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"Economic Medicine" and the Debt Ceiling Debate

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The blood pressure of the patient in the emergency room drops precipitously.

The ER docs have already given 15 pints of blood over the course of many hours. But the patient is still on the verge of dying.

Medical rules and regulations say that more than 15 pints of blood should never be given, as too much transfusion can cause other fatal problems.

The "liberal" doctors want to give the patient more blood. After all, this is a life-or-death emergency … and if they can just buy more time, they might be able to figure out a way to save the patient.

The "conservative" doctors want to stop with the transfusions. After all, giving too much blood could kill the patient … and maybe he'll be able to pull out of it on his own.

Who is right?

Well, the "liberal" and "conservative" doctors are so busy arguing their point of view that they haven't noticed that one of the patient's legs has been half chewed off. He's bleeding out through the huge open wound.

Unless the doctors suture up the wound, the patient will bleed out no matter how much blood they give him.

I've previously explained this fact using water as an analogy:

> "Deficit hawks" like top economic historian Niall Ferguson says that America's debt will drive it into a debt crisis, and that any more quantitative easing will lead our creditors to pull the plug. See this, this and this. Indeed, PhD economist Michael Hudson says (starting around 4:00 into video):
>
>> If the problem that is grinding the economy to a halt is too much debt, and if no one in the government – in either party – is looking at solving the debt problem, then … we're going to go into a depression as far as the eye can see.
>
> Yet the U.S. hasn't reined in its profligate spending. While modern economic theory shows that debts do matter (and see this), the U.S. is spending on guns and butter.
>
> As PhD economist Dean Baker points out, the IMF is cracking down on the once-proud America like a naughty third world developing country. (As I've

repeatedly noted, the IMF performed a complete audit of the whole US financial system during Bush's last term in office – something which they have only previously done to broke third world nations.)

Indeed, economics professor and former Senior Economist for the President's Council of Economic Advisers Laurence Kotlikoff wrote yesterday:

> Let's get real. The U.S. is bankrupt.
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> ***
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> Last month, the International Monetary Fund released its annual review of U.S. economic policy…. The IMF has effectively pronounced the U.S. bankrupt.
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> ***
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> Based on the CBO's data, I calculate a fiscal gap of $202 trillion, which is more than 15 times the official debt.
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> ***
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> This is what happens when you run a massive Ponzi scheme for six decades straight….
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> ***
>
> Bond traders will kick us miles down our road once they wake up and realize the U.S. is in worse fiscal shape than Greece.

On the other hand, as I also pointed out last month, the government isn't even stimulating in an effective way:

> "Deficit doves" – i.e. Keynesians like Paul Krugman – say that unless we spend much more on stimulus, we'll slide into a depression. And yet the government isn't spending money on the types of stimulus that will have the most bang for the buck: like giving money to the states, extending unemployment benefits or buying more food stamps – let alone rebuilding America's manufacturing base. See this, this and this.

(Yes, Congress has just thrown twenty billion dollars at jobs and the states, but it is a tiny drop in the bucket compared to the many tens of trillions of dollars in handouts to the giant banks.)

Keynes implemented his policies in an era of much less debt than we have today. We're now bankrupt, with debt levels so high that they are dragging down the economy.

Even if Keynesian stimulus could help in our climate of all-pervading debt, Washington has already shot America's wad in propping up the big banks and other oligarchs.

More important still, Keynes implemented his New Deal stimulus at the same time that Glass-Steagall and many other measures were implemented to plug the holes in a corrupt financial system. The gaming of the financial system was decreased somewhat, the amount of funny business which the powers-that-be

> could engage in was reined in to some extent.
>
> As such, the economy had a chance to recover (even with the massive stimulus of World War II, unless some basic level of trust had been restored in the economy, the economy would not have recovered).
>
> Today, however, [politicians] haven't fixed any of the major structural defects in the economy [update]. So even if Keynesianism were the answer, it cannot work without the implementation of structural reforms to the financial system.
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> A little extra water in the plumbing can't fix pipes that have been corroded and are thoroughly rotten. The government hasn't even tried to replace the leaking sections of pipe in our economy.
>
> Quantitative easing can't patch a financial system with giant holes in it.

(Note: If you're sure that your side of the aisle is right and the other side is wrong, please read this.)

What are the giant holes?

Some of the biggest are:

- Rampant fraud
- Worse-than-third-world inequality
- Insanely high levels of leverage
- Warping of the economy and the political process by a handful of monstrously bloated banks
- Focusing on policy objectives other than reducing unemployment (which has the net effect of actually increasing unemployment)

Of course, the loss of America's manufacturing base, encouraging jobs to be shipped abroad, out of control derivatives and other shenanigans are giant holes as well. And the government has been throwing money at the big banks instead of the little guy, which – as Steve Keen as demonstrated – is not an effective way to stimulate the economy.

I've used a third analogy to describe these problems.

As I wrote in 2009 in a post called "Why the Patient Is Not Getting Better: Government is Strengthening the Parasite and Poisoning the Real Economy":

> Why isn't the economy getting better, even though the government is pumping trillions of dollars into bailouts and stimulus packages and intervening in markets left and right?
>
> Because the government is treating the wrong patient.
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> Let's say you travel to the tropics and pick up a parasite. You go to your doctor

who gives you very powerful drugs that make you sick. You go back to the doctor, he looks you over, and then adds more potent drugs to your prescription.

You go back a third time and say “Doctor, I’m getting sicker and sicker, why isn’t it working?”

He responds “Oh, I thought the parasite was the patient. The drugs are making it healthier”.

The Government is Strengthening the Parasite

The real economy is:

> (1) People making things or providing real, useful services
>
> (2) People saving money
>
> and
>
> (3) People investing the money they saved into productive businesses which will make more things or provide needed services.

According to top federal reserve officials and economists, the government’s actions will encourage big financial players to make even riskier gambles in the future.

Indeed, the government is in the process of giving hundreds of billions – if not trillions – of dollars and guarantees to hedge funds (hedge funds are some of the biggest speculators of all). Indeed, the various bailout programs are giving huge sums to companies that make money by pushing paper around without actually producing any useful goods or services.

The heads of the big banks and financial companies are also getting huge bonuses even though they have driven their companies so far into the ditch that they need government bailouts. Even Paul Volcker says the incentive system is broken. Indeed, the government is making the CEOs richer by giving them billions of dollars of bailout money with which to feather their own nests.

And credit derivatives [at least to the extent they are naked, unregulated and opaque] act as a parasite on the real economy: credit default swap buyers bet that the referenced company will go down the tubes (see this and this). And yet the government is allowing the credit default swap trades to increase, driving CDS spreads against many companies and governments to reach all-time highs.

The Government is Poisoning the Real Economy

Not only is the parasite being boosted by government actions, but the patient – the real economy – is being poisoned.

Manufacturing has been shipped out of America for decades, and the government is still actively encouraging companies to move manufacturing abroad.

Taxpayers will be on the hook for trillions of dollars of obligations through taxes/or inflation (even Bernanke has admitted that inflation is a tax, because people have less money in their pockets after buying necessities). So

Americans will be able to save less.

And government has not only failed to require that companies accurately report their finances – so that investors can know which companies are stable and productive – but it has actually thwarted such accuracy. For example:

- A government agency prevented the SEC from investigating multi-billion dollar Ponzi-schemer Stanford

- As of 2006:

> "President George W. Bush has bestowed on his intelligence czar … broad authority, in the name of national security, to excuse publicly traded companies from their usual accounting and securities-disclosure obligations."

- One or more treasury department officials actively allowed banks to "cook their books"

The government has been strengthening the parasite and poisoning the real economy. No wonder the patient is getting worse.

I noted a couple of months later:

> Michael Hudson is a highly-regarded economist. He is a Distinguished Research Professor at the University of Missouri, Kansas City, who has advised the U.S., Canadian, Mexican and Latvian governments as well as the United Nations Institute for Training and Research. He is a former Wall Street economist at Chase Manhattan Bank who also helped establish the world's first sovereign debt fund.
>
> Hudson has frequently described Wall Street as "parasitic". For example, in a 2003 interview, Hudson said:
>
>> The problem with parasites is not merely that they siphon off the food and nourishment of their host, crippling its reproductive power, but that they take over the host's brain as well. The parasite tricks the host into thinking that it is feeding itself.
>>
>> Something like this is happening today as the financial sector is devouring the industrial sector. Finance capital pretends that its growth is that of industrial capital formation. That is why the financial bubble is called "wealth creation," as if it were what progressive economic reformers envisioned a century ago. They condemned rent and monopoly profit, but never dreamed that the financiers would end up devouring landlord and industrialist alike. Emperors of Finance have trumped Barons of Property and Captains of Industry.
>
> More recently, Hudson said:
>
>> You can think of the financial sector as being wrapped around the real economy, almost like a parasite, and that's why it's been called parasitic for so long. The financial sector extracts interest

> from the economy, the property sector extracts economic rent, as do monopolies. Now the key thing about parasites, is that it's not simply that they extract nourishment from the host. The parasite takes over the
> host's brain, to make it think it's part of the economy, to make it think
> it's part of the host's own body, and, in fact, that's it almost like a child of the host, to be protected. And that's what the financial sector has done today.
>
> You have Obama coming out and saying, "We have to save the banks in order to save the real economy". The fact is, you can't serve both the parasite and the host.

And see this.

On August 10th, Hudson went even further. Specifically, he said:

- The giant financial institutions have already killed their host – the real American economy
- Since they realize that the American economy is dead, they are trying to suck as much blood out of America as possible while the corpse is still warm
- Because the American economy is dead, their plan is to soon jump to another host. They will ship all of their money overseas

To come back to my original analogy, the dying patient has a horde of leeches inside the gaping wound in his leg, and the transfused blood has done nothing but fed the leeches. [Sorry for the gross analogy.] The doctors have been helping the parasites, not the patient. Unless the doctors clean out the parasites and close the gaping wound, the patient has no chance.

As Dennis Kucinich writes today:

> We have to realize what this country's economy has become. Our monetary policy, through the Federal Reserve Act of 1913, privatized the money supply, gathers the wealth, puts it in the hands of the few while the Federal Reserve can create money out of nothing, give it to banks to park at the Fed while our small businesses are starving for capital.
>
> Mark my words — Wall Street cashes in whether we have a default or not. And the same type of thinking that created billions in bailouts for Wall Street and more than $1 trillion in giveaways by the Federal Reserve today leaves 26 million Americans either underemployed or unemployed. And nine out of ten Americans over the age of 65 are facing cuts in their Social Security in order to pay for a debt which grew from tax cuts for the rich and for endless wars.
>
> There is a massive transfer of wealth from the American people to the hands of a few and it's going on right now as America's eyes are misdirected to the political theater of these histrionic debt negotiations, threats to shut down the government, and willingness to make the most Americans pay dearly for debts they did not create.

> These are symptoms of a government which has lost its way, and they are a challenge to the legitimacy of the two-party system.