

# The AMERICAN INTEREST Publicity Copy

Holidays (November/December) 2011, Vol. VII, No. 2

The following article, in whole or in part, may not be copied, downloaded, stored, further transmitted, transferred, distributed, altered or otherwise used, in any form or by any means, except:

- one stored electronic and one paper copy of any article solely for your personal, non-commercial use; or
- with prior written permission of The American Interest LLC.

To subscribe to our online version, visit [www.The-American-Interest.com](http://www.The-American-Interest.com)

To subscribe to our print version, call **1-800-767-5273** or mail the form below to:

The American Interest  
P.O. Box 15115  
North Hollywood, CA 91615



BEST OFFER! Yes, send me two years (12 issues) of THE AMERICAN INTEREST for only \$69\*. I'll save 23% off the cover price!

Yes, send me one year (6 issues) for only \$39\*. I'll save \$5.75 off the cover price.

Name \_\_\_\_\_

Address 1 \_\_\_\_\_

Address 2 \_\_\_\_\_

City \_\_\_\_\_

State \_\_\_\_\_

Zip \_\_\_\_\_

Country \_\_\_\_\_

E-mail \_\_\_\_\_

Credit Card \_\_\_\_\_

Exp. \_\_\_\_\_

Name on Card \_\_\_\_\_

Tel. No. \_\_\_\_\_

Signature \_\_\_\_\_

Date \_\_\_\_\_

\*Please allow 4-6 weeks for delivery of first issue. Add \$14 per year for delivery to addresses in Canada and \$33 per year for delivery to addresses outside the U.S. and Canada.

- Payment enclosed  
 Bill me later

A15PPC

# CONTENTS

THE AMERICAN INTEREST • VOLUME VII, NUMBER 2, HOLIDAYS (NOVEMBER/DECEMBER) 2011



---

## ON POLITICAL ECONOMY

### 5 **The Foreign Policy of Plutocracies**

*by James Kurth*

A financial plutocracy contributed to Britain's demise as a global power. Is the same fate in store for America?

### 18 **Oligarchy and Democracy**

*by Jeffrey A. Winters*

Democratic institutions aren't sufficient in themselves to keep the wealthy few from concentrating political power.

### 28 **Charles Darwin, Economist**

*by Robert Frank*

*The Origin of Species* is a better guide to our economy than *The Wealth of Nations*.

### 37 **Frontier Economics**

*by Brink Lindsey*

Economic growth is increasingly taking place at the technological frontier. We need policies that keep pushing that frontier forward.

### 46 **Toolbox: Constructive Dialogue**

*by Thomas H. Stanton*

Why have some financial firms weathered the crisis better than others? The answers contain lessons for how to regulate the industry.

---

## POLICY SHOP

### 56 **How to Shrink the IRS and Grow the Economy**

*by Michael J. Graetz*

A plan to ditch the income tax, make taxation fairer and aid economic growth all at the same time.

### 66 **The Global Costs of American Ethanol**

*by Rosamond L. Naylor & Walter P. Falcon*

How U.S. ethanol policy creates global food insecurity.

# AI

The  
AMERICAN INTEREST

## EXECUTIVE COMMITTEE

FRANCIS FUKUYAMA, *chairman*

CHARLES DAVIDSON, *publisher & CEO*

WALTER RUSSELL MEAD, *editor-at-large  
& director, The American Interest Online*

ELIOT COHEN

JOSEF JOFFE

ADAM GARFINKLE, *editor*

DANIEL KENNELLY, *senior managing editor*

NOELLE DALY, *associate editor*

LINDSEY BURROWS, *assistant editor*

DAMIR MARUSIC, *associate publisher*

ANDREW IACOBUCCI, *assistant to the publisher*

ERICA BROWN, MICHELLE HIGH,  
*editorial consultants*

SIMON MONROE, R. JAY MAGILL, JR., *illustrators  
cover design by DAMIR MARUSIC*

## EDITORIAL BOARD

ANNE APPLEBAUM, PETER BERGER,

ZBIGNIEW BRZEZINSKI, TYLER COWEN,

NIALL FERGUSON, ROBERT H. FRANK,

WILLIAM A. GALSTON, OWEN HARRIES,

G. JOHN IKENBERRY, STEPHEN D. KRASNER,

BERNARD-HENRI LÉVY, SEBASTIAN

MALLABY, C. RAJA MOHAN, ANA PALACIO,

ITAMAR RABINOVICH, ALI SALEM, LILIA

SHEVTSOVA, TAKASHI SHIRAISHI, MARIO

VARGAS LOSA, WANG JISI, RUTH

WEDGWOOD, JAMES Q. WILSON

## ADVERTISING & SYNDICATION

DAMIR MARUSIC

damir.marusic@the-american-interest.com

(202) 223-4408

*website*

WWW.THE-AMERICAN-INTEREST.COM

**SUBSCRIPTIONS:** Call (800) 362-8433 or visit [www.the-american-interest.com](http://www.the-american-interest.com). One year (6 issues): \$39 print; \$19 online; \$49 for both. Two years (12 issues): \$69 print; \$38 online; \$98 for both. Please add \$14 per year for print-subscription delivery to Canada and \$33 per year for delivery to addresses outside the United States and Canada. Postmaster and subscribers, send subscription orders and changes of address to: *The American Interest*, P.O. Box 15115, North Hollywood, CA 91615. *The American Interest* (ISSN 1556-5777) is published six times a year by The American Interest LLC. Printed by Fry Communications, Inc. Postage paid in Mechanicsburg, Pennsylvania. ©2010, The American Interest LLC. Application for mailing at periodical pricing is pending in Washington, DC and additional mailing offices. Editorial offices: 1730 Rhode Island Ave. NW, Suite 707, Washington, DC 20036. Tel.: (202) 223-4408. Fax: (202) 223-4489.

77

## Fannie, Freddie and the House of Cards

*by Mary Martell*

The Obama Administration needs to be bolder in reforming the two government-sponsored mortgage giants.

## REVIEWS

88

### Tea Time

*by Jeremy D. Mayer*

Millionaire Wall Streeters, media mavens and corporate titans make for unlikely populists.

98

### The Way We Were?

*by Fred Baumann*

*What So Proudly We Hail* is more than just a memorial to a bygone American era; it's a handbook for recovering endangered civic virtues.

102

### The Justice Trickle

*by Jeremy Rabkin*

Are human rights prosecutions inexorably on the rise? It all depends on how you count them.

106

### Good People, Bad Laws

*by Kenneth M. Davidson*

If you expect the worst from people, they'll often oblige.

110

### Retroview: The Money Man

*by George S. Tavlas*

Alexander Del Mar's views on the origins of money were revolutionary for the 19<sup>th</sup> century. Why have so few people heard of him?

## NOTES & LETTERS

115

### The Post-Imperial Blues: A Letter from Vienna

*by Franz Cede*

Austria-Hungary and the Soviet Union both lost empires. What can we learn from how they coped?

125

### Holiday Note: American Political Dysfunction

*by Francis Fukuyama*

America's system of checks and balances usually works well, but not when it comes to fixing the Federal budget.

128

### Between the Lines

*by Michael Hudson*

Saving banks by sacrificing homeowners.

## HOLIDAY NOTE

# American Political Dysfunction

*Francis Fukuyama*

**D**uring the summer's controversies over the debt ceiling and U.S. credit downgrade, there was a lot of talk about the "dysfunctional" American political system. Obviously, a country that has to play a game of chicken with its reputation for full faith and credit isn't working very well. But what exactly is the source of this dysfunction? If it is a systemic dysfunction, is there something about it that can be fixed?

One possible answer is that the problem doesn't lie in the system, but in the underlying polarization of American society, which is divided over basic governing ideology and increasingly angry in its public discourse. There has been a huge literature on polarization and its sources, which is blamed on electoral districting, residential self-segregation, an ideologically compartmentalized media and the like.

To the extent that the problem resides in the underlying society, there's not much that can be done in terms of institutional tinkering to make the system more functional. The problem is one of political culture, in this case the absence of a dominant culture.

However, there's plenty of evidence from polling data and other sources that Americans are actually not nearly as divided as the common perception would have it. The political scientist Morris Fiorina and his collaborators have gone so far as to call the idea of polarization a myth;<sup>1</sup> on

---

**Francis Fukuyama** is a senior fellow at the Center for Democracy, Development, and the Rule of Law, Stanford University, and chairman of the editorial board of *The American Interest*.

many issues from the environment to stem cells to the budget one can find solid majorities in favor of various forms of pragmatic compromise. If politicians were responding to median voters as they are supposed to, we shouldn't have a problem.

A well-designed democratic political system should mitigate underlying social disagreement and allow the society to come to a consensus on important issues. There is plenty of evidence, however, that the U.S. political system does exactly the opposite: It actually magnifies and exacerbates underlying conflicts, and it makes consensual decision-making more difficult.

The reasons are deeply embedded in the U.S. Constitution. Americans rightly take pride in their system of checks and balances, which were deliberately tailored to limit the power of centralized government. Despite the appearance of a strong executive implicit in a presidential system, there are very few issues on which an American President can act on his own authority. The President must share power with two houses of Congress, the judiciary and a multi-tiered structure of state and local government. Indeed, the American political system is at the far end of the scale in terms of the number of "veto players" it empowers—that is, actors who can independently block or modify government action. This is nowhere more true than in the making of the Federal budget.

This feature is evident when one compares the American system to other types of democratic

---

<sup>1</sup>Fiorina, *Culture War? The Myth of a Polarized America. Third Edition* (Longman, 2010).

politics that tend to concentrate power to a greater extent. A British Westminster system strips out a huge number of veto players: In the classic system (which no longer exists anywhere in a pure form), the power of the executive branch is derived from legislative majorities, which eliminates the possibility of deadlock between the branches of government. A 50 percent-plus-one majority in the House of Commons is sufficient to make binding law. The upper house cannot veto legislation; there is no devolution of power to local governments; and no judicial review. The plurality electoral system combined with strong party discipline ensure that British Prime Ministers are backed by strong legislative majorities. (The current coalition government, resulting from an election where no party won a parliamentary majority on its own, is a highly unusual outcome in the British system.)

As a result of this concentration of power, British governments are able to formulate budgets and make the difficult tradeoffs between spending and taxes with a view to the final outcome. The budget is announced by the government at the beginning of the yearly cycle and then passed by Parliament, with little modification, in a week or two. Whether one likes it or not, the current Cameron government's austerity budget was the product of such an abbreviated procedure.

Compare this to the American system. The President may announce a budget at the beginning of the fiscal cycle, but this is more an aspirational document than a political reality. The U.S. Constitution firmly locates spending authority in Congress, and indeed all 535 members of Congress are potential veto players with an opportunity to stick their favored projects or tax exemptions into the final outcome. With the decline in the power of the congressional committees overseeing the budget, there is no strong central direction to the process. The budget that eventually emerges, months after the announcement of the President's budget plan, is the product of horse trading among individual legislators, who always find it easier to achieve consensus by exchanging spending increases for tax cuts. Hence the permanent bias towards deficits.

Back in 1982, the late economist Mancur Olson published a book entitled *The Rise and Decline of Nations*, in which he argued that

during prolonged periods of peace and prosperity, democratic countries tend to accumulate entrenched interest groups that collect rents from the government and lead to the gradual ossification of political systems.<sup>2</sup> At the time he was thinking about Britain, which was then only beginning its Thatcherite revolution, but his analysis has subsequently been applied to Japan, a variety of other European countries and, of course, the United States.<sup>3</sup> In the context of America's current fiscal gridlock, Olson's name and framework are increasingly invoked to explain what is wrong with the political system.

To Olson's model, I would add the following amendment that comes out of my recent volume *The Origins of Political Order*. Human beings have a natural mode of sociability, which is to favor friends and family. In the absence of strong incentives to behave differently—meaning, for example, something like the existential pressures of war or national crisis—there is a tendency for societies to revert increasingly to patrimonial forms of politics. Existing elites use their access to the system to entrench themselves and will continue to get more powerful with the passage of time, unless the state can get its act together and explicitly block them.

All democratic countries tend to accumulate interest groups and entrenched elites, but in the United States they interact with the system of checks and balances in a particularly destructive way. The decentralized nature of the legislative process hands entire parts of the Federal budget to particular lobbies. Policies that are both sensible and in the long run necessary are simply off the table. Hence we cannot discuss ending or reducing the deductibility of mortgage interest due to opposition from the real estate industry; we can't move away from the current fee-for-service model in health care because of the doctors' lobby. Above all, the financial sector represents the most concentrated source of wealth in the United States today; despite having played a major role in the recent financial crisis, the large banks have emerged politically

<sup>2</sup>Olson, *The Rise and Decline of Nations* (Yale University Press, 1982).

<sup>3</sup>See for example Jonathan Rauch, *Demosclerosis: The Silent Killer of American Government* (Times Books, 1994).

powerful and able to block or undermine efforts to regulate them more strongly.

So how do we get out of this situation? Olson is not terribly optimistic on this point. He suggests that it often takes war or revolution to clear away the accumulation of interest groups. Bombing Germany and Japan to smithereens in World War II allowed them to get a fresh start after 1945. He also suggests that opening up a country to trade competition may have a similar effect. But what if the country is already open, as is the United States?

Seeking major constitutional change to reduce the number of veto players in the American system is also off the table. The broad system of checks and balances is very deeply part of American political culture and for most of the nation's history has served it well. We are not going to move to anything like a Westminster system; even non-Constitutional changes like adopting an Australian-style electoral system (the alternative vote) will be highly controversial.

What does seem to be happening, however, is the emulation of certain features of the Westminster system in the context of the existing American one. The super-committee arrangement that came out of the summer's debt limit fight is a harbinger of a future way forward.

Basically, we are never going to get to a fiscally sustainable budget unless we take its formulation out of the hands of 535 individual legislators and delegate it to a much smaller group, one hopefully influenced heavily by more technocratic types who are not captured by particular interest groups. As in the British system, this group could make painful tradeoffs and then refer the result back to the whole Congress, which would bind itself to pass the legislation as an up-or-down package.

There are already a number of precedents for this, such as the fast-track authority that was once used to pass free trade pacts, or the base-closing commission that facilitated military downsizing. In both cases, there was general recognition that the concentrated interests over-represented in Congress would block any meaningful action if these measures were subject to the normal legislative process. Under this type of delegated authority, legislation was formulated by experts sensitive but not beholden to interest groups—the U.S.

Trade Representative in the first case, a bipartisan commission in the latter.

The super-committee arrangement agreed to by Congress over the summer isn't actually this kind of body. It consists of serving members of Congress, including some who are ideologically allergic to compromise. There is no guarantee that they will come to an agreement on a budget, even under the pressure of automatic budget cuts. Without stronger expert representation, it is entirely possible that the smaller panel will simply replicate the divisions of the existing legislature. Congress, moreover, can't bind itself in perpetuity and is perfectly capable of undoing the existing pact.

Delegating authority to technocrats has never gone down well in American politics, which from the days of Andrew Jackson has been highly suspicious of experts and insistent on an ever-increasing domain of public participation in decision-making. Domains of existing delegated authority like the Federal Reserve have been under continuous populist attack.

Nonetheless, some version of the super-committee idea represents the only way out of the current crisis. It is not clear that individual members of Congress would be willing to give up their tremendous powers to influence the budget for the sake of local constituents. But the growing sense of national crisis has already changed the terms of the debate substantially.

There has been a great deal of comparison recently between the seemingly efficient Chinese authoritarian decision-making system and the paralysis that seems to characterize democratic political systems from Japan to Europe to the United States. The Chinese system, however, embeds plenty of hidden problems that will make it in the long run unsustainable. It is, moreover, absurd to think that it would constitute a realistic model for any modern democracy.

What is less well recognized is that there is a huge degree of institutional variation among liberal democracies. While they have all been moving in a more populist direction in recent years, the looming requirement of re-writing basic social contracts underlying contemporary welfare states will force change. Whether Americans can forthrightly confront the limitations of their own system will be an important test of the resilience of American life. 🍷