The shutdown is over, but the austerity fight continues

By [Yves Smith]

October 18, 2013

The bruising battle on Capitol Hill over the debt ceiling is not over. It has simply been postponed to a longer-term budget negotiation. Congress has agreed to fund the government on an interim basis through January 15 and extend its borrowing authority through February 7, at which date the turmoil of this week might recur.

Although the immediate goal of tea party Republicans in Congress was to defund President Barack Obama's health care law, it is important not to lose sight of their larger purpose. This week's drama is only the latest battle in a decades-long war by radical conservatives, joined by pro-business interests in both parties, to gut the governmental supports for the middle and lower classes responsible for America's postwar prosperity. The mystery is why politicians and pundits tout austerity policies despite ample evidence that they are damaging and counterproductive.

Bipartisanship on cuts

Since 2011, the leadership of both parties has failed to agree on the exact terms of a so-called 'grand bargain' for America's long-term budget outlook. But both sides believe that government debt levels need to be reduced. They also agree that entitlements ought to be shrunk, which would place the burden of debt reduction on middle- and lower-class Americans. The last major round of negotiations foundered over taxes: President Obama insisted that a deal include some increases, including on top earners; the Republicans would consider only spending cuts. Even though the tea party wing of the GOP tried throwing the president's health care law into the mix in this year's shutdown brinksmanship, perhaps as a gambit to force Obama to relent on tax increases, the attempt backfired. The Republicans got almost no concessions in return for reopening the government.

This protracted budget negotiation is not just another effort to whack spending and, with it, the government's size. Recall that President Ronald Reagan came into office with similar bold talk but simply delivered massive tax cuts. Where it differs is in its fundamental consensus on the goal: A major object of both the Republicans and President Obama is to "reform," as in cut, the most beloved and substantial of the remaining New Deal programs — Social Security and Medicare. And if they succeed, it will be the crowning success of a 40-year-long propaganda campaign against the tax and social welfare programs that were the foundation of a formerly healthy American middle class.

To see how far public opinion has shifted in the last 50 years, consider the following statement by Republican President Dwight Eisenhower in 1954:

> Should any political party attempt to abolish social security, unemployment insurance, and eliminate labor laws and farm programs, you would not hear of that party again in our political history. There is a tiny splinter group, of course, that believes you can do these things … Their number is negligible and they are stupid.

Eisenhower was not only making a sound political assessment; he was also correctly pointing out the economic foolhardiness of cutting spending, particularly to programs that bolster middle- and lower-income citizens. Contemporary policymakers should acknowledge the clear evidence that the budget-trimming exercise will be counterproductive, assuming the objective is to reduce the level of government debt, rather than make the rich even richer.

Austerity does not work

The International Monetary Fund admitted earlier this year that its long-cherished belief, that budget cutting lowers fiscal deficits, was wrong. The debt-to-GDP ratio — a statistic commonly used to justify government-spending cuts — involves two interdependent numbers: a numerator and a denominator. Cutting the numerator (government spending) typically winds up shrinking the denominator (the size of the economy) even more. Thus, the ratio used to justify austerity measures winds up unchanged or even more dire, which then prompts further government-spending cuts. It is the economic equivalent of trying to apply even more leeches to a weak patient to return him to health. Lost in these figures is the double whammy to the middle class and the poor: It becomes desperately difficult to find work, and therefore many lose their savings and homes, at the very same time that social safety nets are pulled out from underneath them.

The study cited by legislators and policy analysts as providing conclusive support for budget-cutting policies was famously discredited earlier this year. Economists Carmen Reinhart and Kenneth Rogoff claimed in a 2010 paper that economic growth fell sharply when the debt-to-GDP ratio breached 90 percent. An economics graduate student at the University of Massachusetts Amherst, Thomas Herndon, convinced the pair to share their supporting data. He not only found conceptual errors but pinpointed several Excel-spreadsheet mistakes. When the results were recomputed, their support for Reinhart and Rogoff's thesis disintegrated: Even when debt exceeded the allegedly all-important 90-percent threshold, growth was only modestly weaker than at lower levels of indebtedness. Even if the relationship had been stronger, the economists had failed to establish a causal connection between debt and growth; all they had found was a correlation. Most cases of high debt-to-GDP ratios resulted from a major economic shock that produced both a contraction and a debt spike. This is not surprising: Government indebtedness explodes after financial crises, because tax revenues collapse and borrowing increases to fill the gap.

Even the Congressional Budget Office, America's supposedly non-partisan source for fiscal information, has enabled deficit scaremongering. Virtually all experts accept the CBO's claim that Medicare — the government health program for retirees — will eventually consume much more of federal spending. Even liberal economists like Paul Krugman contend that the problem is not Medicare, per se, but health-care costs in general.

However, the critics most qualified to assess the CBO's analysis demolished it. That this is not more widely known indicates the dire state of American economic debate. Despite its importance to understanding the U.S. fiscal outlook, the paper presenting their findings was relegated to an obscure Italian economics journal. The authors, Glenn Follette and Louise Sheiner, are senior members of the Federal Reserve's fiscal impacts section. Their review, published in 2008, is devastating in the range and nature of its criticisms. Their fundamental objection is that the CBO model naively uses past growth in health-care spending as the basis for its long-term projections. But those increases took place when subsidies to health-care spending, both private and public, were rising rapidly. CBO forecasts are not supposed to project out trend lines; rather, they are supposed to reflect specific policy assumptions — in this case, what happens if the current regime continues. The authors demonstrate that using that framework results in a much more rapid convergence between health-care cost growth and the overall inflation rate, with the result that Medicare does not become the budgetary albatross that the pro-austerity advocates claim it is.

This is not the first time the CBO has painted an unduly dire picture of America's finances. Remember that supposedly scary 90-percent government-debt-to-GDP ratio? An August 2010 forecast by the CBO showed that if a March budget proposal by the administration were passed, the government-debt-to-GDP ratio would hit 90 percent by 2020. But Tom Ferguson and Rob Johnson, senior fellows at the Roosevelt Institute, showed that the CBO had curiously omitted government financial assets from their calculations. When you netted those out, debt levels remained comfortably below the alleged 90-percent danger level — a measure now known to be irrelevant. Even though the Ferguson/Johnson paper was published more than two years ago, the CBO has yet to correct its accounting.

Propagandize and distract

If the conclusions of the "non-partisan" CBO are skewed in favor of austerity policies, it is clear that our public fiscal debate has been corrupted to its core. It demonstrates the effectiveness of a decades-long propaganda effort by right-wing think tanks and their wealthy backers to indoctrinate the public. Although, as Eisenhower pointed out, only a fringe group in his day was keen to eviscerate the New Deal, the further growth of social spending in the 1960s for the War on Poverty, the expansion of civil rights and the demonization of the liberal "Establishment" produced a determined, organized pushback.

A seminal event was former Supreme Court Justice Lewis Powell's 1971 memorandum that set forth a long-term strategy of how to move American values to the right. Writing two months before his nomination to the Supreme Court, he stressed the importance of consistent, continuing action and ample funding, which could only be obtained through a combined effort by corporate executives, pro-business conservatives and the wealthy. An important legacy of his vision was the establishment of such think tanks as the Cato Institute and the American Enterprise Institute, to provide polish and intellectual legitimacy to the conservative agenda. Although this campaign has many fathers, key players include the U.S. Chamber of Commerce and conservative billionaires such as the Koch brothers, Peter Peterson, Richard Mellon Scaife and the Coors family.

Even with the overwhelming majority of Americans firmly opposed to cutting Social Security and Medicare, both parties have embraced this once extreme right-wing agenda under the rubric of "entitlement reform" — which is the sort of Madison Avenue packaging that Powell advocated for selling conservative ideas to the public. Other achievements of this long-term campaign include a "law and economics" movement that has produced a more business-friendly judiciary, changes in campaign finance laws to allow the rich to spend even more, and a money-driven system of staffing Congressional committees.

But even with that level of influence, politicians need cover to implement unpopular moves. The high drama over the federal budget has provided just such a distraction. Remember, it took an imminent market meltdown in 2008 to secure the passage of the wildly unpopular Troubled Asset Relief Program — the U.S. government proposal to keep major financial institutions from collapsing by purchasing their troubled assets. The debt-ceiling showdown risked market and economic upheaval that experts agreed would make the Lehman Brothers collapse that accelerated the 2008 financial crisis look mild by comparison. The question is whether public opposition will make it impossible for a 'grand bargain' against their interests to succeed.

Eisenhower would probably insist that this recklessness confirms his dim view of the opponents of Social Security. As a witness to the devastation of the Depression and World War II, he no doubt had a keener appreciation of how fragile societies are than today’s leaders in Washington and their billionaire funders do.

Opinions expressed here do not necessarily reflect those of Al Jazeera America.