emerging economies everywhere.

(Shah Gilani is considered one of the world's foremost experts on the credit crisis. He not only called for the implosion of the U.S. financial markets, he also predicted the historic rebound that began in March 2009. Shah is the editor of Capital Wave Forecast and Spin Trader. He also writes Money Map Press's most talked-about publication, the Wall Street Insights & Indictments e-letter, where he reveals how Wall Street's high-stakes game is really played, and how to win it.)

## FotM NEWSLETTER #49 (Jan. 11, 2012)—HYPERTEXT INDEX

<u>DATE-ID</u>	<u>TIME</u>	<u>FROM</u>	<u>SUBJECT/TITLE</u>
<a href="#">20120111-00</a>		Pam	<b>Capitalism &amp; Good Government</b> by Pam McRae ("Paul Krugman is Dead Wrong: Debt Matters")
<a href="#">20120110-04</a>	17:07	Dennis	Re: Capitalism & Good Government (reply to Pam, above) & "Have the Super-Rich Seceded from the United States?"
<a href="#">20120110-05</a>	18:30	Art	Re: Capitalism & Good Government (reply to Dennis, above)
<a href="#">20120110-06</a>	19:08	SteveBA	Re: Capitalism & Good Government (reply to Pam & Dennis, above)
<a href="#">20120110-07</a>	20:05	Dennis	Re: Capitalism & Good Government (reply to SteveBA, above)
<a href="#">20120110-01</a>	13:06	SteveG	Fw: CREDO Action Petition: End Indefinite Detention and Close Guantanamo!
<a href="#">20120110-02</a>	13:12	GaryF	Cartoon: Internet
<a href="#">20120110-03</a>	15:24	Phil	Graphic: Give a Sh*t vs. Age
<a href="#">20120110-08</a>	21:54	SteveG	"Over Two-Thirds of Corporations Pay No Federal Corporate Income Tax" (But Their Owners Usually Do)
<a href="#">20120110-09</a>	22:34	Art	Re: "Over Two-Thirds of Corporations Pay No Federal Corporate Income Tax" (But Their Owners Usually Do) (reply to SteveG, above)

<a href="#">20120110-04</a>	17:07	Dennis	Re: Capitalism & Good Government (reply to Pam, above) & "Have the Super-Rich Seceded from the United States?"
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from Pam:

I hate to say it--patriotic American that I am--but I wonder why no one seems to question the whole idea of capitalism.

Capitalism works relatively well for a lot of people and predatory capitalism works absolutely great for a few more..... "Who Is John Galt?"

"Have the Super-Rich Seceded from the United States?" by: Mike Lofgren, Truthout

Jan. 10, 2012, (<http://www.truth-out.org/have-super-rich-seceded-united-states/1326127151>)

It was in 1993 during Congressional deliberation over the North American Free Trade Agreement. I was having lunch with a staffer for one of the rare Republican members of Congress who opposed the policy of so-called free trade. I distinctly remember something my colleague said: "The rich elites of this country have far more in common with their counterparts in London, Paris and Tokyo than with their own fellow American citizens."

That was just the beginning of the period when the realities of outsourced manufacturing, financialization of the economy and growing income disparity started to seep into the public consciousness, so at the time it seemed like a striking and novel statement.

At the end of the cold war, many writers predicted the decline of the traditional nation state. Some looked at the demise of the Soviet Union and foresaw the territorial state breaking up into statelets of different ethnic, religious or economic compositions. This happened in the Balkans, former Czechoslovakia and Sudan. Others, like Chuck Spinney, predicted a weakening of the state due to the rise of fourth-generation warfare and the inability of national armies to adapt to it. The quagmires of Iraq and Afghanistan lend credence to that theory. There have been hundreds of books about globalization and how it would break down borders. But I am unaware of a well-developed theory from that time about how the super-rich and the corporations they run would secede from the nation state.

I do not mean secession in terms of physical withdrawal from the territory of the state, although that happens occasionally.<sup>1</sup> It means a withdrawal into enclaves, a sort of internal immigration, whereby the rich disconnect themselves from the civic life of the nation and from any concern about its well-being except as a place to extract loot. Our plutocracy now lives like the British in colonial India: in the place and ruling it, but not of it. If one can afford private security, public safety is of no concern; if one owns a Gulfstream jet, crumbling bridges cause less apprehension - and viable public transportation doesn't even show up on the radar screen. With private doctors on call, who cares about Medicare?

To some degree, the rich have always secluded themselves from the gaze of the common herd; for example, their habit for centuries has been to send their offspring to private schools. But now this habit is exacerbated by the plutocracy's palpable animosity toward public education and public educators, as Michael Bloomberg has demonstrated. To the extent public education "reform" is popular among billionaires and their tax-exempt foundations, one suspects it is as a lever to divert the more than one-half trillion dollars in federal, state and local education dollars into private hands, meaning themselves and their friends.<sup>2</sup> A century ago, at least we got some attractive public libraries out of Andrew Carnegie. Noblesse oblige like Carnegie's is presently lacking among our seceding plutocracy.

In both world wars, even a Harvard man or a New York socialite might know the weight of an Army pack. Now, the military is for suckers from the laboring classes, whose subprime mortgages you just sliced into CDOs and sold to gullible investors in order to buy your second Bentley or rustle up the cash to employ Rod Stewart to perform at your birthday party. Courtesy of Matt Taibbi, we learn that the sentiment among the super-rich toward the rest of America is often one of contempt rather than noblesse; Bernard Marcus, co-founder of Home Depot, says about the views of the 99 percent: "Who gives a crap about some imbecile?"

Steven Schwarzman, the hedge fund billionaire CEO of the Blackstone Group who hired Rod Stewart for his \$5 million birthday party, believes it is the rabble who are socially irresponsible. Speaking about low-income citizens who pay no income tax, he says: "You have to have skin in the game. I'm not saying how much people should do. But we should all be part of the system." But millions of Americans who do not pay federal income taxes pay federal payroll taxes. These taxes are regressive and the dirty little secret is that over the last several decades they have made up a greater and greater share of federal revenues. In 1950, payroll and other federal retirement contributions constituted 10.9 percent of all federal revenues; by 2007, the last "normal" economic year before federal revenues began falling, they made up 33.9 percent. By contrast, corporate income taxes were 26.4 percent of federal revenues in 1950; by 2007, they had fallen to 14.4 percent. Who has skin in the game now?

As is well known by now, Schwarzman benefits from the "Buffett Rule": financial sharks typically take their compensation in the form of capital gains rather than salaries, thus knocking down their income tax rate from 35 percent to 15 percent. But that's not the only way Mr. Skin-in-the-Game benefits: the 6.2-percent Social Security tax and the 1.45-percent Medicare tax apply only to wages and salaries, not capital gains distributions. Accordingly, Schwarzman is stiffing the system in two ways: not only is his income tax rate less than half the top marginal rate, he is shorting the Social Security system that others of his billionaire colleagues like Pete Peterson say is unsustainable and needs to be cut.

This lack of skin in the game may explain why Willard Mitt Romney is so coy about releasing his income tax returns. It would also make sense for someone with \$264 million in net worth to joke that he is "unemployed," as if he were some jobless sheet metal worker in Youngstown, when he is really saying in code that his income stream is not a salary subject to payroll deduction. The chances are good that his effective rate for both federal income and payroll taxes is lower than that of many a wage slave.

The real joke is on the rest of us. After the biggest financial meltdown in 80 years - a meltdown caused by the type of rogue financial manipulation that Romney embodies - and a consequent long, steep drop in the American standard of living, who is the putative front-runner for one of the only two parties allowed to be competitive in American politics? None other than Romney, the man who says corporations are people. Opposing him, or someone like him, will be the incumbent President Barack Obama, who will raise up to a billion dollars to compete in the campaign. Much of that loot will come from the same corporations, hedge fund managers, merger and acquisition specialists and leveraged buyout artists the president will denounce in pro forma fashion during the campaign.

## **The super-rich have seceded from America even as their grip on its control mechanisms has tightened.**

Footnotes:

<sup>1</sup>Erik Prince, who was born into a fortune, is related to the even bigger Amway fortune and made yet another fortune as CEO of the mercenary-for-hire firm Blackwater, moved to the United Arab Emirates in 2011.

<sup>2</sup>This stratagem follows the template of Halliburton's privatized military logistics activities as well as George Bush's proposed Social Security "reform": funneling public dollars into corporate hands.

<a href="#">20120110-05</a>	18:30	Art	Re: Capitalism & Good Government (reply to Dennis, above)
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Pretty good article. I know during the medieval age a French noble felt much closer to an English noble than to any French peasant. Why is today any different?

<a href="#">20120110-06</a>	19:08	SteveBA	Re: Capitalism & Good Government (reply to Pam & Dennis, above)
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I have to agree with Dennis that command economies are doomed to fail. Everybody is enamored with china but but corruption and selfish leaders will doom them. Think Japan in the 80's. Free vmarkets like democracies are messy, but over time work better than any other system we have seen.

[Beyond tribal living, we seem to have found no economic engine that works better than capitalism, though it might be argued that it also works too well. –SteveB]

<a href="#">20120110-07</a>	20:05	Dennis	Re: Capitalism & Good Government (reply to SteveBA, above)
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Or think the U.S.A. right now. It's as much a command economy as China. China was a command economy when it was Communist, but it's more of a predatory capitalist economy since the Communist Party of China started believing they were just like the Republicans. Both are authoritarian and rigged (distorted) by the bankers.

<a href="#">20120110-01</a>	13:06	SteveG	Fw: CREDO Action Petition: End Indefinite Detention and Close Guantanamo!
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from CREDO Action:

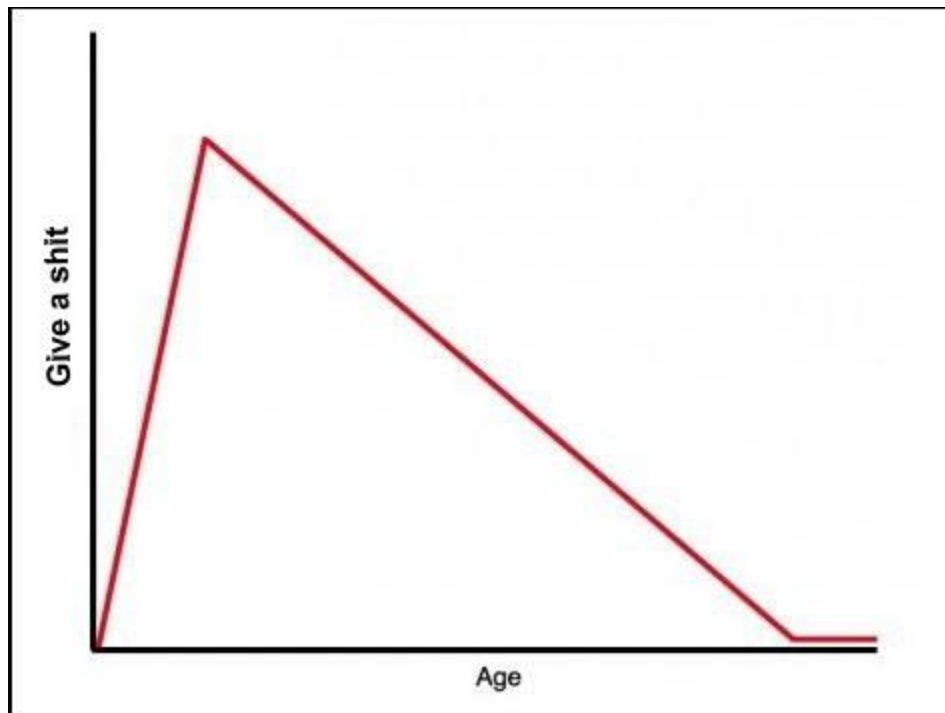
"Indefinite detention without charge or trial is fundamentally contrary to the democratic values that our system of government rests upon. The recent law that authorizes the indefinite military detention of American citizens is an outrage and must be rolled back. Additionally, the detention facilities at Guantanamo Bay, which continue to be a dark spot on our national conscience, should be closed."

Tell President Obama and Congress: End indefinite detention and close Guantanamo:

<http://act.credoaction.com/campaign/gitmo/?r=366373&id=33280-3891339-HomE7Px>.



This is a deceptively simple philosophy that I have been working on and refining for most of my life. I am delighted to say that I believe I have refined it down to its essence sufficiently to share it with a select group of friends that may appreciate its elegance and simplicity.



[Verified by Snopes.com. -SteveB :-)]

For the privilege of not having to pay taxes corporations create no jobs, grossly overpay their CEOs and accumulate almost all the money that exists in the world.

"Over Two-Thirds of Corporations Pay No Federal Corporate Income Tax" by Huff Post Business

Jan. 10, 2012, ([http://www.huffingtonpost.com/2012/01/10/corporations-pay-no-tax\\_n\\_1196875.html?utm\\_campaign=011012&utm\\_medium=email&utm\\_source=Alert-business&utm\\_content=FullStory](http://www.huffingtonpost.com/2012/01/10/corporations-pay-no-tax_n_1196875.html?utm_campaign=011012&utm_medium=email&utm_source=Alert-business&utm_content=FullStory))



At a time when the federal government is starved for cash -- and facing layoffs and cuts in services across the board -- more and more corporations are sidestepping their traditional tax rate and keeping millions of dollars for themselves.

The number of U.S. corporations structuring their businesses in such a way that they can avoid higher taxes has skyrocketed in the past quarter century, *The Wall Street Journal* reports.

In 1986, about 24 percent of corporations were what's known as nontaxable businesses -- meaning the companies themselves pay no federal income taxes -- instead passing on the earnings to individual investors to pay taxes on. By 2008, these businesses accounted for about 69 percent of all corporations, a designation that can save companies hundreds of millions of dollars in a single year

Advocates for the business community have expressed frustration with the country's 35 percent corporate income tax rate, calling it unreasonably high. In practice, though, it's common for big businesses to pay much less, thanks to a cornucopia of tax-code loopholes and exemptions won by lobbyists.

The issue of corporate tax participation has become especially pressing in recent years, as the country struggles to manage its ballooning deficits. Corporate taxes for non-financial companies have fallen more than 13 percent since 2007, according to Bloomberg. At the same time, the national debt grew to \$15.23 trillion from \$9.13 trillion -- a number larger than the economy itself.

According to a recent analysis of nearly 300 Fortune 500 companies by the Citizens for Tax Justice, the average company was paying just 18.3 percent in taxes -- a little more than half the official rate. And by using techniques like industry subsidies, stock option packages, and moving assets overseas where they can't be taxed, 30 companies mentioned in the report -- including Wells Fargo, Verizon, Boeing and General Electric -- didn't pay a cent in federal taxes in 2008, 2009 or 2010, the report found.

The phenomenon affects state income taxes as well as federal. Last month, another study from the Center for Tax Justice found that corporate tax avoidance had cost states a combined \$42.7 billion between 2008 and 2010 -- a period when budget shortfalls forced states to cut spending for health care, public schools and care for the elderly and disabled.

[The tax situation, in my humble opinion, is not what this article makes it out to be. --SteveB]

<a href="#">20120110-09</a>	22:34	Art	Re: "Over Two-Thirds of Corporations Pay No Federal Corporate Income Tax" (But Their Owners Usually Do) (reply to SteveG, above)
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I would only add that in your hypothetical example the business running screaming to the Congress rep will also use the Republican holy words "JOB KILLING!!!!"

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—Friends of the Middle,  
Steven W. Baker (SteveB), Editor/Moderator

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