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Who will Bear the Burden of Adjustment?

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The great question that concerns us here is how to understand the current state of American politics. Many Americans and many foreigners are interested and even concerned about the apparent polarization of American politics and the apparent gridlock or standstill that American politics seem to suffer from both in general and in particular in the aftermaths of this very serious crisis. The answers to this question are complex and multi-faceted. There are cultural, social, regional, ethnic and religious components to the divisions in American society, but, as a political economist, I would like to focus on the political economy and particularly the economic roots of some of the problems that the country faces in the context of its own unique political institutions.

► **US... and Europe, are very big and diverse countries**

Let me start with a simple observation, which is sometimes lost in these discussions. The United States is a very big country and a very varied, diverse one. Perhaps as varied and diverse as Europe. The poorest counties in America are poorer than Portugal with an income per capita below \$20,000 a year; the richest counties have per capita incomes above \$100,000 a year, much richer than Luxemburg, which is the richest country in Europe. We can look at the regional level and find there is more variation than there is in the European Union. We have 45 million foreign-born immigrants in the United States, which means a Spain inside the country. So it is no exaggeration to say that on many dimensions, variation within the United States is as great as

it is in the European Union, I should perhaps say the Euro zone as it is a bit tighter. There is a lot of political dispute going on within Europe and within the Euro zone over the future of the region and there is a lot of dispute going on in the US based on this variation.

The variation I would like to emphasize is an economic one, that is among economic interests within the country. I think the role of economic interests in American politics is often underplayed in favor of cultural, religious, social, ethnic interpretations. But I think that income, economic interests are still very powerful determinants of political views. In fact, it is well established that income is the strongest correlate of political preferences. Within every State, within every region, the poor people are the more likely to vote democratic, the richer they are the more likely they are to vote republican. There are many other dimensions of American politics, but I think the economic one is extremely important.

► **Three Americas**

In the inter-war period, it was common to talk about two “Englands”, North and South. In the US, I think we can talk about three “Americas”. There is the top third who have done very well over the last 40 years, whose per capita income has grown continually, who are satisfied, who like the way things have gone and want to see them continue to go in that direction.

There is the bottom third whose per capita incomes, whose real wages have stagnated, actually declined since 1973; whose living standards are certainly in relative terms and perhaps also in absolute terms worst than they were forty years ago, whose conditions are poor and in terms of the social services they receive, like education, or health, deteriorating.

And there is the middle third, squeezed to some extent between these two thirds. The middle third has seen its per capita income grow gradually, stagnate sometimes but grow gradually, but has in particular seen a gap, an ever wider gap grow between them and the top. So that the middle-class which used to be seen as close to the upper echelons of American society today has no hope of reaching these positions and sees a growing divergence between them and the wealthy in the United States.

I think that this economic division is crucially important, that the deterioration of income distribution both in the bottom third and in the middle third has been the fundamental underlying factor of American politics in the last forty years, one that is very seldom discussed but I think stands at the root of many discussions and debates that have been going on.

This kind of economic division of the country has been exacerbated by the experience of the past decade.

We had relatively rapid growth between 2001 and 2007 but that growth was extraordinarily unevenly distributed, unlike at any time in post-war American history. In that 2001-2007 period, during which the economy was growing rapidly, two thirds of the income growth of the entire economy went to the top 1% and the rest was divided among the remaining 99%.

That top 1% is made up of households with per capita income above \$40,000 a year so, in those seven years, their income grew by 60% when for the rest of the population the average income growth was only 6% that is less than 1% per year.

In other words, even in the good times, the vast majority of society was not doing particularly well and of course any gains that were made in those seven years were wiped out within the space of a year and a half once the crisis hit.

The crisis itself had extraordinarily uneven effects on the different groups of American society. We can look for example at the unemployment rate. At the peak of the crisis, unemployment rate reached about 10% throughout the economy; but here again we can divide the labor force in thirds. For the bottom third –and we are talking about 100 million people and their dependants– the unemployment rate at that point reached 18%. And if you add on people who were involuntarily part-time employed and people who were what the labor bureau calls “discouraged”, *e.g.* no longer looking for work even though they wanted to find work, the unemployment rate reached 35%, which is depression level standard.

Now look at the top third, household earning in excess of \$80/85,000 a year representing 100 million people and their dependants. For this top third, when unemployment in the country was 10% as a whole, it was 4%. If you add on involuntary part-time workers and the discouraged workers, it goes up to 8-9%.

That helps understand why the “response to the response of the crisis” has been so different, why it is that many Americans, not surprisingly those in the upper third, are very reluctant to pursue any policies that are going to have substantial future fiscal effects; they oppose the stimulus, oppose future stimulus because they understand that the tax effects will be primarily on them and the positive effects will be primarily on other people. They are being asked to increase their taxes on the long run, to eventually finance the debt service on the deficit in order to deal with the crisis, which is not primarily affecting them.

This economic differentiation also has a regional component. In Massachusetts, in the Boston area the unemployment rate today is below 6%. Housing prices fell by about 5% during the crisis and have since recovered. While in Nevada the unemployment rate is about 15% and housing prices have gone down by about 40%.

So there are real divisions based on real clashes of interests.

► **A comparison with Europe**

I want to go back to the European comparison because I think it might help clarify or fix ideas on the topic. There are really good reasons why people in northern of Europe have a different opinion about southern debts than people in the south. They have different interests at stake. It is not surprising that there are debates going on within Europe over how to deal with the southern debt.

The same thing can be said of the US. There are many people in the US who are net creditors to the rest of the country and there are net debtors.

The US in the aftermaths of the crisis is facing what every debt-crisis country has faced. There have been 150 debt crises since WWII. Every single one of them is characterized during and in the aftermaths of the crisis, by an eruption of political conflict with one topic: who will bear the burden of adjustment, who is going to pay for the crisis? We spent seven to eight years building up – depending on how you want to count it– something between 5 and eventually \$12 trillion debt, debt of the federal government, debt of the household sector. We now have about a 10 trillion debt to the rest of the world. Those debts have to be serviced. The question Americans are asking themselves explicitly or implicitly, is who is going to pay for it? Is the adjustment going to come out of public sector workers, is it going to come out of tax-payers, farmers, teachers, those that are beneficiaries of the public sector? The US is facing the typical political aftermath of a debt crisis, which is between five and ten years of difficult political battles over how to distribute the adjustment burden.

Some Europeans might say that there is little social solidarity in the US. It might be right if you compare it to the kind of social solidarity that exists within relatively small European countries –at least compared to the US. But I might ask –to be a little bit unfair– how much solidarity is there between Germans and Greeks? Or between a French stockbroker and a North-African youth in the *banlieue*? About as much as there is between Americans in similar conditions. The US needs to be compared to Europe, not to individual European countries.

These underlying economic divisions I think are reflected in the American political system. You have to remember that the American political system is set up to make dramatic, rapid change very difficult. We have many vital points: the House of Representatives, the Senate, the Executive, the Judiciary, regulatory agencies and 50 very powerful States. And all slow down or stop changes in policy making. The system is designed that way.

On the other hand, what it means is that when changes are undertaken, they typically are consensual and they stick. It may be frustrating for those of us who might want more rapid change. In the case of health care, we can see that there are continual battles over how to help the Reform Act to be implemented.

There are real underlying reasons why Americans disagree about major policies. Reasons, which may have a lot to do with culture, religion, ethnicity or region, but have as their fundamental core, underlying differences in the economic positions that people have in American society.

To our puzzled European friends, I would say that we are not really so different. The United States like Europe is fragmented and divided by the very troubled economic times that we face and the major conflict of interests of how best to respond to them. We are probably in for a resolution, more slowly than a different political system would. But I think that over time, resolutions will be found ; they may not be the best ones but they will be such as most of the major players in the American political system will be able stomach.