

The great austerity war: what caused the US deficit crisis and who should pay to fix it?

James Crotty*

Rapidly rising deficits at both the federal and state and local government levels, along with prospective long-term financing problems in the Social Security and Medicare programmes, have triggered a one-sided austerity-focused class war in the USA and around the globe. A coalition of the richest and most economically powerful segments of society, conservative politicians who represent their interests and right-wing populist groups like the Tea Party has demanded that deficits be eliminated by severe cuts at all levels of government in spending that either supports the poor and the middle class or funds crucial public investment. It also demands tax cuts for the rich and for business. These demands constitute a deliberate attempt to destroy the New Deal project, begun in the 1930s, whose goal was to subject capitalism to democratic control. In this paper I argue that our deficit crisis is the result of a shift from the New Deal-based economic model of the early postwar period to today's neoliberal, free-market model. The new model has generated slow growth, rising inequality and rising deficits. Rising deficits in turn created demands for austerity. After tracing the long-term evolution of our current deficit crisis, I show that this crisis should be resolved primarily by raising taxes on upper-income households and large corporations, cutting war spending and adopting a Canadian- or European-style health care system. Calls for massive government spending cuts should be seen as what they are—an attack by the rich and powerful against the basic interests of the American people.

Key words: Deficit crisis, Fiscal crisis, Austerity, Social Security crisis, Health care crisis

JEL classifications: E60, E62, H60

1. Introduction

We have reached what may be a crucial point in the evolution of the political economy of the USA. Rapidly rising deficits at both the federal and state and local government levels,

Manuscript received 23 June 2011; final version received 27 September 2011.

Address for correspondence: James Crotty, Economics Department University of Massachusetts, Amherst, MA 01003, USA; email: jcrotty@comcast.net

* University of Massachusetts, Amherst, MA. I am grateful to Gerald Epstein and Tom Weisskopf for helpful comments on an earlier draft, to Yasemin Dildar and Nina Eichacker for research assistance, and to the Helen Sheridan Memorial Scholars' Program for research support.

© The Author 2012. Published by Oxford University Press on behalf of the Cambridge Political Economy Society. All rights reserved.

along with prospective long-term financing problems in the Social Security and Medicare programmes, have triggered a one-sided class war. A somewhat disparate right-wing coalition composed of rich households, large corporations, smaller businesses, ideological conservatives (such as the Religious Right and, more recently, the Tea Party) and conservative politicians has demanded that the deficits be eliminated primarily by severe cuts at all levels of government in spending that either supports the poor and the middle class or funds crucial public investment in education, health care, infrastructure and technology. Simultaneously, the coalition has demanded huge tax cuts for wealthy households and businesses. These cuts would ratchet up political and economic pressure to further decimate government social and investment spending by creating even larger deficits. This is an example of the conservative 'starve-the-beast' strategy that pushes for sustained regressive tax cuts under any and all fiscal circumstances in order to shrink government spending other than on defence and programmes that enrich corporations.

Similar austerity pressures have developed in Europe. The adoption of austerity programmes across the globe threatens to sink economies deeper into recession or even depression, perhaps triggering another global financial crisis. However, I will not focus on this pressing danger of austerity here. The USA needs a serious jobs-creation programme over the next several years, but it obviously cannot be built on the deep cuts in public spending and regressive tax cuts demanded by the right-wing coalition.

Not all members of this coalition agree on every aspect of policy. Older Tea Party members defend Medicare. Libertarians such as Ron Paul want to bring America's overseas armies back home. Good luck with that. Wall Street and non-financial business occasionally disagree on concrete policy issues. Nevertheless, there appears to be widespread support for such core post-Reagan Republican Party policies as unrelenting regressive tax cuts, major reductions in non-defence government spending, a continuation of the long-term assault on government regulation of business, open borders to facilitate the unrestricted cross-border movement of trade, investment and finance, attacks on unions, and serious cutbacks in, or the privatisation of, Social Security and Medicare. Whatever the infighting, we know that these are the programmes currently supported by the Republican Party with the assistance of a not insignificant number of Democratic politicians and there has not been a vigorous, public attack on these policies by any important coalition segment.

This paper makes three main points. First, the current austerity war has deep historical roots. The terrible economic costs of the Great Depression led to powerful political movements in the USA and Europe demanding an end to the uncontrolled capitalism that had caused such devastation and its replacement with new economic systems designed to meet the needs of the all the people. The Western economic models that evolved from these movements are variants of social democracy, or democratic capitalism, or regulated capitalism, or the mixed economy. In the USA, the foundations of the new model were built in the 1930s with the creation of the New Deal under Franklin Delano Roosevelt (FDR) and the Democratic Party. The objective of social democratic systems is to subject markets to the guidance and ultimate control of democratic governments that represent majority interests. The government is expected to: invest in infrastructure and technology; support crucial economic sectors subject to market failure, such as education, health care and housing; regulate business; provide an expanding social safety net to assist those who do not fare well in the market system; use the tax system to generate the revenue required to fulfil these obligations and limit inequality; and ensure that the economy generates adequate employment at rising wages through macroeconomic policy. A right-wing

coalition has been trying to destroy social democracy in America ever since its emergence in the 1930s and is closer to success at the moment than ever before.

Second, the current government debt crisis is the result of right-wing economic policies implemented since President Reagan took office that not only led to a deterioration in economic performance, but generated large budget deficits as well. Our debt-to-GDP ratio was very low before 1980, but, with the exception of the latter part of the Clinton presidency, it has been rising rapidly ever since. Rising deficits create financial market and political pressure to cut government spending on productive investment and shrink the social safety net—cornerstones of the New Deal. At least until now, attempts to slash social spending on programmes such as Social Security and Medicare have not been politically feasible, and military spending has remained bloated. Since tax cuts have not been matched by substantial spending cuts, the result is endless deficits.

Third, rather than attack the root causes of the current deficit crisis—slow growth under the post-Reagan right-wing economic model, the radical deregulation of financial markets that contributed to the recent global financial crisis, endless regressive tax cuts and excessive defence spending on wars of choice—both Democrats and Republicans have insisted that substantial non-defence spending cuts must bear the brunt of deficit reduction. The Democrats offer large cuts in social spending, while the Republicans want to destroy the entire New Deal project.¹ Both parties also propose regressive tax cuts that will increase deficits, thus ratcheting up the pressure for even more spending reductions.

This increasing political pressure to destroy the foundations of the New Deal is paradoxical. The right-wing coalition is on the verge of succeeding in its 80-year quest to defeat the New Deal, not in spite of, but *because* it produced three decades of economic failure and exploding deficits. The worse the economy performs and the more the deficits grow, the greater the likelihood the coalition will achieve its ultimate goal.

2. Understanding today's austerity war requires an economic and political history lesson

In the boom of the second half of the 1920s there was little regulation of business, very low taxes on business and rich households, a crippled union movement, a powerful financial sector that rained money on the wealthy, and a political system dominated by economic elites. From 1923 to 1929, 70% of the growth in income went to the richest 1% and only 15% went to the bottom 90% of the income distribution. This was a right-wing dream world.

The out-of-control capitalism of the period led to a financial crisis in late 1929 that eventually became a financial collapse accompanied by a severe depression. This economic

¹ The absence of strong, concerted business opposition to extreme austerity policies such as those contained in the House budget bill of April 2011 is curious, because if that bill became law it would lead to a rapid decline in aggregate demand and the onset of a very serious and possibly catastrophic recession that would slash business profit. It has been suggested that financial capital supports strong austerity policy and is more politically powerful in the current era than non-financial business. But this hypothesis fails to explain why financial capital desires extreme austerity, since this policy would cripple growth and make future individual, business and sovereign debt defaults more likely. It is possible that the perceived long-term benefits to financial and non-financial business of moving away from the constraints of social democracy exceed the expected cost in terms of lost short-term profit. Perhaps more important, the people who run large financial and non-financial corporations are very wealthy. To augment and protect their wealth they strongly support low corporate taxes and low taxes on high-income earners and on capital gains and dividends. This explains why they tend to argue that deficit reduction should be focused on spending cuts rather than revenue increases.

disaster generated such serious social and political unrest that the very existence of capitalism in America was called into question. Trade union militancy exploded while communist, socialist and semi-fascistic movements sprung up across the country. The idea that unregulated capitalism posed an extreme danger to the economy and society became the dominant view. FDR and the Democratic Party took control of the government in 1933 and began to implement a series of programmes that became known as the New Deal. They included strict regulation of financial markets, creation of the Social Security programme, support for the rising industrial union movement, large public employment programmes, deficit-financed stimulus spending of various kinds and the beginning of a system of unemployment insurance. The New Deal helped stop the collapse of the economy and restored economic growth, but when the Democrats tightened the budget in 1937 under pressure from antideficit forces, unemployment began to rise again. It took the central planning and huge government spending of World War II to restore full employment and create general prosperity.

The economic role of government grew substantially after World War II. Federal spending was about 3% of GDP in 1929, but increased to 16% in the 1950s. Social Security was expanded, Medicare and Medicaid were created, and various income security programmes were instituted that expanded the social safety net. Union membership peaked at 34% of all workers in 1954. Unions were the most important constraint on the power of corporations and the rich both in the political arena and in the economy, and the most important force pushing for government economic policies in the interest of the emerging middle class and the poor.

US elites were split on the question of whether to accommodate some aspects of the New Deal in the early 1930s, but the strength of right-wing resistance increased in the latter part of the decade as the danger of mass rebellion against capitalism ebbed. The right-wing coalition tried to undermine all aspects of the New Deal: the regulation of industry; the ‘confiscation’ of private wealth through income taxation (which did not exist prior to 1916); the reduction of inequality; support for unions; Social Security; unemployment insurance; the regulation of business; the commitment to full employment that weakened business control over labour; and the diminution of elite control over the government. The coalition wanted to restore the 1920s regime.

Much of the opposition to the New Deal was based on economic self-interest, but there were powerful moral and ideological dimensions as well. The New Deal was seen not just as a threat to profit, but as a threat to deeply held values and a way of life, a fact stressed by Kim Phillips-Fein in her excellent study of the history of right-wing resistance to the New Deal from the 1930s through the Reagan years. Right-wing forces:

dreamed of a return to the low-regulation, low-tax economy of the 1920s or even the late 19th century . . . They feared the power of the state and the threat of economic redistribution. They believed that at the heart of the New Deal and the labor movement was an excess of democracy—that the organization of working-class people into labor unions led to the rise of the welfare state and the perversion of the market economy . . . They believed that the free-market was equivalent to freedom itself, that regulating the market meant surrendering political liberty as well as economic strength. For them, the turning back of the New Deal was a question not only of the bottom line but of the deepest social principles. They had [a deep-seated] antipathy toward social democracy. (Phillips-Fein, 2009, p. 269)

The right-wing coalition had some early victories. For example, the Taft-Hartley law passed in 1947 was a major blow to the union movement. The Goldwater presidential campaign in 1964 was perhaps the high-water mark of anti-New-Deal efforts until the late

1970s. The coalition's problem was that the expanding role of government in the economy was very popular because it created a prosperous economy from World War II through the mid 1970s—the so-called 'Golden Age' of modern capitalism. The rate of economic growth was high, unemployment was low, real wages and family incomes rose rapidly, and inequality plummeted. Much of the business sector distanced itself from coalition efforts to overthrow the New Deal in the 1950s and 1960s because profits were so high. Programmes in the tradition of the New Deal continued to expand in the 1970s. In terms of the economic role of the government, President Nixon was an activist who was more progressive than most of today's Democrats:

The surge of government activism accelerated under Nixon . . . Nixon, not Johnson, oversaw the most rapid increase in domestic spending since the New Deal. He signed on to a huge expansion of Social Security, as well as to the creation of a national food stamps program . . . Nixon, not Johnson, signed into law the huge extensions of regulatory policy that marked this period, creating the Environmental Protection Agency (1970), the Occupational and Health Administration (1970), the National Traffic Safety Commission (1970), the Consumer Protection Commission (1970), and the Mine Safety and Health Administration (1973) . . . Compared to the leaders of today's GOP [Republican Party]—or even many current Democrats—Nixon looks like a full-throated Social Democrat. (Hacker and Pierson, 2010, pp. 96–7)

The mid to late 1970s marked a turning point. The 1970s were economically turbulent. Jumps in oil prices hit the economy both early and late in the decade, causing spikes in the rate of inflation. Given that the 'Keynesian' policy model adopted in the USA relied almost exclusively on the use of fiscal and monetary policy to alter total spending in the economy (and not on more micro-oriented industrial policies), the government had only two choices. It could stimulate spending to sustain growth at the expense of inflation or restrict spending to stop inflation at the cost of rising unemployment and slower growth.² In the wake of the first oil price hike in 1973, it chose the latter course, which caused the unemployment rate to rise from 4.9% in 1973 to 8.5% in 1975. Inflation declined from 1975 through 1977, but then rose again near the decade's end with the second oil price increase. Slower growth, higher inflation and unemployment, and falling profits and stock prices created growing discontent with the economic status quo. Meanwhile, social unrest was stirred by racial conflict over integration, the anti-Vietnam-war movement, the women's movement, pro-choice struggles, student radicalism and a youth rebellion.

These developments led to a political alliance between resurgent right-wing economic forces and the rapidly increasing ranks of cultural conservatives. As a result, business and other conservative forces saw a dramatic increase in their ability to raise money to elect friendly politicians, organise grass-roots pressure on all politicians, and spend money on an expanding right-wing ideological infrastructure of think tanks and university influence. They also used their control of the media to interpret economic and political events for the public through a conservative prism. As top executives from giant corporations began to shift toward more aggressive conservative economic positions, they created a formidable fund-raising and lobbying operation. Wealthy right-wing families also poured money into the political process. While business and the rich provided the rising supply of money, the increasing cost of political campaigns created a pressing demand for funds. Republicans were overpowering Democrats in the electoral money wars. Meanwhile, the percentage of American workers in unions had fallen to 23% and many Southern Democratic

² In fact, these were not Keynes's preferred policies. For an explanation of the more radical policies Keynes actually supported, see Crotty (1999).

congressmen had jumped to the Republican Party. Democrats responded to this new environment by becoming more business-friendly and more conservative on economic issues. By the late Carter administration, the right-wing coalition was in position to begin to challenge the foundations of the postwar political economy. For example, President Carter and Congress enacted a deep cut in the capital gains tax and initiated what became a long-term attack on the government regulation of business.

By 1980, the country had come to a cross roads. The existing set of government institutions and policies, in combination with the increasing globalisation of production, investment and finance that brought rising foreign competition, were no longer generating the widespread prosperity the public had come to expect. Either we had to reconstruct and reinvigorate our social democratic model or replace it with an alternative model. Right-wing forces had a clear vision of the alternative model they wanted—a modern version of the 1920s economy situated in a globalised economic system—and had vastly increased their political clout. Supporters of the basic New Deal philosophy were confused about how to restructure the government–economy nexus in the face of economic adversity, and a large and growing percentage of Democrats had lost their commitment to the New Deal project.

Progressive academics and politicians offered proposals to deal with the main economic problems of the era that were consistent with the New Deal philosophy. The late 1970s temporary inflation spike could have been met with temporary wage–price controls. Instead, Fed policies drove interest rates and the exchange rate of the US dollar through the roof, creating massive unemployment and the devastation of our industrial base. Financial chaos could have been avoided by a reconstitution of effective financial market regulation to deal with changes over the preceding period, rather than by the radical deregulation and globalisation of finance that actually took place. We could have instituted industrial policies to facilitate the expansion of our domestic manufacturing system and the creation of more well-paying jobs. We could have adopted policies that made it less attractive to US-based transnational corporations to flee the country for cheaper labour in the underdeveloped world. We could have strengthened the union movement rather than adopt policies that led to its decline. We could have imposed progressive tax increases and used the additional revenue to protect the social safety net and increase productive government investment. A combination of stronger unions, a rising minimum wage, tougher regulation of financial markets and a more progressive tax policy could have sustained the relatively low inequality of the Golden Age. Instead, under the policies adopted after the late 1970s, the degree of inequality exploded.

The main point is that there are always many paths available to a mixed economy. But in the economic, political and cultural milieu of the late 1970s, it was the model favoured by the right-wing coalition that was gaining political and ideological power.

The election of Ronald Reagan in 1980 represented a major victory for right-wing forces. With the assistance of congressional Democrats, Reagan implemented policies that constituted a major step toward the creation of a modern version of the 1920s model, a model that became known as global neoliberal capitalism. He restricted the growth of government spending on the poor and the middle class, and simultaneously instituted large tax cuts focused on corporations and the very wealthy. Reagan attacked the union movement, striking the first blow when he fired the air traffic controllers who went on strike in 1981. The massive unemployment of the first half of the 1980s further undercut union strength. By 1989 only 16% of workers were in unions.

Under Reagan, the government accelerated the deregulation of business. Financial market deregulation was especially dramatic. The combination of financial market deregulation, high unemployment, regressive tax cuts and attacks on unions inevitably triggered a rapid rise in inequality. Moreover, globalisation gave mobile industrial capital a huge advantage over immobile domestic labour by increasing the threat that firms would shift production outside the country unless workers accepted lower wages and benefits, became more compliant and disavowed unions. Increased capital mobility also facilitated a 'race to the bottom' in which transnational firms threatened to invest only in those countries with the lowest corporate taxes and least effective regulatory regimes.

Since Reagan not only cut taxes but also increased defence spending by about 1.5% of GDP, he created by far the largest federal budget deficits since the end of World War II. There were only three years after 1948 in which the deficit exceeded 3.0% of GDP until the Reagan administration. But from 1982 through 1987, annual deficits averaged 5.9% of GDP. These deficits were so large that Reagan supported several tax laws designed to increase revenue. A 1986 law cut the maximum tax rate on corporate income, but also eliminated many tax loopholes. The immediate impact was an increase in corporate tax revenue. Not surprisingly, the low tax rate stayed in place in subsequent years while lobbyists stuffed the tax code with new loopholes under both Republican and Democratic Presidents. This lowered the effective corporate tax rate and drained tax revenues.

The general direction of policy under Reagan continued during the presidency of George Bush senior. Bill Clinton campaigned as a progressive in the 1992 presidential election, but governed as a pro-business centrist. The Democrats lost the House and Senate in 1994. The House leadership—men such as Newt Gingrich, Dick Armey and Tom Delay—were by far the most radical right-wing group to control the House in the post-World War II era. Moderate Republicans had become an endangered species, while the Democratic Party was now to the right of Eisenhower and Nixon on economic issues.

Clinton's record on the economy was mixed. He did preside over a rapid economic expansion in the second half of the 1990s and he orchestrated a modest increase in upper income tax rates that, together with rapid economic growth, led to the first budget surpluses since 1969 in the last three years of his presidency. But there were serious economic problems as well. First, the expansion was driven by several unsustainable forces whose collapse triggered a recession as soon as he left office: an Internet bubble, a telecommunications bubble and a stock market bubble. Second, he supported and achieved substantial additional financial market deregulation that directly contributed to the financial market collapse in 2008 and the deficit explosion that followed. Third, he seriously weakened the welfare system. Fourth, he extended the globalisation process by forcing the North American Free Trade Agreement through Congress against the strong opposition of the union movement and a substantial segment of the Democratic Party, and helped establish the World Trade Organization. Fifth, the income share of the top 1% of the income distribution rose from 15% to 22% during his presidency.³ By the end of Clinton's presidency, union membership was down to 13.5% of the workforce.

George W. Bush took office in 2001, just as the Clinton-era bubbles deflated. Bush oversaw the passage of large regressive tax cuts that haemorrhaged trillions of dollars of government revenue. He started wars of choice in Iraq and Afghanistan that have cost at least \$1.4 trillion to date. Revenue was also constrained by the extremely weak growth of

³ See <http://www.stateofworkingamerica.org/charts/view/155>.

the economy; from 2000 to 2008 real GDP growth averaged only 2.1% a year. The implosion of financial markets in 2008 kicked the already weak economic recovery into a tailspin that slashed government revenue and automatically triggered greater spending on programmes such as unemployment compensation and Medicaid. The government responded to the economic collapse with a substantial deficit-financed stimulus programme to try to prevent the deep downturn from turning into a bottomless depression. Though the stimulus package did help stop downward momentum, it was both too small and too poorly designed to trigger a strong economic upturn, especially given the weak underlying economic trajectory.

The failed right-wing economic model combined with the reckless policies of George W. Bush and the Obama administration's efforts to prevent a depression created by far the largest federal budget deficits in peacetime history just after Obama took office. To make matters worse, in 2010 President Obama and Congress agreed to extend all the Bush tax cuts for two more years at an estimated revenue loss of \$850 billion, something Obama promised he would not do. The top 1% of taxpayers are expected to get 25% of the tax cuts, while the bottom 40% get just 9% (Citizens for Tax Justice, 2010).

So instead of solving our fiscal problems by eliminating the causes of the deficit, right-wing Republicans and conservative Democrats strongly influenced by the oligarchs who fund them used the deficit crisis to unleash an austerity war against the American people that protects and even enriches the wealthy, and targets the poor and the middle class.

Phillips-Fein concluded her study of the long struggle by the right to undo the New Deal as follows: 'The political cause for which [the anti-New-Deal forces have] labored has in large part been triumphant: the New Deal has been turned back' (Phillips-Fein, 2009, p. 322). While much of the New Deal edifice remains in place, its enemies are clearly in ascendance.

3. The right-wing economic model brought slower economic growth and increased inequality

The economic regime change that began in the USA in the late 1970s has been characterised by a substantial decline in the rate of economic growth and a dramatic rise in the degree of inequality of income and wealth.

The growth rate of real GDP was 3.75% a year from 1950 through 1979, but only 2.75% a year from 1979 through 2010.⁴ It is hard to disentangle the various chains of causality collectively responsible for this slowdown, but the shift to a right-wing economic model clearly played an important role. Consider a few examples of the impact of the new model. The US economy was bound to lose some of its post-World War II competitive advantage over Europe and the less-developed world as time passed, eroding our trade surplus, and US multinational corporations were likely to shift some of their investment outside the country to take advantage of rapidly growing markets and cheaper labour in countries whose technology was advancing, in part due to rising US investment. However,

⁴ This paper argues that higher growth is needed to improve conditions in the labour market and raise the rate of growth of tax revenues. But more rapid growth under current conditions will exacerbate environmental problems, contribute to global warming and overutilise non-renewable resources. We need an economic model that takes these problems into account. Conversion to such a model could add to both growth and employment. See, for example, Pollin *et al.* (2009).

conservative economic policy since 1980 greatly accelerated these trends as the USA led the fight to remove barriers to the movement of goods and money across borders while, as discussed above, little was done to facilitate job creation and wage growth at home in the changed environment. Repressive monetary policy in the early 1980s led to the rapidly rising interest and exchange rates that triggered massive trade deficits as well as a collapse in jobs and income. Meanwhile, right-wing policy caused income to be redistributed to the highest income segments with the lowest propensity to consume, restraining aggregate demand growth. Lastly, radical deregulation allowed financial markets to explode in size and economic influence. This helped sustain growth for a while, but ultimately created overindebted households and contributed to the ongoing global economic and financial crisis.

Figure 1 shows that median real family income more than doubled from 1947 to 1979, but its growth slowed dramatically as the New Deal model began to erode. By 1993 it barely exceeded its 1979 value. Median family income increased by almost 17% in the Clinton expansion, then actually declined by 3% during the presidency of George W. Bush. In 2010 it was no higher than it had been in 1997. After rising by 2.4% a year in the period from 1950 to 1979, median family income increased by a meagre 0.4% annually in the 1979–2009 period. The rate of change would have been negative if not for the growth in hours worked per family after 1979.

Figure 2 presents data on market-generated incomes that do not include government transfer payments but do include capital gains. It shows that real per capita income grew much more rapidly in the years from 1946 to 1976 than it did from 1976 to 2007 and that

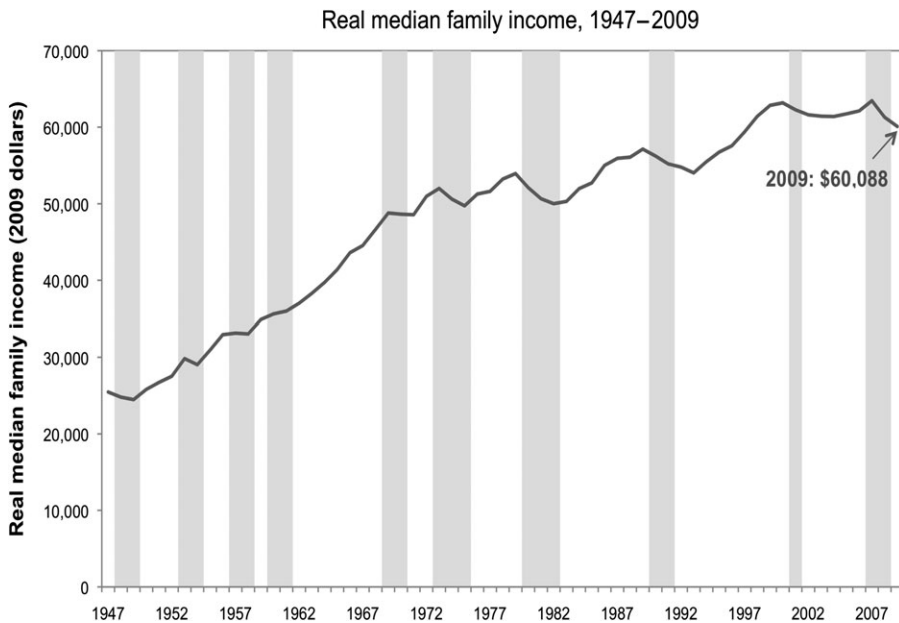


Fig. 1. Median income growth slows substantially since early 1970s. Note: Shaded areas denote recessions. Source: Economic Policy Institute, *State of Working America*. www.stateofworkingamerica.org/charts/view/139 [date last accessed 6 June 2011].

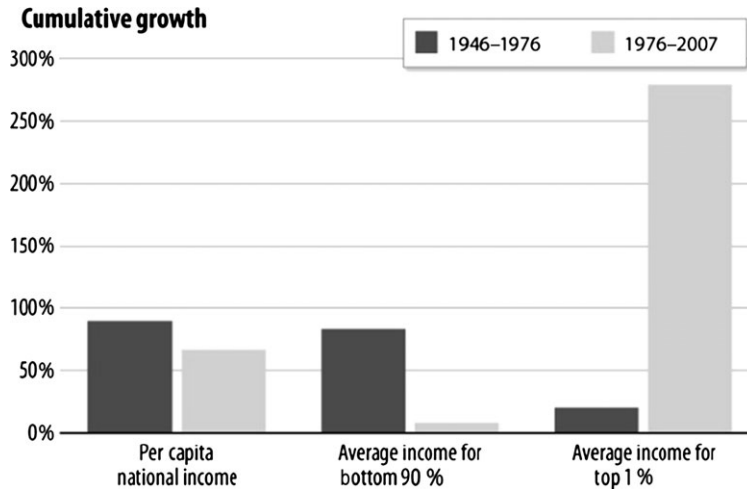


Fig. 2. *The relationship between national income and living standards of ordinary Americans has broken down.* Source: Center on Budget and Policy Priorities, Testimony of Robert Greenstein. http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=3f8f9515-f078-4a5e-8248-02d1c72cad0b [date last accessed 3 September 2011].

the average income of the bottom 90% grew much faster than that of the top 1% in the earlier period. However, while per capita real GDP increased by 66% in the latter period, the average market income of the bottom 90% grew by a paltry 8%, while the average income of the top 1% increased by a spectacular 280% (Center on Budget and Policy Priorities, 2011A). In the expansion of 2002–07, the top 1% had inflation-adjusted income gains of 61.8%, the super-rich in the top 0.01% saw their income rise by 94.1%, but the bottom 90% had gains of just 3.9% (Feller and Stone, 2009). The Bush expansion made the late 1920s look egalitarian. The right-wing growth model clearly generates enormous inequality.

Figure 3 shows real family income growth by quintiles or fifths. Income here includes government transfer payment but excludes capital gains. The rate of growth of family income was much higher during the period in which New Deal programmes were expanding than it was after the late 1970s. For the bottom 80% of the income distribution the differences between the periods are stunning. Moreover, the distribution of income gains was much more egalitarian in the pre-Reagan era.

The use of quintiles hides the fact that the rise in inequality is concentrated at the very top of the income distribution. From 1979 to 2007 the top 1% received a higher share of income growth than did bottom 90%, an outcome that would have been unthinkable prior to the Reagan revolution.⁵ The share of market income (including capital gains) received by the top 1% hit a peak of 23.9% at the height of the late 1920s' financial boom. It fell dramatically after 1929 and stayed at about 10% throughout the Golden Age. However, precisely when right-wing political forces began to strengthen in the 1980s, this index of inequality began a prolonged rise that took it to 23.5% in 2007, just before the financial bubble burst.⁶

⁵ See <http://www.stateofworkingamerica.org/charts/view/82>.

⁶ Hacker and Pierson (2010) estimate that about 38% of the rise in the income share of the top 1% from 1970 to 2004 was created by tax cuts (p. 49).

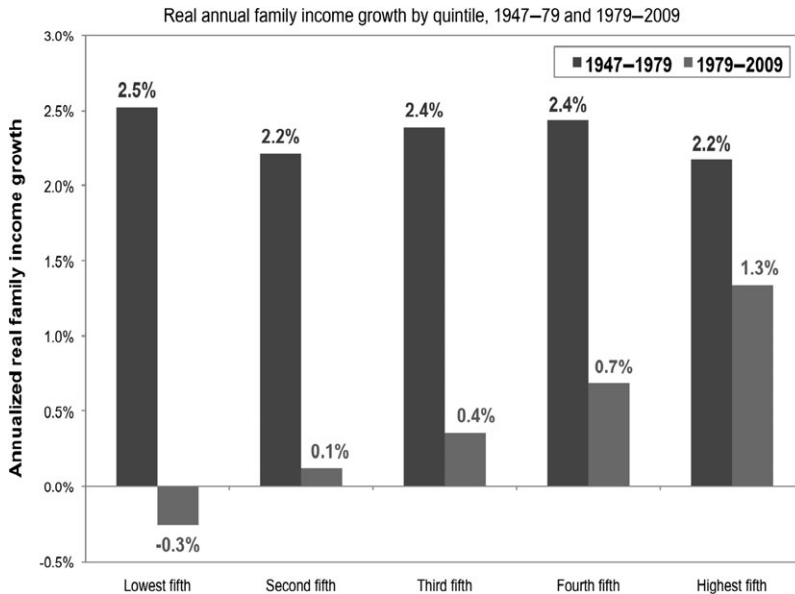


Fig. 3. Family income growth in two eras. Source: Economic Policy Institute, *State of Working America*. www.stateofworkingamerica.org/charts/view/49 [date last accessed 6 June 2011].

4. The right-wing economic model and wars caused the deficit crisis

Since the right-wing economic model relentlessly pursues regressive tax cuts and slows the economic growth rate, it has a strong structural tendency to restrain the growth of government tax revenue. While committed to reducing government spending on the social safety net and public investment, it supports increased defence expenditure and giveaways to corporate America. However, proposals by conservative politicians to defund or privatise popular spending programmes such as Social Security and Medicare have, until recently, triggered a powerful political backlash that has made them impossible to implement. In practice, *at least until now*, the model restrains revenue growth more effectively than it lowers spending. *This combination has made rising deficits a structural attribute of the right-wing model.*

Federal government debt in the hands of the public as a percentage of GDP peaked at 112% in 1946 just after World War II ended. During the early postwar decades, the rate of economic growth was much faster than the rate of growth of government debt, so the debt-to-GDP ratio became smaller over time. In the year before Ronald Reagan became President, the ratio was at a postwar low of 26%. *There was no deficit or debt problem before the Reagan presidency.* When Reagan left office in 1988, the debt-to-GDP ratio had risen to 41%—a jump of almost 60%. During the presidency of George Bush senior it rose to 48.1%, almost double what it had been in 1981. The oft-heard claim that Republicans are fiscal conservatives is utterly inconsistent with the historical record.

The debt ratio fell from 49.3% to 34.7% in the Clinton years. Indeed, when George W. Bush took office in January 2001, the Congressional Budget Office (CBO), the bipartisan group charged with assessing the prospective budget implications of all tax and spending legislation, estimated that under then-current policies (including the tax rates carried over from the Clinton administration) the federal government would run ever-rising surpluses

over the next decade. *The cumulative surplus was projected to be \$5.6 trillion* (CBO, 2001). These estimates took the expected future status of Social Security, Medicare and Medicaid funding into account. In 2001, the total debt held by the public, accumulated from the birth of the nation, was only \$3.3 trillion.

These prospective surpluses were converted into huge deficits by the Bush tax cuts and war spending in the context of a self-destructing financial system and a structurally weak economy. *In fact, the decade from 2001 to 2011 saw a cumulative \$4.7 trillion deficit—a \$10.3 trillion deterioration from the CBO's 2001 projection.* The Bush tax cuts alone resulted in \$3 trillion in lost revenue from 2001 to 2010 (Fieldhouse and Pollack, 2011B). But right-wing political strategists considered this to be a benefit of the policy. Paul Krugman commented in 2003 that the tax cuts were:

so large that the nation can't possibly afford it while keeping its other [spending] promises. But then maybe that's the point. The *Financial Times* suggests that 'more extreme Republicans' actually want a fiscal train wreck: 'Proposing to slash spending, particularly on social programs, is a tricky electoral proposition, but a fiscal crisis offers the tantalizing prospect of forcing such cuts through the back door.' It's no secret that right-wing ideologues want to abolish programs Americans take for granted. (Krugman, 2003)

In the year George W. Bush took office, the debt-to-GDP ratio was 32.5%. When he left office in 2008 it was 40.3% and the deficit was about to explode. In the first year of President Obama's term the ratio hit 53.5%. In 2010 it was 62.5%. The deficit was projected to hit 75.1% in 2012, in part due to the two-year extension of the Bush tax cuts agreed to by President Obama and Congressional Republicans in 2010. But if all the Bush tax cuts are again extended after 2012, as is quite possible, the figure would rise to about 95% in a decade. This would constitute a serious debt problem. An extension of all the cuts is projected to cost \$5.4 trillion over the next decade (Citizens for Tax Justice, 2011A).

Figure 4, based on a Center on Budget and Policy Priorities analysis of CBO data, shows that the prospective deficits of the next decade can be attributed to four key factors: the wars in Iraq and Afghanistan; the Bush tax cuts; the revenue and spending effects of the economic downturn and projected sluggish recovery; and, to a lesser degree, measures taken to prevent a depression and financial market collapse.⁷ The figure suggests that these four factors together explain virtually the entire projected deficit, with the tax cuts playing an increasingly large role as the decade proceeds. 'If not for the Bush tax cuts, the deficit-financed wars in Iraq and Afghanistan, and the effects of the worst recession since the Great Depression (including the cost of policymakers' actions to combat it), we would not be facing these huge deficits in the near term' (Center on Budget and Policy Priorities, 2011B).

Figure 4 does not take into account the fact that tax cuts and war spending will provide some stimulus to future aggregate demand in the coming decade, and thus raise the rate of economic growth modestly relative to what it would have been in their absence, though the regressive nature of the tax cuts will constrain this effect. This will make the residual deficit larger than indicated in Figure 4. Nevertheless, there is wide agreement that the net effect of the tax cuts and deficit-financed wars on the budget will be substantially negative, so the conclusion drawn from Figure 4 is likely to be qualitatively correct: regressive tax cuts and war spending will add substantially to prospective deficits even though they will make some contribution to the growth rate. The policy implication is that we need a large increase in spending on public investment and social programmes that have high multipliers to

⁷ These numbers include the effects of changes in interest payments caused by the four factors.

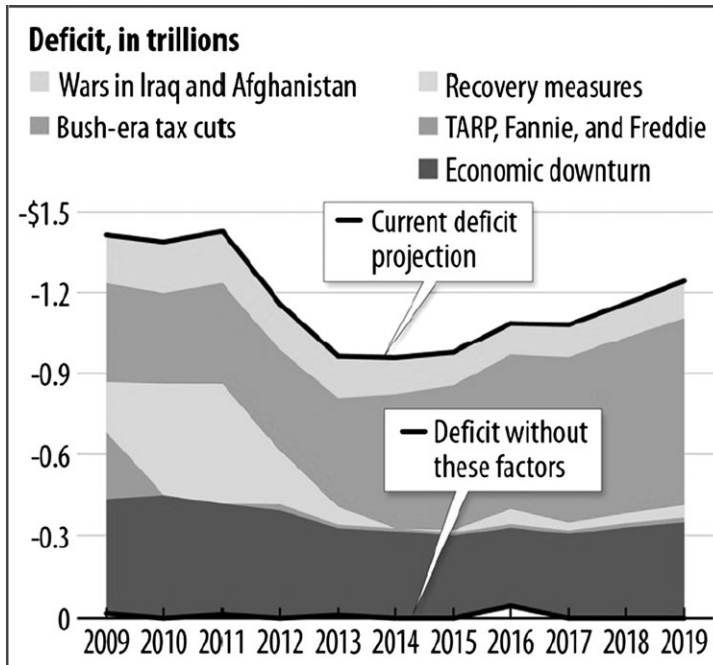


Fig. 4. Economic downturn and legacy of Bush policies drive record deficits. Source: Center on Budget and Policy Priorities, www.cbpp.org/files/5-10-11bud.pdf [date last accessed 6 July 2011].

accompany proposed tax increases and war spending cuts in order to sustain aggregate demand growth in the short to intermediate run. The underlying problem is that we have a dysfunctional economic model that cannot sustain an adequate growth rate even with substantial fiscal and monetary stimulus. The post-2001 expansion was exceptionally weak in spite of huge tax cuts, war spending, and a construction and household debt bubble.

5. What should be done to resolve the deficit crisis over the next decade?

To address the deficit problem over the coming decade, we need to restrain expenditure as well as raise tax revenue, but other than in defence spending and health care, the gains from sensible spending cuts are limited. Social Security must be defended, and Medicare and Medicaid must be protected until the national health care system is radically reformed. Non-defence discretionary spending—primarily targeted to important social services such as housing assistance, food programmes, unemployment compensation, support for education, and veterans' benefits and services, as well as to public investment—has not been a contributor to the recent deficit explosion. Indeed, discretionary non-defence spending was a smaller percentage of GDP in 2008 than it had been when Ronald Reagan took office. To lower deficits and inequality as well as fund necessary government programmes, we need to generate much higher government revenue. Total federal tax revenue in 2010 as a percentage of GDP was at a 60-year low (Bartlett, 2011). The fact that the USA is, by international standards, a very lightly taxed nation suggests that it would be possible to raise substantial additional tax revenue without serious economic side effects. If the USA had the same

tax-to-GDP ratio as the median country in the Organization for Economic Co-Operation and Development (OECD) country in 2009, we would have had \$1.4 trillion in extra revenue that year and we would not have a deficit problem at all.

Our low tax revenues are caused by a combination of low official tax rates on individual and corporate incomes, and a vast swamp of loopholes written into the tax code over decades. These loopholes, called ‘tax expenditures’, substantially lower effective tax rates. By raising rates and cutting loopholes we could generate much greater tax revenue from both the individual and corporate income taxes to lower the deficit and finance essential government programmes.

Figure 5 shows the effective federal tax rates on different levels of family income in 2007. Taxes include income, social insurance and excise taxes. The effective rate is calculated as the actual taxes paid divided by the ‘adjusted gross income’ (AGI)—total income minus a disparate set of deductions. In 2010, the total revenue lost to individual federal tax expenditure was in excess of \$900 billion. As a result of these large and regressive loopholes, there is virtually no progressivity for incomes above \$100,000. The effective tax rate is flat from \$100,000 through \$352,900 and then declines substantially for the super-rich. *In 2007, the top 400 filers, whose average income was \$345 million, paid about the same tax rate as those in the \$50,000 to \$74,700 range.* Figure 6 shows that the effective tax rates on the rich have declined dramatically since the early 1990s and effective tax rates on the super-rich have fallen even more (Feller and Stone, 2010). High tax rates on the super-rich are compatible with, and perhaps a precondition for, a healthy economy. The effective federal tax rate on the top 0.01% of incomes—including income, estate, social insurance and corporate taxes—was, at 70% in 1960, more than twice its 2004 value (Picketty and Saez, 2007).

US-based corporations claim that they cannot compete in the global market place because the top nominal US corporate tax rate of 35% puts them at a competitive disadvantage. But the tax code is riddled with loopholes that make the effective corporate tax rate much lower than 35%. The US Treasury Department estimated that in 2007 the average effective US corporate tax rate was 13.4%. By comparison, the rate in the UK was 27.7% and the rate in France was 20%. Postwar corporate tax revenues as a percentage of GDP remained above 4% through the 1960s; they then fell to a low point of 1% in the deep recession of 1983, and have stayed between 1% and 2% since then (Marr and Highsmith, 2011). Many of the most profitable large corporations pay no taxes and even



Fig. 5. Total effective federal tax rate by income, 2007. Source: Center for American Progress “Tax Expenditure of the Week: Capital Gains”, www.americanprogress.org/issues/2011/02/te022311.html [date last accessed 6 July 2011].

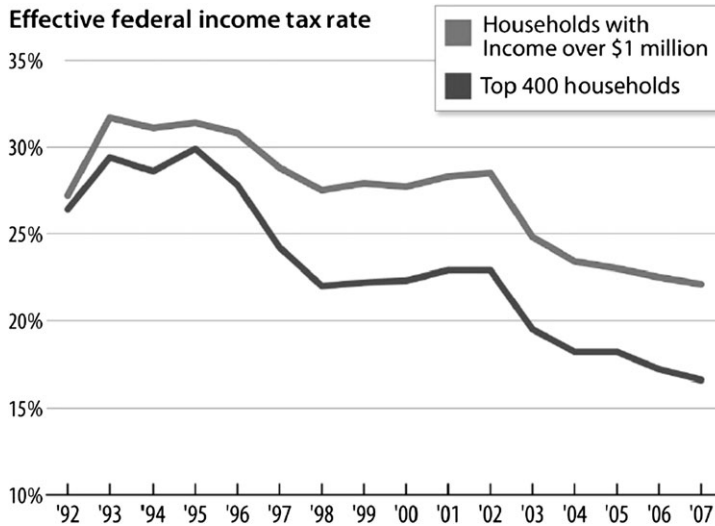


Fig. 6. Tax rates dropping sharply for highest earners. Source: Center on Budget and Policy Priorities, www.cbpp.org/files/2-23-10tax.pdf [date last accessed 6 June 2011]

receive substantial subsidies from the government from time to time. For example, Boeing reported \$9.7 billion in pretax US profits from 2008 to 2010, yet paid no taxes and received \$3.5 billion in tax rebates (Citizens for Tax Justice, 2011B). In 2010, 25 of the 100 highest paid US Chief Executive Officers earned more than their companies paid in federal taxes (Reuters, 2011).

The CBO budget projections of January 2011 provide information that can be used to assess the potential impact on the budget in the coming decade of eliminating the Bush–Obama tax cuts after 2012 and reducing our troop levels in Iraq and Afghanistan (CBO, 2011). If the 2010 tax cuts are extended beyond 2012, and the exemption for the Alternative Minimum Tax (ATM) continues to be indexed for inflation, the cumulative 2011–21 deficit (including the extra interest payments generated by these cuts) is projected to be \$11.6 trillion and the debt-to-GDP ratio will rise to over 95% by 2021. But this debt crisis will only take place if we continue our present right-wing policies. If all the tax cuts are allowed to expire in 2012 as current law requires, and the ATM exemption is not inflation-indexed, the cumulative deficit falls to \$7 trillion and the debt-to-GDP ratio peaks at 77% and holds steady thereafter.⁸ ‘By that one simple step, Congress would put the deficits and debt on a sustainable path for the next decade’ (Ruffing and Horney, 2011). If we also reduce troop numbers in Iraq and Afghanistan to 45,000 from the current 215,000 by 2015, the cumulative deficit falls to \$5.7 trillion and the debt-to-GDP ratio will begin to fall. *These two changes alone would cut the prospective decade-long deficit in half, reducing it to manageable proportions without gutting important government programmes.*

⁸ In my opinion the Bush–Obama tax cuts should be eliminated in their entirety, but some adjustment of the ATM exemption for inflation is justified because inflation will eventually cause millions of families to be subject to the ATM provisions unfairly.

But there are other ways to raise revenue in addition to letting all the Bush–Obama tax cuts expire.⁹ The ones I list here are not intended to be a coherent tax policy. Rather, they are examples of various ways to deal with the deficit problem that do not include cutting important federal spending on investment or the social safety net. Note that if all the tax increases on the rich and super-rich mentioned in this paper were simultaneously enacted, we might exhaust their ability to pay.¹⁰ However, the objective of ending the deficit crisis without destroying essential government programmes can be achieved using a subset of the tax increases mentioned in the paper.

Consider two possible progressive reforms in the taxation of individuals. First, individual tax rates for the well-to-do could be raised well above those used in the Clinton years and the 20-plus tax-rate trigger levels used before 1992 to increase progressivity at upper income levels could be restored. Currently the top marginal rate of 35% is used for all income levels above \$373,650. This destroys progressivity for the rich and super-rich. For example, if we raised the tax rate on the AGI of the top 1% of taxpayers by just 5 percentage points and on the top 2%–5% of taxpayers by 3 percentage points, this would generate \$1.2 trillion over a decade (Stiglitz, 2010). If the effective rate on the top 1% (those with taxable incomes of \$380,000 or more in 2008) was increased by 10 percentage points, which would have put this rate at 33.3%, we would increase tax revenue by about \$1.7 trillion over a decade (Bartlett, 2011B). Second, eliminating just 20% of the more than \$900 billion annual loss of revenue through individual tax expenditure would generate nearly \$1.8 trillion in revenue over a decade. The gain from taxing dividends and capital gains at the same rate as wages and salaries and not excluding capital gains on inherited assets from taxable income alone would increase tax revenue by an estimated \$1.1 trillion over a decade—and substantially lower inequality (US Senate Joint Committee on Taxation, 2011, p. 25). In 2005, the top 0.6% of taxpayers with incomes greater than \$500,000 received 73% of the tax cuts due to low rates on capital gains and dividends, while the top 0.01% with incomes above \$10 million received 28% of these gains (Citizens for Tax Justice, 2007).

Third, raising the effective corporate income tax rate by eliminating 75% of business tax expenditure would generate \$1.2 trillion over a decade (Citizens for Tax Justice, 2011B).

Fourth, the institution of a very small financial transactions tax on stock and derivative sales would generate \$1.5 trillion over ten years while cutting financial market gambling substantially. A small tax would not materially affect long-term investors, but it would make the high-frequency trading of securities done by institutional speculators much more expensive (Baker, 2011A).

Tax changes such as these along with the cut in defence spending discussed above could eliminate all deficit problems over the coming decade. Moreover, Nobel laureate Joseph Stiglitz argues that the government could save an additional \$1 trillion over a decade by

⁹ The Progressive Caucus of Democratic Party in the House of Representatives offered a budget proposal that would dramatically lower prospective future deficits while limiting cuts to productive public investment and the social safety net. The Economic Policy Institute estimates that the Caucus plan would cut the cumulative deficit from 2012–21 by \$5.6 trillion relative to an adjusted CBO baseline. It would create a surplus in 2021 and lower the prospective debt-to-GDP ratio in 2021 from the CBO's estimate of 95% (under the assumption that the Bush tax cuts remain in place) to 64.1%, which would be close to what it was in 2010. See http://www.epi.org/page/-/WP290_FINAL.pdf.

¹⁰ The ability of the top one percent to pay increased taxes is substantial. Doubling the average US individual income tax rate on the top 1% [of] income earners from the current 22.5% to 45% would increase tax revenue by 2.7% of GDP per year, as much as letting the Bush tax cuts expire (Piketty, Saez and Stantcheva, 2011). If we assumed that GDP remained constant for the next ten years, the increased tax revenue over the decade would still be in excess of \$4 trillion.

ending 'excessive payments to pharmaceutical companies under the provisions of the [Bush] Medicare bill, which restricted the government's ability to bargain with them on prices' (Stiglitz, 2010).

The main point is that the widely circulated claim that to resolve our deficit crisis we have no choice but to slash federal spending on programmes that fund productive government investment and assist the poor, the middle class, the sick and the elderly is simply not true.

6. Longer-run deficit problems in Social Security and health care

Social Security by law cannot borrow to fund itself; if tax payments are inadequate, benefits *must* be cut. Therefore, until 2011, it did not contribute to the deficit.¹¹ The Social Security Trust fund has run surpluses since 1985 that were invested in US Treasury bonds. The claim that Social Security increased the deficit because the government has to pay back these loans can also be said of any individual or institution here or abroad that owns US Treasury securities.

Social Security is probably the most successful government programme ever. The poverty rate among the elderly fell from 35% in 1959 to 9% in 2009 largely because of Social Security.¹² If Social Security payments stopped, the poverty rate for those aged 65 and over would rise to 45% (Van de Water and Stone, 2010). Yet it is not excessively generous. The average annual payment to retirees is around \$14,000 and more than 80% of benefits go to families whose other annual income is less than \$20,000. Indeed, it is 'the main source of income for most seniors' (Morrisey, 2011). Protecting Social Security is more important than ever because private sector sources of old-age security are in rapid decline. From 1983 to 2007, the percentage of workers with traditional defined-benefit pension plans fell from 62% to 17%, while those covered by defined-contribution plans rose from 12% to 63%.¹³ Yet in 2007, the median value of all retirement accounts for those aged 55–64 years was a woefully inadequate \$100,000 (Purcell, 2009).

*The Social Security system is not in crisis.*¹⁴ In 2010, the 75-year projected shortfall was estimated to be 0.6% of the cumulative GDP for that period. The projected shortfall should be eliminated without raising the age at which full benefits can be earned, which is now 67, or by reducing the already modest level of Social Security payments. Those who want to increase the full-benefit age argue that life expectancy has risen substantially in recent decades. But between 1982 and 2006, men in the lower half of the income distribution had a gain in life expectancy of only 1.1 years (while men in the upper half

¹¹ In December 2010 the President and Congress enacted a one-year reduction of employee contributions to Social Security equal to 2% of earnings. This is expected to cost about \$112 billion in lost revenue. Since the law requires the Treasury to replace whatever revenue is lost by the Social Security Trust Fund in 2011, it has created the first case in which Social Security will add to the deficit.

¹² See <http://www.stateofworkingamerica.org/charts/view/181>.

¹³ See <http://www.stateofworkingamerica.org/charts/view/191>.

¹⁴ In a major speech to Congress on 8 September 2011, President Obama proposed that for 2012, employee contributions to Social Security be cut to 3.1% from the standard 6.2% at a one-year cost of \$175 billion, and that employer contributions be reduced as well at an annual cost of \$70 billion. The President promises to replace this revenue loss with general tax revenue as was the case in the 2011 employee rate reduction. Many Social Security advocates fear that conservatives, including many Democrats, will ultimately demand that the cuts be made permanent and that revenue losses be charged to the Social Security Trust Fund. Should this happen, pressure to drastically cut benefits would be unstoppable. Even if only the current employee tax reduction was made permanent and the associated revenue losses accrued to the Social Security Trust Fund, the Fund would run out of money 15 years earlier than currently expected, the projected long-run deficit would double and demands to privatise the programme would spike; see Baker (2011B) and Miller (2001). See <http://www.stateofworkingamerica.org/charts/view/181>.

gained 5 years), and the age for full payment has already increased by two years (Morrisey, 2011).

Social Security taxes are not imposed on income from financial or other investments, only on wages and salaries, and the income on which the tax is based is capped at a certain amount. If the cap on earnings, now at \$107,000, was removed, 95% of the projected shortfall would be eliminated.¹⁵ The remaining gap could be filled by a modest increase in payroll tax of 0.1%—from 12.4% to 12.5%. Even just raising the cap to \$180,000, so that it covered 90% of the wage base as intended by the Greenspan Commission that overhauled Social Security funding in 1983, would eliminate 43% of the deficit (Mulvey, 2010). Of course, faster real wage growth would cut the prospective funding shortfall substantially.

There is a long-term crisis brewing in both the publically funded and privately funded provision of health care in the USA. In 2010, 17.3% of GDP was spent on health care and this ratio is rising very rapidly. The CBO estimated in 2009 it would rise to almost 33% by 2035. The government pays about half this cost. No other country spends nearly as much on health care, yet most developed countries have health outcomes as good as or better than those in the USA. In 1970, Canada and the USA both paid about 7% of GDP for health care, but in 2009 Canada spent 6.9% of GDP less than we did (Lemer and Crooks, 2011).

The only feasible long-run solution to our health care problems is to adopt a system more like those in other relatively rich countries, one that does not allow private insurance companies and pharmaceutical companies to take such a big bite of the health care dollar. *A Canadian-style health care system in the USA would save more than \$10 trillion over a decade, ending the Medicare–Medicaid crisis.* If we adopted a single-payer system based on Medicare, with no other changes, we could save as much as \$4 trillion over a decade (Common Dreams, 2011). The fact that the federal government has refused to seriously consider these needed changes is testimony to the political power of large insurance companies, giant drug companies and influential hospital chains.

In summary, there are moderate problems in Social Security funding and serious problems in Medicare and Medicaid funding, but there is no need to severely cut the budgets of these crucial programmes or destroy them through privatisation as the right-wing coalition demands. There are alternative solutions that can preserve and even improve both programmes.

7. The current austerity war

7.1 *The state and local government battle*¹⁶

The ferocity of the right-wing attack on New Deal programmes is quite evident in the response of conservative state governors to the fiscal crisis. They are ‘jettisoning the heart of the US-style social contract the Democrats have constructed over more than 70 years, starting in the wake of the great depression’ (McGregor, 2011).

Excessive long-term growth in social spending did not cause the large current and prospective deficits at the state and local levels. The main causes of these deficits are the deep recession that hit the country after mid 2008, slow economic growth since 2001, a collapse in the value of pension fund assets in the financial meltdown and an erosion of the tax base over several decades.

¹⁵ Severe labour market weakness has already led to more pessimistic projections of future programme revenue flows. For example, the very latest estimate of the impact of removing the earnings cap is that it would eliminate 86% of the projected 75-year shortfall, as opposed to the 95% estimated last year (*Wall Street Journal*, 2011B).

¹⁶ Most of the data in this section comes from Pollin and Thompson (2011) and Pugh (2011).

State revenues fell by 13% between 2007 and 2009.¹⁷ Such a steep revenue loss is unprecedented in the post-World War II era. The depth of the revenue loss reflects the severity of the current economic decline plus a decades-long process of tax cuts. For example, state corporate income taxes yielded 10% of state revenue in the late 1970s, but just 5.4% in 2010. Moreover, many states have cut corporate taxes in response to the crisis, even in the face of exploding deficits. Governors justify business tax cuts on the grounds that they will help attract new business to their states. But these cuts create a typical 'race-to-the-bottom' dynamic in which, as a whole, states gain no additional investment, but business gains sweeping tax cuts.

The combination of revenue losses and the rise in social spending caused by the recession generated a total estimated annual gap of \$140 billion, or 21% of state spending commitments in 2010. Federal grants covered about one-third of the gap that year, but those funds are drying up. Since almost all states are legally required to avoid deficits, and since most states refuse to raise taxes substantially if at all, the gap has to be eliminated primarily through spending cuts. Thus, the austerity war is now raging. States are cutting funds for programmes such as health care for the poor, home care for the infirm, and support for education at the elementary, high school and college levels. More than 467,000 state and local jobs were lost from the official end of the recession in June 2009 to June 2011, including 188,000 jobs in schools. At a similar point after the 2001 recession ended, 249,000 jobs had been added (Wiseman, 2011).

The deficit crisis created an opportunity for conservative state governments to both slash government spending and seriously weaken or destroy public sector unions. It is clear from what is happening in states such as Wisconsin, Michigan, Indiana and Florida that have right-wing governors and legislatures that this conjuncture is seen as an opportunity to destroy public sector unions by substituting legislative fiat for most collective bargaining processes, and placing enough restrictions on unions that their membership will desert them. Since public sector union members are a majority of the country's dwindling union ranks, success would help complete the long-sought destruction of the union movement in America. The argument that the defeat of public sector unions is necessary to achieve state fiscal solvency was shown to be specious in Wisconsin. The fact that unions offered major concessions on wages and benefits did not prevent Governor Walker from pushing a bill through the legislature designed to destroy public sector unions.

The biggest long-term fiscal problem, it is argued, is caused by the excessive compensation of public employees in the form of salaries and, especially, health care and pension costs.¹⁸ Ironically, public employees, not Wall Street bankers, are now depicted in the corporate media as America's new privileged elite. However, careful studies that compare public sector versus private sector compensation of employees with similar education and experience show that public sector workers are relatively undercompensated via salary and overcompensated via benefits. The net result is that, on balance, they earn slightly less than their private sector counterparts.¹⁹

¹⁷ Local governments, which depend heavily on property taxes, suffered substantial revenue losses due to the real-estate price collapse.

¹⁸ Conservative think tanks argue that the present value of unfunded state and local pension liabilities is as high as \$3 trillion, but to generate such a high number they have to assume that the return on financial assets will be miniscule in the future. If the return is close to its long-term average, their estimate should be cut by at least two-thirds.

¹⁹ See, for example, the series of studies done by the Economic Policy Institute at: http://www.epi.org/analysis_and_opinion/entry/public_sector_workers_earn_less/.

There is a problem with the underfunding of pensions, but it is of recent vintage in most states. *In 2000, state pension funds as a whole had no unfunded liabilities.* However, pension fund accounts lost \$900 billion in value between mid 2007 and mid 2009, and some states fell behind in providing appropriate resources to their pension funds over the low-growth past decade. To restore adequate provisioning, states should: increase economic growth under a new national economic model; provide higher government contributions to pension funds financed by progressive tax rate increases, taxes on services as well as goods and on goods sold over the Internet; and increase employee contributions moderately through collectively bargaining. Additional annual fund contributions of about 4% of current state spending would accomplish the goal.²⁰ Keep in mind that one-third of all state and local government employees are not eligible for Social Security.

The medical insurance problem requires a national solution, as discussed above.

7.2 House Republicans declare all-out war on the New Deal

The radical budget bill passed by the House in April 2011 demonstrated conclusively that the Republican Party is committed to the destruction of New Deal programmes. The bill calls for non-defence spending cuts of \$4.5 trillion dollars over ten years (not counting reduced interest payments). Cuts in low-income programmes, at \$2.9 trillion, would be almost two-thirds of the total. An additional \$400 billion would come from unspecified cuts in discretionary programmes serving lower-income Americans. The CBO's analysis of the House bill states that all federal spending other than on Social Security (which the bill does not address), Medicare, Medicaid and interest payments will drop 'from 12 percent [of GDP] in 2010 to 6 percent in 2022 and 3.5 percent by 2050'. It notes that 'spending in this category has exceeded 8 percent of GDP in every year since World War II' (Greenstein, 2011A).

The House bill calls for the privatisation of Medicare. The government would give seniors a grant to help pay for private insurance. The CBO estimates that *by 2030 the voucher would pay for just one-third of the cost of a Medicare-equivalent private insurance policy.* Medicaid would be turned into a block grant given to the states, who would be under no obligation to spend the money on health care for lower-income families. The CBO estimates that by 2022, federal funding of Medicaid would fall by 35% from its 2010 level; by 2030 it will be 49% lower (Greenstein, 2011B). Clearly, the deficit problem caused by the right-wing coalition has empowered that coalition to seriously propose the most radical attack on the economic and social role of government ever. As the *Financial Times'* respected senior columnist Martin Wolf put it: 'In the US, utopians of the right are seeking to smash the state that emerged from the 1930s and the second world war' (Wolf, 2011).

Under the 'starve-the-beast' strategy that drives the right-wing coalition, spending cuts are an opportunity to enact even greater regressive tax cuts, not eliminate deficits. The House bill makes all of the Bush tax cuts permanent at an estimated cost of \$5.4 trillion over a decade. In addition, the House budget proposes a series of tax cuts 'that would primarily benefit high-income households at a cost of nearly \$3 trillion over that period'. Most of these additional tax cuts are 'assumed to be offset by reductions in tax expenditures', but not a single loophole to be eliminated is identified in the House bill. However, as we saw with President Reagan's corporate tax cut in 1986, the lower rates are

²⁰ The rise in security prices since the bottom of the market in early 2009 has moderately reduced the problem of unfunded liabilities.

likely to be permanent, while the elimination of loopholes, even if adopted, would quickly disappear under a relentless attack by lobbyists. The bill cuts the top tax rate for both individuals and corporations from its current 35% to 25%. Ninety-five percent of Americans would receive no benefit at all from cutting the top individual rate to 25%, because they are already in tax brackets of 25% or less (Marr and Highsmith, 2011). This bill puts the top individual tax rate at its lowest level since before the New Deal. *It also drops the tax on capital gains to zero*—a huge gift to millionaires and billionaires with a large cost in terms of lost tax revenue.

The revenue loss from these tax cuts could be over \$7 trillion. If so, the sum of spending and tax cuts would add an additional \$2.5 trillion to the cumulative deficit over the next decade. The House bill would thus slash taxes on corporations and the rich, push the degree of inequality well beyond its late 1920s level, destroy key economic functions of the federal government *and raise the deficit*. The Center on Budget and Policy Priorities calls this bill ‘a massive redistribution of income from the poorest Americans to the wealthy’. Were the tax cuts to become law, the federal government would have no choice but to impose unthinkable large spending cuts. As Speaker Ryan insisted: ‘this isn’t a budget. This is a cause’ (*New York Times*, 2011A).

Not to be outdone, the Senate Republicans proposed a balanced budget amendment that states that federal spending cannot exceed 18% of GDP unless approved by a two-thirds vote in Congress. For technical reasons, the effective cap would be 16.7 % of GDP (Center on Budget and Policy Priorities, 2011B). The last time spending was this low was in 1956, when Medicare and Medicaid did not exist, Social Security covered millions fewer people, and the social safety net was much smaller. The amendment would also preclude the use of fiscal policy to fight serious recessions.

7.3 President Obama offers substantial austerity, with two dollars of spending cuts for each dollar of increased revenue

President Obama accepts the idea that most of the reduction in deficits will have to come from spending cuts and that permanent large tax cuts are appropriate, with even key New Deal programmes under assault. With severe problems in the job market projected to last at least several more years, a government stimulus programme focused on targeted spending projects with large multiplier effects—such as infrastructural investment, green jobs, and transfers to state and local governments—is appropriate, but major spending cuts and regressive tax cuts are not.

In April, the President proposed a budget that would cut about \$4 trillion over 12 years relative to a scenario in which the Bush tax cuts remain in place.²¹ Rather than let all the Bush–Obama tax cuts of 2010 expire after 2012, he wants to continue the tax cuts for the first \$250,000 of household income. The \$250,000 cap will save a trillion dollars, but keeping the rest of the tax cuts will cost about \$4 trillion in lost tax revenue, making the pressure to cut spending even stronger (Citizens for Tax Justice, 2011A). However, there is no reason to accept tax rates lower than those that existed under the Clinton presidency and every reason to raise rates well above Clinton-era levels on incomes above a few hundred thousand dollars. Astoundingly, Obama’s proposed tax rate on capital gains and dividends is, at 20%, still well below the 28% capital gains tax rate for high-income earners enacted under the Reagan administration. The President also proposes unspecified

²¹ For an analysis of Obama’s proposals, see *Wall Street Journal* (2011A) and Landler and Shear (2011).

spending cuts of \$2 trillion that would inevitably lead to large cuts in the funding for important programmes that had no role in creating the current deficit crisis.

Moreover, Obama suggested that Congress pass two automatic triggers that would be activated if there was insufficient progress on deficit reduction. First, if the deficit, which is currently about 10% of GDP, exceeds 3% after 2014, unspecified automatic tax hikes and spending cuts would take place to force compliance with the 3% limit. Continued sluggish growth would therefore automatically be met by restrictive fiscal policy that would make economic conditions worse. Second, if Medicare spending grows faster than per capita income growth plus 0.5% per year, automatic cuts to the programme would kick in. But the historic average growth rate of Medicare spending is per capita income plus 2.0%. So this trigger is just a way to cut spending on Medicare without taking the political risk of calling for the same outcome directly.

Thus, the President is focused on regressive austerity policy even as the rates of unemployment and underemployment remain at semi-depression levels. As of July 2011, the unemployment rate was 9.1%, the employment-to-population ratio was 5.6 percentage points below 2001 and the percentage of long-term unemployed, which was 11.8% in 2001, was 44.4%. The Bureau of Labor Statistics' broadest measure of 'labour under-utilisation', which includes the unemployed, those who work part-time but need full-time jobs and those who have dropped out of the labour force, was 16.3%. And the median real wage of the full-time male worker was no higher in 2009 than it had been in 1968. The USA has a moderate deficit problem that could be easily resolved, and a severe crisis in employment and wages that will become disastrous unless the war on social democracy ends.

What the American people need at this dangerous juncture is a progressive Democratic Party led by a fighter—a new FDR—who will help organise and lead a vigorous counterattack against this deadly assault on the American people. Unfortunately, what we have is a business-friendly, centrist-to-right Democratic Party that is unwilling or unable to resist the demands made on it by its funders and a President who seems quite comfortable in his current position as the Great Compromiser.

7.4 *The debt-ceiling fiasco*

When President Obama signed a bill extending all the Bush tax cuts in December of 2010, something he had pledged not to do, he was asked by reporters why he did not demand in return an agreement by Republicans to raise the federal debt ceiling so the government could continue to finance its operations without interruption. He replied that this was unnecessary because he was sure the Republicans would not act irresponsibly in this regard, an answer that leads one to wonder what planet the President lives on. The hyperaggressive right-wing Republican Party not surprisingly turned around and used a threat to shut down the government by refusing to allow the debt ceiling to rise to extract an astounding series of budget concessions by our pliant President. In the end, the Democrats agreed to a bill that cuts at least \$2.2 trillion in federal government spending over the next ten years *but does not generate a single dollar in new tax revenue*, something the President had also pledged he would not permit. If enacted, these spending cuts will worsen rapidly deteriorating economic conditions.

The budget cuts come in two stages. The immediate stage enacts \$1.1 trillion in cuts through automatic caps on spending over a decade, mostly to non-defence discretionary programmes. Funding for crucial public investment projects and for many vital social

programmes will be eviscerated by cuts this deep. Non-defence discretionary spending as a percentage of GDP is expected to fall from its current 3.5% level to 2.0% in 2021—which would be the lowest level in over half a century (Fieldhouse and Pollack, 2011A). In the second stage, a congressional ‘supercommittee’ composed of six Republicans and six Democrats has to propose at least \$1.2 trillion in additional spending cuts by 23 November 2011 that, by law, must be voted up or down without amendment. A simple majority can approve the cuts, which would begin in early 2013. If the bill fails, automatic across-the-board spending cuts of \$1.2 trillion over the next decade will be enacted. The supercommittee has the power to raise tax revenue, but since all six Republican members have signed a pledge not to vote for tax increases, there are not likely to be any. The second round of spending cuts is expected to reduce non-defence discretionary spending to 1.7% of GDP by 2021.

A *New York Times* editorial called this law ‘a nearly complete capitulation to the hostage-taking demands of Republican extremists’. It complained of ‘a political environment laced with lunacy’ (*New York Times*, 2011B). Paul Krugman called it ‘an abject surrender on the part of the President’ (Krugman, 2011). This accommodation of the Democratic Party to the extremist demands of the right-wing coalition represents a major coalition victory in their long-term war to destroy the New Deal.

8. Concluding comments

The long-run battle to restore the ‘natural’ order of our economy and society as it existed in the 1920s could possibly be entering a decisive phase. Government regulation of industry and finance is again pathetically weak, the union movement is a shell of its former self and under savage attack at the state level, inequality is back where it was in the late 1920s, government spending on the poor and the middle class is under unprecedented assault, and corporations and the very rich again control politics.²² Moreover, the media that creates and propagates the semi-official narrative that explains to the American people what caused the deficit crisis and what policies should be taken to resolve it does not tell the truth about this crucial issue. The three major television networks and most major ‘liberal’ newspapers generally follow the more ‘responsible’ austerity story adopted by President Obama and the Democrats, though some of their business reporters and op-ed writers are less conservative than Obama on these issues. And a very large percentage of Americans get their information on politics and the economy from popular right-wing cable outlets like Fox News, along with right-wing talk radio and conservative newspapers. This segment of the media relentlessly transmits an extreme right-wing version of reality. *There may not be a single important media source trusted by large segments of the American public that tells them the truth about the deficit crisis.* Thus, much of the public accepts some aspects of the right-wing explanation of the causes of the deficit crisis, and this makes them susceptible to seduction by people and parties operating against their interests.

The situation is not totally bleak. The fact that many Americans face stagnant or declining real incomes, a disastrous labour market, precarious retirement prospects and the threat of a severe retrenchment in government programmes crucial to their health and welfare has led to an increase in political resistance to current policy trends.²³ Polls

²² Their degree of control was substantially augmented by the recent Supreme Court decision in the *Citizens United* case.

²³ For a survey of state-level rebellions against extreme right-wing policies imposed by conservative governors and legislators see Nichols (2011).

consistently show that a majority of Americans support higher taxes on corporations and the rich, and oppose spending cuts in Social Security, Medicare, Medicaid and other important government programmes that assist the poor and the middle class. In other words, there is a potential majority in support of something like the policies I present in Sections 5 and 6 to solve intermediate and long-term deficit problems. Equally important, large numbers of Americans are fighting back against the right-wing assault on New Deal programs. Many people have engaged in organized political resistance to attacks on public workers and large cuts in social programs in states governed by right wing politicians. For example, the people of Ohio recently created and won a special election that overturned legislation passed by a reactionary governor and legislature that would have crippled public-sector unions. Meanwhile, the Occupy Wall Street movement has spread rapidly across the country, raising public awareness that the same conservative economic policies that drove the share of incomes of the top one percent to late-1920s heights are responsible for the high unemployment and stagnant incomes of the majority of American household. Rising inequality and deteriorating economic conditions are two sides of the same coin. This movement has encouraged more Americans, especially young people, to resist austerity pressures.

Obviously, serious progressive tax reform is not on the political agenda in the USA at the present moment. But if we continue on the current path of austerity politics, wherein almost all deficit reduction is to be accomplished by spending cuts, a political backlash is likely to develop that will force substantial progressive tax increases into the political spotlight. Either the government will make progressive tax increases a major component of deficit reduction policy in the intermediate future or the country will face the destruction of core New Deal programmes and long-term stagnation as well as endless future debt problems.

The right-wing coalition has been so successful over recent decades that the long-run challenges facing the country today are daunting. The US economy no longer serves the needs of the majority of Americans and the global neoliberal capitalist system within which it is embedded is in crisis. A second global financial disaster is not unlikely in the intermediate future. We need radical changes in both our economic and political systems. We have to change to an economic model that can produce reasonable prosperity and security for American families with much less inequality than we have at present. To achieve such an economic transformation, we have to create a functioning democracy in which the informed priorities of the majority are reasonably reflected in the outcomes of the political process, one that will replace the oligarchic control over the politics of the present moment. To achieve a functioning democracy, we need a well-informed public that understands the causes of our economic problems and can distinguish between policies that are and are not in their interest.

On the other hand, as we have seen recently, those who are attacked do fight back and often get widespread public support. Resistance struggles have broken out in various forms across the country and, indeed, across many countries in Europe, such as Greece, Portugal, Italy and Spain. As mentioned in the Introduction, the class-based austerity war is global in scope, but so are the emerging struggles against the destruction of social democracy.

Bibliography

Baker, D. 2011A. 'The Deficit-reducing Potential of a Financial Speculation Tax', Center for Economic and Policy Research, Issue Brief, January, <http://www.cepr.net/index.php/>

- publications/reports/the-deficit-reducing-potential-of-a-financial-speculation-tax [date last accessed 12 September 2011]
- Baker, D. 2011B. 'The Payroll Tax Cut: A Stimulus That Progressives Should Oppose', Center for Economic Policy Research, 15 July, <http://www.cepr.net/index.php/op-eds-tax-cut-a-stimulus-that-progressives-should-oppose> [date last accessed 12 September 2011]
- Bartlett, B. 2011A. Health care costs and the tax burden, *New York Times*, 7 June
- Bartlett, B. 2011B. The rich can afford to pay more taxes, *New York Times*, 23 August
- Center on Budget and Policy Priorities. 2011A. Testimony of Robert Greenstein, President, Center on Budget and Policy Priorities before the Senate Committee on Budget, 9 May, <http://www.cbpp.org/cms/index.cfm?fa=view&id=3426> [date last accessed 12 September 2011]
- Center on Budget and Policy Priorities. 2011B. Statement by Robert Greenstein on Senate Republican Leaders' proposed balanced budget amendment, 31 March, <http://www.cbpp.org/cms/index.cfm?fa=view&id=3442> [date last accessed 12 September 2011]
- Citizens for Tax Justice. 2007. New IRS data pegs cost of special low tax rates on capital gains and dividends at \$92 billion in 2005 alone, 10 August, <http://www.ctj.org/pdf/cgdiv.pdf> [date last accessed 12 September 2011]
- Citizens for Tax Justice. 2010. Compromise tax cut plan heavily tilts in favor of the well-off, 10 December, <http://www.ctj.org/pdf/taxcompromise2010.pdf> [date last accessed 12 September 2011]
- Citizens for Tax Justice. 2011A. President Obama breaks promise on taxes again, 2 August, <http://www.ctj.org/pdf/debtdeal.pdf> [date last accessed 12 September 2011]
- Citizens for Tax Justice. 2011B. Statement of Robert S. McIntyre, Director, Citizens for Tax Justice before the Senate Budget Committee regarding business tax subsidies administered by the Internal Revenue Service, 9 March, http://sanders.senate.gov/graphics/CTJ_testimony.pdf [date last accessed 12 September 2011]
- Common Dreams. 2011. Doctors' group hails reintroduction of Medicare for all, 15 February, <http://www.commondreams.org/newswire/2011/02/15-4> [date last accessed 12 September 2011]
- Congressional Budget Office. 2001. The budget and economic outlook: fiscal years 2002–2011, 31 January, <http://www.cbo.gov/doc.cfm?index=2727> [date last accessed 12 September 2011]
- Congressional Budget Office. 2011. The budget and economic outlook: fiscal years 2011 to 2021, January, http://www.cbo.gov/ftpdocs/120xx/doc12039/01-26_fy2011outlook.pdf [date last accessed 12 September 2011]
- Crotty, J. 1999. Was Keynes a corporatist? Keynes's radical views on industrial policy and macro policy in the 1920s, *Journal of Economic Issues*, vol. 3, no. 3, 555–78
- Feller, A. and Stone, C. 2009. Top 1 percent of Americans reaped two-thirds of income gains in last economic expansion, Center on Budget and Policy Priorities, 9 September, <http://www.cbpp.org/cms/index.cfm?fa=view&id=2908> [date last accessed 12 September 2011]
- Feller, A. and Stone, C. 2010. Tax rates for richest 400 taxpayers plummeted in recent decades, even as their pre-tax incomes skyrocketed, Center on Budget and Policy Priorities, 23 February, <http://www.cbpp.org/cms/index.cfm?fa=view&id=3090> [date last accessed 12 September 2011]
- Fieldhouse, A. and Pollack, E. 2011A. Debt ceilings threaten deep job losses and lower long-run economic growth, Economic Policy Institute, 4 August
- Fieldhouse, A. and Pollack, E. 2011B. 'Tenth Anniversary of the Bush-era Tax Cuts', Economic Policy Institute Policy Memorandum no. 184
- Greenstein, R. 2011A. 'Chairman Ryan Gets Nearly Two-thirds of His Budget Cuts from Programs for Lower-income Americans', Center on Budget and Policy Priorities, 20 April
- Greenstein, R. 2011B. 'CBO Report: Ryan Plan Specifies Spending Path that Would Nearly End Most of Government other than Social Security, Health Care, and Defense by 2050', Center on Budget and Policy Priorities, 7 April
- Hacker, J. and Pierson, P. 2010. *Winner-take-all Politics: How Washington Made the Rich Richer and Turned Its Back on the Middle Class*, New York, Simon and Shuster
- Krugman, P. 2003. Stating the obvious, *New York Times*, 27 May
- Krugman, P. 2011. The President Surrenders, *New York Times*, 31 July
- Landler, M. and Shear, M. 2011. Obama urges cuts and taxes on the rich, *New York Times*, 13 April

- Lemer, J. and Crooks, E. 2011A. Healthcare: transparently opaque, *Financial Times*, 21 February.
- Marr, C. and Brunet, G. 2011. Under House budget, 'tax reform' places top priority on high-income tax cuts and ignores deficit reduction, Center on Budget and Policy Priorities, 26 May, <http://www.cbpp.org/cms/index.cfm?fa=view&id=3480> [date last accessed 12 September 2011]
- Marr, C. and Highsmith, B. 2011. Six tests for corporate tax reform, Center on Budget and Policy Priorities, 28 February, <http://www.cbpp.org/cms/index.cfm?fa=view&id=3411> [date last accessed 12 September 2011]
- McGregor, R. 2011. Republicans despair in hunt for competitive candidate, *Financial Times*, 23 May
- Miller, M. 2001. Would Obama payroll tax cut hurt Social Security? Reuters, 9 September
- Morrisey, M. 2011. 'Beyond "normal": raising the retirement age is the wrong way to go', Economic Policy Institute Briefing Paper no. 287
- Mulvey, J. 2010. Social Security: raising or eliminating the taxable earnings base, Congressional Research Service, 24 September, <http://aging.senate.gov/crs/ss9.pdf> [date last accessed 12 September 2011]
- New York Times*. 2011A. The budget battles: prosperity for whom? 5 April
- New York Times*. 2011B. To escape chaos, a terrible deal, 31 July
- Nichols, J. 2011. The Democrats' rural rebellions, *The Nation*, 27 August
- Phillips-Fein, K. 2009. *Invisible Hands: The Businessmen's Crusade Against the New Deal*, New York, W. W. Norton
- Picketty, T. and Saez, E. 2007. How progressive is the U.S. federal tax system? A historical perspective, *Journal of Economic Perspectives*, vol. 21, no. 1, 3–24
- Piketty, T., Saez, E. and Stancheva, E. 2011. Taxing the 1%: Why the top tax rate could be over 80%', *VOX*, December 8, <http://www.voxeu.org/index.php?q=node/7402> [date last accessed 30 December 2011]
- Pollin, R., Heintz, J. and Garrett-Peltier, H. 2009. 'The Economic Benefits of Investing in Clean Energy', Center For American Progress, June
- Pollin, R. and Thompson, J. 2011. The betrayal of public workers, *The Nation*, 1–14 March
- Pugh, T. 2011. States broke? Maybe they cut taxes too much, McClatchey Newspapers, 28 March
- Purcell, P. 2009. Retirement savings and household wealth, Congressional Research Service, 8 April, <http://www.policyarchive.org/handle/10207/bitstreams/19203.pdf> [date last accessed 12 September 2011]
- Reuters. 2011. Some firms paid more to CEOs than taxes, 31 August
- Ruffing, K. and Horney, J. 2011. Economic downturn and Bush policies continue to drive large projected deficits, Center on Budget and Policy Priorities, 10 May, <http://www.cbpp.org/cms/?fa=view&id=3490> [date last accessed 12 September 2011]
- Stiglitz, J. 2010. 'Principles and Guidelines for Deficit Reduction', Working Paper no. 6, The Roosevelt Institute
- US Senate Joint Committee on Taxation. 2011. Background information on tax expenditure analysis and historical survey of tax expenditure estimates, 28 February, <http://www.jct.gov/publications.html?func=startdown&id=3740> [date last accessed 30 December 2011]
- Van de Water, P. and Sherman, A. 2010. Social Security keeps 20 million Americans out of poverty, Center on Budget and Policy Priorities, 11 August, <http://www.cbpp.org/cms/index.cfm?fa=view&id=3260> [date last accessed 12 September 2011]
- Wall Street Journal*. 2011A. Obama stokes deficit fight, 14 April
- Wall Street Journal*. 2011B. Key seniors association pivots on benefit cut, 17 June
- Wiseman, P. 2011. Usually a job engine, localities slow US economy, *Common Dreams*, Associated Press 6 June
- Wolf, M. 2011. From Italy to the US, Utopia vs reality, *Financial Times*, 13 July