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US deadlock sows uncertainty worldwide

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BILL Clinton famously called the US "the indispensable nation". With the shutdown grinding on, America seems more incomprehensible than indispensable. And further crises lie ahead, as showdowns on the debt ceiling and the automatic sequester loom.

The difficulties partly reflect the historical origins of US budget processes. In Europe, annual budgets emerged as parliaments imposed their sovereignty on recalcitrant monarchs. In Britain, for example, Edmund Burke's "economical reform act of 1782 gave the House of Commons the right to "correct ... every branch of the public revenue".

As the party system evolved, securing approval of the budget became the litmus test of parliamentary confidence in the government, while the budget served as the focus of co-ordination within the executive.

However imperfectly, fiscal outcomes therefore had a political owner, as Labor (yet again) discovered merely weeks ago.

By contrast, having broken free of the monarch, spending and taxing decisions in the US were from the outset part of the loose fabric of congressional deal-making. Rather than a centralised process that imposed fiscal discipline on what was initially a weak presidency, congressional committees provided multiple points at which those decisions could be initiated, revised or vetoed. And in a system of government in which the executive does not depend on the confidence of the legislature, budget resolutions never acquired make-or-break status.

It took the fiscal demands of World War I to trigger the first attempts at federal budget reform. Those included moves towards a recognisable annual budget in 1921, but even then, congressional decisions on expenditure remained separate from those on revenue-raising.

Tighter budgetary co-ordination only developed after World War II, mainly through the House Committee on Ways and Means, which was chaired from 1958 to 1974 by Arkansas Democrat Wilbur Mills. Rising to power during a period of strong government expansion, Mills was a fiscal conservative who ruthlessly sought to force spending constraints on an increasingly imperious presidency.

But those efforts collapsed as Mills was enveloped in a scandal involving an Argentine stripper known as Fanne Foxe. Mills's departure hastened a decline in budget processes that a long list of institutional innovations proved unable to stem.

As the constraints on spending weakened, fiscal decision-making degenerated into a blame game. With each component of the system dodging responsibility for outcomes, successive administrations ran budget deficits from 1975 to 1993, while shifting any savings far into the future; 1993 marked a reversal in the trend but it was not sustained, with rising deficits in the 2000s.

Fiscal deterioration was accompanied by increasingly acrimonious budget politics. Both congress and the president advocated tough decisions but neither was willing to actually take them, especially once voters severely punished George HW Bush and then Clinton for their efforts at fiscal discipline.

As well as frequent failures to pass the budget, those divisions led to periodic shutdowns of non-essential parts of government, with the first in 1976. Merely a year later, it was followed by a crisis over the federal debt limit.

Introduced in 1917 as a way of facilitating war finance, that limit should simply reflect the federal budget, which congress approves. But proposed debt ceiling increases provided excellent opportunities for grandstanding. Those reached a peak in 1977, when congress's refusal to ratify the increase in time led to the US being briefly in technical default.

Now, with the administration rapidly running out of credit, another debt limit confrontation is on the cards. Given that 70 per cent of public debt is held by Americans, the US is unlikely to default. But avoiding that outcome will doubtless involve further cliffhangers. And adding to the gloom, the automatic spending cuts (sequesters) mandated by the 2011 Budget Control Act, which was intended to terrify lawmakers into solving the budget mess, are set to ramp up next year.

True, some progress has been made, as Republicans have forced annually appropriated government spending to 1 per cent below 2007 levels. But that is far from sufficient, and further progress seems a very hard slog.

Deep-seated economic and political factors compound the difficulties. Thanks partly to rising income inequality, the top income deciles, who mainly support the Republicans, pay well over two-thirds of income taxes, while the Democrats now command the votes of the beneficiaries from higher federal spending, including public sector employees.

At the same time, greatly increased geographical sorting of the American population means Republican and Democratic members of congress overwhelmingly hold safe seats: of the 435 house districts, only nine are likely to be tightly competitive in 2014.

The greatest risk incumbents face is therefore not from the other side of politics but from within, with party primaries becoming the centre of political rivalry. And though American voters are no more polarised than they have been historically, the core party supporters are, with especially high levels of polarisation among college graduates, who have a disproportionate impact on the outcomes of the all-important primaries. That makes compromise ever more risky. Little wonder the Senate Minority Leader, Kentucky's Mitch McConnell, who faces a tough primary for Republican renomination, refused to play a conciliatory role in the road to the shutdown.

Add to that mix a weakened president who is unwilling to use what little political capital he has left to break the deadlock and the result is a take-no-prisoners political dynamic that, instead of solving problems, cloaks the failure to do so in illusory righteousness.

None of that means the system will collapse, much less the American economy: the US is far more robust than that. Yet the uncertainty it creates will resonate around the world. Getting our own fiscal house in order is therefore all the more urgent.

Yes, the US may refuse to take the difficult decisions; as a small, open economy, that is a luxury we just don't have.

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