

## Up from Here? Challenges and Barriers to Recovery from the Crisis

**“Amazingly, people making less than \$113,700 a year, i.e., the bottom 98% of the population, will actually see a larger increase in their overall tax rates than will the top one percent because of the fiscal cliff deal, according to the Center for Economic and Policy Research.”**

*Eric Laursen, page 9*

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## Welcoming Remarks

James K. Galbraith

We're now five years after the very dramatic events of 2007 through early 2009, the years that have come to be known as the Great Financial Crisis. The forecasts that were prevalent at that time, including the official forecasts of agencies like the Congressional Budget Office, projected that we would be past those events by now. The economy was expected to recover substantially to rates of employment that prevailed in normal times. This hasn't happened. It's fair to say that, in addition to the very discouraging performance of employment, many other indicators of economic performance have been discouraging. We continue to be preoccupied with the budget consequences of that discouraging performance. In addition to conditions on this continent, in Europe there is an ongoing crisis of economic performance and of the political institutions that were created 20, 30 years ago to frame and govern economic activity.

It seemed to us appropriate to convene a panel that would address the question of what is our present condition, what are the prospects in the near and the long term? Do we face barriers to a full recovery and a return to what was in the postwar years considered to be normal rates of economic growth and employment?

We were very fortunate to be able to convene a panel of really great distinction on this topic. I shall introduce them very briefly in alphabetical order. I begin with Kenneth Arrow, whom I know from his days as a professor at my father's institution, Harvard University, sometime

ago departed there for the sunnier coast, and a, shall we say, epochal figure in the history, the modern development of economic theory.

Robert Gordon of Northwestern, a longstanding member and stalwart of Economists for Peace and Security, and author — particularly in the last year — of some of the most provocative and insightful work addressing the question of whether conditions going forward will really be different from those of the most recent half-century or so.

Over the last years we've seen the question of economic performance tied up very closely with the issue of the structure of social institutions, and particularly of social insurance; and so I thought it appropriate to have on this panel a great authority on the history and economic growth of the Social Security system. That's Eric Laursen. His book, *The People's Pension*, has just been named an Editor's Choice of Booklist. It's a terrific history of the political battles that have surrounded Social Security since its inception.

Yanis Varoufakis, of the University of Athens, I'm happy to note, has recently arrived at the University of Texas at Austin on a visiting professorship. Yanis is a voice of singular importance on the question of what is happening in Europe. He speaks from the platform of a very close observation in the country that is most severely affected by the European crisis, but has the capacity and the knowledge to address himself to the entire range of European — and indeed broader — economic issues.

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## Panel Moderator

James K. Galbraith holds degrees from Harvard (BA magna cum laude, 1974) and Yale (PhD in economics, 1981). He teaches economics and a variety of other subjects at the LBJ School, where he directed the School's PhD Program in Public Policy from 1995 to 1997. He directs the University of Texas Inequality Project, an informal research group based at the LBJ School. Galbraith maintains several outside connections, including serving as a Senior Scholar of the Levy Economics Institute and as Chair of EPS.



## Panelists



Robert Gordon is Stanley G. Harris Professor in the Social Sciences and Professor of Economics at Northwestern University. His undergraduate work was at Harvard; he then attended Oxford University on a Marshall Scholarship. Gordon is author of *Macroeconomics*, eleventh edition, which has been translated into eight languages, and of *The Measurement of Durable Goods Prices*. He is an economic adviser to the Congressional Budget Office, and a trustee of EPS.



Eric Laursen is an independent journalist who has covered political and financial news for more than a quarter-century. Most recently, he's been studying Social Security, and is author of the recently published *The People's Pension: The War Against Social Security from Reagan to Obama* (AK Press, Spring 2012). He is co-author of *Understanding the Crash* (Soft Skull Press/ Counterpoint, 2010), and the co-founder and former managing editor of *Plan Sponsor*, a magazine that focuses on pension funds.

Yanis Varoufakis is an economist who heads the Department of Economic Policy at the National and Kapodistrian University of Athens. Mr. Varoufakis received his doctorate in 1987 at the University of Essex, in the United Kingdom. From 1990 to 2002, he was a senior lecturer in economics at the University of Sydney, in Australia. Since 2000, he has been a professor of economic theory at the University of Athens and director of the university's doctoral program in economics.



## Kenneth Arrow

I'll just say a few words about the immediate situation as background, because I really want to talk about more long-run implications.

The current recession is by no means a unique occasion. The history of capitalism is a history of fluctuations of prosperity and depression, unemployment, idle resources, sometimes financial crises. This was first observed around 1819, after the end of the Napoleonic Wars, when there was unemployment; but there was no drought, there was no hail, no natural circumstances that would explain it. This recurred all through the 19th Century, and it couldn't be blamed on government, because government's role in the economy was extremely small during this period, by modern standards.

We find in the current situation a monetary policy that does not work (although it clearly has functioned on occasion) because we're at the zero interest rate bound; it can't go anywhere from there. We have quantitative easing designed to bring down the long-term interest rates, which I guess has probably worked; the long-term interest rate is certainly very low, though whether that's the real constraint on borrowing is another question, long-term or short-term. That leaves us with fiscal policy.

By some standards, our fiscal policy is pretty aggressive. The deficit of the federal government is roughly seven percent of gross domestic product. Seven percent of GDP as a deficit is a large number, and it's a little hard to see how we can be more aggressive. Certainly, we're taking a very different stance from European countries like Great Britain, which are much more given to austerity. However, it is important to distinguish between the short- and long-run problems. I want to look at more of the long-run implications of the current discussions and the current interim settlement — the postponement of basic decisions.

In the long run, there's a real problem. It is agreed by most people on both sides that, between the aging of the population and growing medical costs, the percentage of gross domestic product that's going to be allocated for Social

Security and medical costs paid by the federal government will rise. The figure that's currently given is around 8.7 percent of GDP for those two together. It's expected to rise in 25 years to 12.7 percent — in other words, another 4 percent of GDP. Projections show that under any policies that are within the political spectrum, we're going to have a steadily rising debt-to-GDP ratio.

**It is a rational policy to borrow a lot now and then pay it back with extremely high taxes a few years from now, but I have some doubts that policy is sufficiently flexible to accomplish that.**

I do consider the debt to be a problem. I've heard neo-Keynesian arguments that the debt is no issue at all; but I think that's false. It seems to me quite clear that if the debt-to-GDP ratio continues to rise, we're in trouble. Although interest rates are currently very low, making it a very opportune time to borrow, they're not going to remain low. When we have to renew the debts, we're going to pay higher interest rates. Higher interest rates mean higher taxes, and I don't think anybody's going to deny that taxes are a source of inefficiency in the economy. The debt is not infinitely costly, but it is costly. In the long run, the taxes have to balance the expenditures. We have to have higher taxes, either now or in the future. It is a rational policy to borrow a lot now and then pay it back with extremely high taxes a few years from now, but I have some doubts that policy is sufficiently flexible to accomplish that. Essentially, we have to raise taxes or cut medical expenditures below the levels that have been anticipated.

The growth in medical costs is not by any means an unambiguous "bad." One

of the main reasons driving the growth is the fact that we can do expensive things that couldn't be done at all before. We now have open-heart surgery and expensive pharmaceuticals that have saved a great many lives. In some sense, the price of medical care is falling rapidly. When you go from something that you can't do at all, with a price of infinity, to being able to do it for a finite price, there has been a big reduction; but expenditures may go up as prices go down. The fact that medical costs are rising is not by itself necessarily a bad thing.

I want to emphasize the implications for the distribution of income and welfare. The way the problem became focused was most unfortunate. The big emphasis has been on tax rates, especially from the Obama administration. First, we're talking about falling on people who are fairly rich, about whether the tax cut should start at \$250,000 or \$400,000. The term "middle class" has been thrown around a lot. An income of \$250,000 is not middle class by any reasonable definition. When per capita income per family is in the order of \$50-\$55,000, the \$250,000 means we're talking about the upper 2 percent — 3 percent at most. We have to seek some kind of redistributive element.

I will say the income tax has already achieved a good deal of equity at the lower end. You need close to an above-average income to pay any income taxes at all; and the earned income tax credit really was a great success. However, I want to argue that the redistribution of welfare implicit in Social Security, and especially in Medicare and Medicaid, is much more significant than any redistribution through tax rates. If there's a choice between maintaining the entitlements and raising taxes, I'd rather protect the entitlements than protect high tax rates.

Quite contrary to what Presidential candidate Romney thought, Americans tend not at all to be redistributors. They don't really believe in taking from the rich and giving to the poor. The poor don't believe that, either. As an illustration, take the California estate tax.

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## Kenneth Arrow (continued)

Essentially, all the principals were the same as the federal, except another five percent was added for the state. An initiative to repeal this was passed. What percentage of estates do you think were subject to any tax whatever? Five or less, so why did the 95 percent of the voters who were losing vote for it? This illustrates to me that taxes are a major negative to the bulk of the American population.

On the other hand, the judgment about medicine is quite different. Somehow, no matter how laissez-faire and libertarian people are, they find it very difficult to say a person should be denied medical care because they can't afford it.

Total medical costs divided by the number of people leaves roughly \$6,500 per person per year. For perfect insurance for a family of four, that would mean \$26,000 in premium, clearly putting this out of the reach of a great many people. I don't know any politician who'd openly say, "Yeah, well, if you're poor, you can't afford a Mercedes Benz, and if

you're poor you can't afford good medical service, expensive medical service." Nobody's going to say that.

The federal government today spends 55 percent of all medical costs one way or another. In Canada, which has a nice socialized system, the corresponding figure is 65 percent. The fact is we're well into this business. Undoubtedly, there is a vast amount of inefficiency in the system; our medical costs per capita are way above those of any other country. Medical costs are rising as a percentage of GDP in every country that has a serious medical care system. However, they're all well below those of the United States — the population of which, by the way, does not have outstanding health. US longevity is about tenth or twelfth among the world's countries. Infant mortality is even worse. We're ranked closely with Cuba.

There's one more consideration: how do we value health? One widely used figure is the so-called "value of the statistical life." This is based on comparing the workers in different industries where

they have different accident risks, or different chances of dying on the job. Wages are higher in industries where the mortality rate due to accidents is higher, so the value of a statistical life is about \$6.5 million per life. Well, that's a large figure. I was working with some colleagues trying to get a measure of wealth to be used for sustainability. We weren't particularly interested in health, but for completeness we thought we ought to include health. It ended up that health dominates any reasonable measure of wealth.

It's not only that society has a view that health is kind of a supreme value, and we need to do things for other people's health that we're not willing to do for other aspects of their livelihood; but it's also true that everybody values health much more highly than is reflected in our national statistics.

For all these reasons, I think any solutions will need to place much more emphasis on trying to defend the entitlements, particularly medical entitlements, than be concerned about tax rates.

## Robert Gordon

There are two independent reasons to be pessimistic about the future of US economic growth. Over the century-plus from 1891 to 2007, the United States achieved growth in per capita real GDP at precisely 2.02 percent per year. My (pessimistic) prediction is that we're headed toward 1 percent for total GDP per capita, with 0.5 percent growth for the bottom 99 percent. That subtraction of half a point is the amount that goes to the top 1 percent based on the actual outcome of the last 20 years or so. Those two independent reasons have to do with, first, less fruitful innovations. Innovation continues apace, but innovations are not producing the kinds of things that yielded 2 percent annual growth. Secondly, there are what I call the six headwinds.

I prefer to take a long view. From 1300 to 1800 the UK, and then the US, experienced just slightly above zero

economic growth. There was a definite step upward in real growth starting around 1800, peaked for the United States in the period between the 1920s and the 1950s. It's been gradually slowing down since. Five years ago, I projected out to 2100 a growth rate of about 1.2 percent. We're currently running 10 points below that pessimistic forecast.

We recently got some new numbers from Sweden for comparison. Sweden actually registered zero growth in per capita income between the mid-16th Century and 1800. From 1800 to the 1970s, they did a little better than the US, but are now slowing down at the same pace. Sweden is being emphasized because it has relatively good national income accounts.

I propose an outrageous hypothesis: maybe the whole idea of economic growth is a two- or three-century phenomenon. We didn't have any before

1800. Are we going to have it forever into the future?

Let's go back to the 2 percent growth in the 20th Century. That was made up of 2.2 percent growth in output per hour and about a minus 0.2 percent decline in hours per capita, because as society was getting richer, people decided to work shorter hours and take longer vacations.

In my interpretation, the 2.0 growth achievement was propelled by the second Industrial Revolution of the late 19th Century and all of its spinoffs, the last three being air conditioning, the interstate highway system, and jet commercial air travel. The early days of the computer revolution continue the process by which people working were replaced by machines. By the way, a big part of our progress in the early part of the 20th Century was horses being replaced by machines.

## Robert Gordon

The story about innovation is really based on a judgment that the things that were invented at the end of the 19th Century were just more important. Only once did we move from the speed of the horse to the speed of a Boeing 707; only once could we urbanize; only once could we move from hot and cold rooms to rooms that are always 70 degrees Fahrenheit, thanks to central heating and air conditioning.

Why have hours per capita grown so slowly? We had a seven percent decline in hours per capita between 2000 and 2004. We had a very weak recovery with *no* recovery in the level of hours per capita for four years, with an 8 percent decline in 2008 to 2012. This is total aggregate billions of hours of work per million of people in the population, everybody from 16 to infinity, 120 years old, whatever. I believe there are six headwinds that are slowing down the economy.

The first headwind is the demographic events that are causing our per capita decline. One of the reasons for this is retirement of the baby boomers. We also have what David Brooks calls the missing fifth, the steady decline in the labor force participation of prime age males. Prime age male labor force participation, ages 25 to 54, has gone from about 95 percent in 1964 to the current roughly 82 percent.

The second headwind is the state of American education. The completion rate in American higher education of four-year degrees is 41 percent for people aged 25 to 34; in Canada, it's 56 percent. That's a 15-point gap in educational inferiority for the American system. We have a trillion dollars in student debt, more than the total automobile debt. The US ranked 21 out of 26 OECD countries in high school graduation rates. Eighty-five percent of foreign exchange students coming for a year in American high schools say their courses are much easier than they were in their native countries. The black-white achievement gap has not varied since the 1960s. We have real deterioration going on in the quality of the labor force.

The third headwind is inequality. I subtract half a point for inequality.

Average real income growth was 1.3 percent per year from 1993 to 2008.

**We do have to take seriously the size of the federal debt, and the federal deficit has to shrink a great deal; but whether fast or slow, sequester or carefully negotiated finance, every conceivable method of reducing the federal debt would reduce the growth rate of disposable income compared to GDP.**

That same number for the bottom 99 percent of the income distribution was 0.75 percent, and there is no reason this growing inequality will stop. All the technological optimists who think we're going to be employing more and more robots to replace the humans forget that the workers don't own the robots; the capitalists own the robots, to be really Marxist with it. That's where I get my final forecast for everybody who really counts, the bottom 99 percent, down half a point per year.

Then there is globalization, the fourth headwind. Globalization is the same as free trade. Who could be against that? However, the United States has low-wage states and high-wage states, unionized states and right-to-work states. Japanese, Korean, and German foreign-owned auto plants aren't located in Michigan; they're almost entirely in the South. They provide sensational jobs compared to those otherwise available in Alabama and South Carolina, but they erode the remaining vestiges of union rents in the high-wage UAW states. American manufacturing is sliding down

the labor demand curve. Manufacturing is having a revival, but riding on lower wages, which contributes to growing inequality.

The fifth challenge is the environment. Now here's where I'll get everybody upset: forget fighting global warming. There's a definite reason for this. Any action by the US government to raise taxes to control carbon emissions would help to derail the recovery. The basic undeniable fact is that the pollutants coming from China and India are now far greater than those coming from the US. China alone creates more pollutants in a year than the United States, and they say to us, why should you strangle our growth worrying about global warming, when nobody was there in 1905 and 1910 telling the United States it had to stop polluting?

The final headwind is the overhang of consumer and government debt. As if all this weren't bad enough, the economy was artificially pumped up beyond any sustainable growth performance in the fifteen years up to 2007 by stop-market bubbles and cash-out refinancing related to the housing bubble. We moved from 1980 to present to an increasingly consumer-driven society, heavily based on consumers going into debt. Much of this consumption was spent on imports. The sum of consumption and net exports did not increase nearly as much. Our American consumers going heavily into debt, pouring their money into goods made abroad, ultimately harmed the American standard of living.

We do have to take seriously the size of the federal debt, and the federal deficit has to shrink a great deal; but whether fast or slow, sequester or carefully negotiated finance, every conceivable method of reducing the federal debt would reduce the growth rate of disposable income compared to GDP. Raise taxes; that cuts disposable income. Cutting transfers cuts disposable income. Of course, if you cut non-defense spending, there goes somebody's job, weakening the economy and raising unemployment.

There is a little room for the balanced budget multiplier idea from elementary

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## Robert Gordon (continued)

economics. We know there are some things that have high multipliers, like unemployment compensation and food stamps. We know there are some things that have very low multipliers, like raising taxes on the rich. To some extent, you can finance social spending with higher taxes on the rich.

If you compare the Clinton era to the share of GDP during the Obama administration [see below], spending is down by 4.2 percentage points, the expenditures up by only 2.4. That's very different from the message you get from The Wall Street Journal or elsewhere. The revenue problem is greater than the expenditure problem, but that's shortsighted. Our entitlements, i.e. our expenditures, are going to grow rapidly in the future due both to aging of the population and the medical care situation.

I have three flavors of potential output. It happens that my middle estimate is very close to the current CBO estimate that says we're currently running about 6 percent of GDP in actuality below potential output.

How can we close that output gap? Well, monetary policy is doing its job, monetizing the deficit. That's fine as long as all that new monetary base creates excess reserves. By definition, fiscal pol-

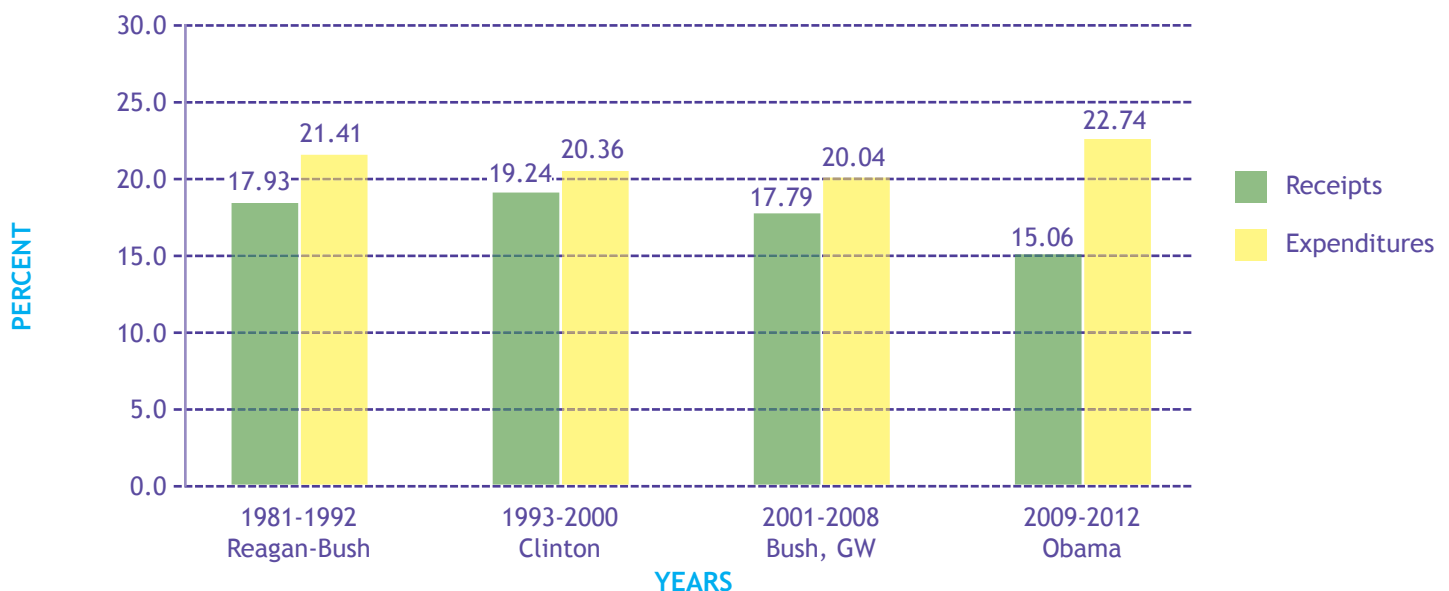
icy must be contractionary if there's any progress to be made on the federal deficit, with an important qualification: that different expenditures and revenues have different multipliers. This means we must give up the attempt to kickstart the economy by the only fiscal stimulus that we know actually worked in US history, in 1940-41. The share of total government spending increased from 12 to 25 percent in six quarters between the fall of France in 1940 and the dawn of the day before Pearl Harbor. The GDP gap went from -20 percent in early 1939 to zero several weeks before Pearl Harbor. The multipliers were pretty high back then,  $2\frac{1}{2}$  to 3, partly because we didn't import so much and we had lower income taxes. This was the great fiscal policy experiment, but we don't have any wars to fight. We don't have any legitimate reason to go through this again.

Boskin, Hubbard, Taylor, and many others have been feeding the media the story that low marginal tax rates for the rich create jobs. The first counter-example, of course, is that tax rates were higher in the Clinton era and economic growth in the Clinton era was almost the highest in the postwar period. High incomes are rents, almost by definition. If I raise the top rate from 35 to 50 per-

cent, which of the following people would quit their jobs for their next best opportunity? Alex Rodriguez, Tom Brady, Tom Cruise, Jamie Dimon, or Lloyd Blankfein, the CEO of Goldman Sachs? How can you say we need the saving of the rich to fund investments when we have trillions of dollars of cash sitting inside corporate vaults and more than a trillion of excess bank reserves? Going back to Henry George, rents are the ideal to be taxed because the dead-weight losses are smallest. We also must impose a Buffett rule. Let's get it back to 39.6, so that we don't have incentives to pay out corporate executives in the form of capital gains.

What the Left must abandon, or at least must consider carefully, is a decline in the future growth of entitlements. That doesn't mean that the poor widow living on \$12,000 in Social Security suddenly has to go down to \$10,000; it just means we want to taper off the growth rate in the future. That can be accomplished by a combination of things that don't affect the current beneficiary population, like raising the retirement age — indexing it to life expectancy. The 0.2 life expectancy gain should go directly into the retirement age of Social Security. I would join with Marty

### AVERAGE FEDERAL GOVERNMENT RECEIPTS AND EXPENDITURES TO POTENTIAL GDP RATIOS, SELECTED INTERVALS



## Robert Gordon

Feldstein and his conservative buddies with an all-out attack on what he calls tax expenditures, loopholes, subsidies, and deductions.

Everybody agrees that we should have unlimited immigration of highly skilled people, but I propose that we should have unlimited immigration, with more young people to support the growing population of old people. Wouldn't we be flooded with Hispanics, which would create unemployment? No, immigration self-regulates itself to the business cycle. We had unlimited immigration from 1865 to the 1920s. There is an amazing correlation between the immigration of the population and the trend of GDP. The US had a great depression in the 1870s; everybody found out about it and nobody came. Then the economy boomed in the early 1880s. The actual number of immigrants in 1882 was four times higher than in 1875.

The focus of American secondary and elementary education needs to move away from the constant beating up on teachers. In Chicago public schools in 2011, 20 percent on average of African-American elementary school students were absent for more than a month from school. This is transmitting a new generation of poverty. I agree with Jim Hechtman that, as a society, by far the highest ratio benefit to cost is pouring compensatory tutorial help into poverty-stricken families.

As far as the New Deal, Ken never mentioned the difference between American medical care expenses and other countries. Other countries figured out how to do this efficiently, and we have not. The latest OECD data from 2010 show that US spending as a percent of GDP from 2010. Our spending as percent of GDP is 17.6; Canada, 11.4; OECD average, 9.5. The difference

between the US and Canada at American GDP levels comes out at almost a trillion dollars per year. What do we get in return for our excess investment of one trillion dollars? The US is ranked thirty-eighth on international tables of life expectancy.

The explanation of the extra US spending can be divided into three categories. Thirty-one percent is due to the fact that American doctors are paid higher; 14 percent is due to the fact that we do more procedures, apparently without generating returns in terms of life expectancy; fully 40 percent is due to higher administrative costs. In many categories, we had four times the ratio of administrative workers in medical care to doctors than in other countries. The US will never cope with its medical care inflation until we adopt a single-payer system and drive every private insurance company out of business.

## Eric Laursen

I'm the one person on this panel who's not an economist. I'm a journalist and historian. Especially after the somewhat harsh words on entitlements, I'm going to see if I can provide some useful perspective on the role of Social Security in the recession.

Social Security had nothing to do with the crisis in 2008. If anything, Social Security has helped keep the real economy afloat during the weak recovery in three closely related ways. First, keeping seniors active as consumers at a time when everybody else was cutting back. Second, forestalling something like the tragedy that took place during the Great Depression, when millions of seniors who couldn't find work were forced to depend on their adult children for support, further straining desperate working households. Third, enabling seniors to help out their working adult children with extra cash, money for education expenses, and even a place to live when they lost their homes.

We were lucky, in fact, that in January 2009, when the full impact of

the recession was first being felt, Social Security recipients got one of their largest annual benefit adjustments in over 20 years, 5.8 percent. Combined with a one-time \$250 bonus payment to everyone who received Social Security or disability benefits, Social Security is one of the most effective short-term counter-cyclical forces in the economy.

Very low inflation kept seniors from receiving any cost-of-living adjustment at all in 2010 and 2011; and the bonus payment was not renewed. Instead, it was replaced by the partial payroll tax holiday in 2011, renewed in 2012. Social Security again played a counter-cyclical role. There are private sector estimates that the payroll tax break added .7 percent to annual US economic growth. That's quite a bit, given that the economy's growth has been around 2 percent.

Things could be done to make Social Security an even better counterweight to recession. Our moderator, for one, has called for temporarily lowering the age for receiving full Social Security benefits to 62, which would open up more jobs

for younger workers. Most important to learn from its history, however, is that Social Security has been one of the most effective tools for keeping recessions from becoming much worse.

One can't help noticing that since 2009, Social Security has generally been portrayed as an obstacle to economic progress. The Republican right and the Democratic center right have done a brilliant job of switching the script. The subject has changed from "how to jumpstart the economy and lower unemployment," to "how to lower tax rates for corporations and the affluent, and cut long-term government spending" — even if that means imposing austerity on working Americans at exactly the wrong time.

The discussion about how to engineer this goes back to 2006 and the last years of the Bush administration. It continued through the tortuous negotiations and congressional wrangling that resulted in the creation of the fiscal cliff, and the recent post-election negotiations.

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## Eric Laursen (continued)

Cuts in Social Security have always been a deficit-cutting item endorsed by prominent leaders of both parties. They will continue to be, given so many still-unresolved issues. In particular, the need to boost the debt limit creates an opening for Republicans to insist the White House keep Social Security and Medicare on the table.

Why is this? The President said that his goal was to cut deficit by \$4 trillion over ten years through a combination of tax hikes and spending cuts. After his re-election, Obama offered to include in his package a reduction in the formulae used to calculate initial Social Security benefits when a worker retires, switching from the traditional CPI to something called the chained CPI. His Republican counterparts embraced the idea. In fact, Senate Minority Leader McConnell has said repeatedly that major cuts to entitlements are the absolute minimum concession that his party would accept from the President.

The cut in the Social Security benefit formula wouldn't actually achieve much deficit reduction. The President shocked and angered some of the more progressive members of his party last month when he announced a new ten-year offer to the Republicans that would have cut spending by \$1.2 trillion: \$800 billion from cuts to discretionary spending, \$290 billion from savings on interest on the national debt, and \$122 billion from adopting the chained CPI. That's well under 10 percent of the whole package, because the vast majority of the benefit reduction from the chained CPI would have happened in later decades, and would have hit future generations of retirees the hardest. Surely the White House could have found more money over the next ten years from some other source, but that's precisely the point. Cutting Social Security is not part of any rational deficit or debt reduction exercise. The short-term savings are too small, and the much larger long-term savings can always be reversed by a later Congress once working people realize how hard they're going to be hit.

I'd just say parenthetically that the main reason the so-called insolvency date for Social Security has moved so

**[T]he main reason the so-called insolvency date for Social Security has moved so much closer in recent decades is not an aging society... [but] real wage stagnation in this country for the majority of the last 40 years.**

much closer in recent decades is not an aging society. It's not even because of medical costs. It's because of one very simple thing: real wage stagnation in this country for the majority of the last 40 years. That tends to dampen payroll tax receipts, which in turn means that it's harder to fund Social Security. If Americans had had a raise during that period, Social Security's insolvency date would have been pushed back to 2055, where it was in the Greenspan Commission 1983 amendments. At that point, Baby Boomers would be fully retired, and the costs of funding old age benefits would have stabilized. The real culprit here is not an aging society, which has been predicted for a long time, but wage stagnation. End of parenthesis.

In Washington, cutting Social Security has come to be seen as something of an end in itself. Alice Rivlin told the House Budget Committee in 2009 that fixing Social Security would be a confidence-building achievement for bipartisan cooperation and would enhance our reputation for fiscal prudence. That is, we'd give the bond markets confidence that Washington will continue to prioritize good stewardship for their investments. Robert Zoellik, the former head of the World Bank and long-time Bush trade negotiator, wrote in December that "countries around the world are assessing the effectiveness of other states' political systems by exam-

ining whether governments can make public pension plans financially sustainable." One measure that Zoellik endorsed was switching to the chained CPI because, he said, it "makes more sense than adding to the cost of labor by taxing workers' wages more." Actually, in poll after poll, workers have expressed willingness to pay higher payroll taxes if it would strengthen Social Security for the future.

However, Zoellik isn't interested in what working people think or want. Employers in the US and other industrialized countries have benefited greatly over the past four decades from downward pressure on labor costs. The real threat posed by Social Security and an aging society is that the declining cost of labor could reverse itself in succeeding decades. Fewer workers in relation to retirees means that employers may have to pay workers more to keep them in the labor force. Cutting Social Security benefits, on the other hand, means that many of the elderly will have to keep working, even if they prefer not to, giving the upper hand back to employers.

The ten-year period that has become standard in the deficit reduction conversation is purely artificial — a convenient way to show that the alleged problem is being pushed too far into the future. Fiscal talks over the past couple of years are really about assuring the business and financial community that the advantageous economic balance of power (the one Washington has helped create for them over the last four decades) won't be upended. The claim is that costs to government and to government bondholders won't rise; those costs will instead be shifted away from government and onto the backs of working households. That's why Social Security has had such a prominent and misplaced role in fiscal cliff negotiations, a role that will continue as we lurch into the next of Washington's seemingly endless succession of debt wrangles. That's why the extremely useful role that it has played in blunting the effects of the recession hasn't placed it in better stead with powerful people in Washington.

What will happen in future recessions if the chained CPI is adopted?



## Eric Laursen

Briefly, working people will find it even harder to bounce back from recessions. Washington has been toying with the idea of solving its fiscal problems by changing the CPI for the better part of twenty years. The chained CPI is simply the most recent version, but Washington sees it as a magic bullet to solve deficit woes because it both raises taxes and slows increases in benefits payments. This can be disguised as a technical correction, and therefore doesn't carry too great a stigma for lawmakers who vote for it.

Whenever ideas like this come up, it's customary for the Washington media to concentrate almost exclusively on how much money could be saved from these measures. Very little space is given to analyzing the actual impact on people who participate in Social Security. It's one of the more shameful aspects of national journalism these days.

Of course, the whole story isn't just what the chained CPI would do to expenditures. There are no thorough studies of the actual impact of the chained CPI on working households or on retirees, but something of the impact can be understood from the following facts. Two-thirds of people over 65 who receive Social Security rely on it for over half of their total household income, and that rises to three-quarters for non-married person over 65. Over 13 million Americans depend on Social Security for over 90 percent of their income, and yet Social Security is not very generous. The last time that significant changes were made to Social Security (in 1983), old age benefits were reduced long-term by 13 percent by gradually raising the retirement age from 65 to 67. The change is still working its way through the system as more people are affected by the higher retirement age. The average monthly benefit for new retirees in 2011 was \$1,241, from which Medicare Part A premiums subtract an average \$115.40. Many people lifted "out of poverty" by Social Security are only lifted to just the right side of the poverty line, which is a less than realistic measure to begin with. In short, there's really no such thing as a small technical correc-

tion to the CPI formula for Social Security. Even very modest cuts have a huge impact on people whose ability to get by is balanced on a knife's edge.

The Obama administration circulated ideas for softening the impact of the chained CPI for people at greatest risk. They've talked about a bump-up of benefits for people in their mid-80s and older, or continuing to apply the traditional CPI to supplemental security income — the insurance program for indigent seniors and the disabled. The latter amounts to exactly what Social Security's critics have been advocating since the program came into being: shifting the benefits as much as possible from the contributory social insurance structure (which invests workers and beneficiaries with a sense of ownership in the program itself) to a more welfare-like system that's more easily cuttable in Washington.

The problem, of course, is that softening the blow from implementing the chained CPI would save the government less money, especially over the first 10 years. In all, the chained CPI is projected to save some \$220 billion over that period. That includes the \$120 billion from Social Security, plus other savings from federal employee's pensions, veterans' benefits, and from higher taxes. The plain fact is that the chained CPI saves Washington money because it weighs heavily on those who can least afford it. Making it more equitable would defeat the purpose.

Social Security cuts were left out of the partial fiscal cliff deal that Congress passed [in early January]. The ironic thing is that, under that deal, the flow of guaranteed income from Social Security will loom even larger as a factor in the economic recovery. So much of the stimulus, and even some other elements of the safety net, are at risk. The Senate bill extended unemployment insurance, but only temporarily. It allowed a partial payroll tax holiday to expire and didn't replace it with anything else, meaning taxes will go up for low- and middle-income households, who will thus have much less discretionary income to spend. A series of tax credits for low-income households was also extended,

but only for five years. Amazingly, people making less than \$113,700 a year, i.e., the bottom 98% of the population, will actually see a larger increase in their overall tax rates than will the top one percent because of the fiscal cliff deal, according to the Center for Economic and Policy Research. Furthermore, the advantageous rates the Republicans earned for their supporters are permanent, not temporary. Meanwhile, a host of discretionary programs, including the WIC nutrition program for women and infants, low-income energy system, and rental housing assistance for the poor, are still on the chopping block. Quite likely, the White House will be admonishing the progressive Democrats that, in order to preserve these programs, they will have to agree to long-term cuts to Social Security and Medicare. Republican lawmakers are already more or less pledging to make the debt ceiling the occasion for attacks on Social Security and Medicare. If that happens, you can be sure that the chained CPI will again be a hot topic.

All of this underscores the stark reality: the retirement crisis is mounting fast in this country. Home equity, employer-based pensions, personal savings — all of which used to be important ingredients in working people's old age planning — have eroded frighteningly. Higher health care costs and the cost of helping out struggling children and grandchildren present new burdens on elderly people. Social Security, despite all the attempts to portray it as an out-of-control entitlement, is the one element of retirement income that most Americans can still count on. If anything, Washington should be looking for ways to expand it into a true national retirement system, rather than a supplement to private pensions, which is how Social Security has been cast for most of its history.

If Washington goes the other way, if the right and the center right achieve this sort of harmonic convergence toward which they've been moving, where they can begin phasing out Social Security gradually, we'll see deeper and more disastrous recessions in the decades to come.

## Yanis Varoufakis

Economists for Peace & Security — what a splendid idea, especially for somebody coming from the European continent, which is energetically cultivating deep insecurity from Ireland to the streets of Athens, from Lisbon to the frozen lakes of Finland. One of the most invigorating aspects of being in the United States is that we have discussions like this, in forums like this. In Europe, it is highly unlikely that we would have a session like this, I say with much pain. But before I get carried away with tales of woe from my beloved Europe, let me address the issue at hand: up from here? What are the impediments to recovery?

Of course, debt matters, but the extent to which it matters is obscured if we fail to see the counterparty to debt, which is a huge savings glut globally. In addition to the savings of the East that played such a significant role in bringing about the crash of 2008, we now have the deleveraging of the West. These two combine to create a mountain of glut, nicely hidden behind a mountain of debt. The tragedy of our era is the breakdown of the mechanism which allows those two mountains to cancel each other out.

In December 2012, the difference between bank deposits and bank loans in the US rose to above 2 trillion dollars for the first time. At the same time, labor's share of national income continues to fall. It's been falling for many decades, but the crash of 2008 increased the shrinkage of labor's share. Taken together, you come up with a very simple realization that, rather than technological change causing machines to turn into our slaves, the mother of all market failures has effectively made us the victims of our own creations. This picture explains quite nicely, and in an uncomplicated way, the dearth of effective demand which is facing the world.

Now, up from here? There are two ways that recovery can take place in financialized capitalism. One is to create a new bubble, or reinstate an old bubble, which is precisely what central bankers have been trying to do. The second way is through global coordination of spending programs, perhaps at the level of G20. Given the utter unwillingness or

incapacity of politicians to operate at the level of G20, it's perhaps not too unwise for central bankers to try to inflate the old bubble or raise new ones. In the United States, the United Kingdom, Switzerland, Japan, and Scandinavia, we have monetary priming, which has many side effects, as we all know. Monetary leakage into the global monetary system has caused a great deal of frustration and anxiety in places like Brazil and the rest of the BRICS [Brazil, Russia, India, China, and South Africa]. China is perhaps an exception; China on its own since 2008 has created the same amount of credit as the whole United States banking system creates in one year. That's additional credit!

**In addition to the savings of the East that played such a significant role in bringing about the crash of 2008, we now have the deleveraging of the West. These two combine to create a mountain of glut, nicely hidden behind a mountain of debt.**

These are some of the some of the impediments to recovery. As long as this kind of monetary planning is continued in lieu of any serious attempt to rebalance the mountain of debt with the glut of savings, we will be unlikely to have a robust recovery. Europe is plotting its own downfall by feeding and stoking the fires of recession simply because the elite is in denial of the awful architecture of the Eurozone which it created ten, fifteen years ago. Toxic derivative-like institutions, such as the European Financial Stability Facility and the European Stability Mechanism, based on toxic economic theory, are breaking up the Eurozone architecture and can only perpetuate the downturn caused in the first

place by trying to find remedies that effectively purchase some semblance of stability at the expense of genuine economic continuation.

Monopoly power is increasing globally through acquisitions, mergers, and bankruptcies, and the banking sector enjoys financial gains without any serious regulation. For example: according to JP Morgan's own books, in June of 2012, JP Morgan had deposits of \$1.2 billion, and it had lent only \$693 million. Some people may argue that this gap between deposits and loans can be explained on the basis of quantitative easing and the bankers' penchant for purchasing US Treasuries, but that is not what is really happening. This gap is explained by the gain that goes on through repurchasing agreements and repledging of the repos that have been issued.

Lastly, the United States as a macro-economy is failing to do what it was doing prior to 2008 — to use its true deficit in order to recycle other people's surpluses and to push them into productive use.

As long as these conditions continue, we will have a recovery of asset prices in Western countries in control of their currencies, like the US and UK, but massive anxiety in countries like Brazil. Quantitative easing and monetary priming is flooding these countries with flighty capital, which can be lost at any moment, causing bubbles to burst. We can have vicious depression in the European periphery, and a recession that is eating away at the very foundation of the European project and even European democracy. The fact that we have Nazis in the Greek parliament at the moment is not irrelevant. We also have a kind of post-mortem protectionism, which manifests in the US in the quaint notion of America managing to recoil from the rest of the world, become self-sufficient, and base future growth and prosperity on ecologically devastating gas and shale oil production.

What do we need to do in order to remove these impediments and give recovery a chance?

Well, the first thing we need to do is end the game the banks play using the

## Yanis Varoufakis

gap between deposits and savings, and lending. The current regulatory regime doesn't stand a chance of succeeding in this realm. We need a coordinating program at the G20 level for recusing private sector debt, a kind of quantitative easing for households and small companies. We need a coordinating program for spending on things that humanity really genuinely needs, a kind of Manhattan Project, or a series of Manhattan Projects, again on the level of the G20. These projects should create the green knowledge to compete with the polluting, planet-destroying technologies of drilling and fracking.

If technology is making progress synonymous with the loss of good-quality jobs in manufacturing, surely the education and health have the capacity of improving humanity's lot by creating labor-intensive pockets. These sectors

harness expertise and knowledge that machinery can never possibly replace, in a manner which is both growth-enhancing and developmental.

Finally, we need to restore not the bubbles that crashed in 2008, but something that the global economy enjoyed from the late 1940s and 2008, and which is *sine qua non*: a mechanism, a method, some system by which surpluses can be recycled. Between 1950 and the end of the Breton-Woods, the United States was actively pursuing this surplus society through different programs, the Marshall Plan being just one example. The United States was recycling its own surpluses to Europe and Japan in a manner that allows demand both in monetary and in the goods and services sectors to be self-sustaining at the global level.

Once Breton-Woods died, we had an

audacious new recycling mechanism. It worked fabulously in recycling other people's (non-American) surpluses, through the operation of the United States trade deficits; but it was a very unbalanced mechanism which was bound to crash and burn. Unfortunately, financialization was built on the back of that mechanism. When the system burned, even though US trade deficits and federal budget deficits quickly regained their pre-2008 levels, they no longer managed to recycle surpluses into productive activities to the extent necessary to create effective demand both here and abroad.

How could this happen? This is a very big question; but I feel unless we face it, we shall not be able to escape from the mire in which we find ourselves, and recovery will be something that we will continue to discuss at academic conferences.

### The Economics of Peace and Security Journal, Vol. 8, No. 1 On the defense and firearms industries, growth, and foreign aid

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### UPCOMING EVENTS

- **June 15 – July 13, 2013** The 2013 Bologna Symposium on Conflict Prevention, Resolution, and Reconciliation will be hosted by the International Peace & Security Institute in Bologna Italy. In cooperation with the Johns Hopkins University Paul H. Nitze School of Advanced International Studies (SAIS), the Symposium will bring together the globe's brightest minds from top graduate institutions, NGOs, international organizations, grassroots peace movements, and the armed services.

To learn more about the symposium, go to  
<http://ipsinstitute.org/bologna-2013/?PHPSESSID=c49b22cc9dfd21f61d40e9c8090ff67c>.

- **June 19 – 21, 2013** The Fifth International Conference on Conflict Management, Peace Economics and Peace Science will be held at Bloemfontein, South Africa.

For more information, contact Manas Chatterji at  
[mchatter@binghamton.edu](mailto:mchatter@binghamton.edu).

- **June 24 – 26, 2013** The 13th Jan Tinbergen European Peace Science Conference will be held in Milan, Italy. The Jan Tinbergen Conference is interdisciplinary. Presentations that address any issue relating to peace and security broadly defined are welcome. The conference strives for a multi-disciplinary program comprising contributions with a wide range of theoretical and methodological approaches, including strictly theoretical work, game theory and formal modeling, statistical and econometric analysis, qualitative studies, and experiments.

Find out more about the conference when you visit  
<http://www.europeanpeacescientists.org/jan.html>.

- **July 20 – August 17, 2013** The 2013 Hague Symposium on Post-Conflict Transitions & International Justice will be hosted by the International Peace & Security Institute in The Hague, The Netherlands. Participants will undergo intensive training from 25 of the field's premier political leaders, academic experts, practitioners, and advocates in the skills necessary to holistically restructure a post-conflict society, as well as serve justice to those responsible for human rights violations.

For further information, see  
<http://ipsinstitute.org/the-hague-2013/>.

- **September 17 – 18, 2013** Peace and Conflict: an International Interdisciplinary Conference hosted by The Conflict Research Society at the University of Essex, UK. The conference seeks to bring together developments in the "real" world and developments in academic understanding – topical issues and enduring issues.

Details about the conference can be found at  
<http://www.conflictresearchsociety.org.uk/2013%20CRS%20Annual%20Conference%20.html>