The Great Austerity War:

What Caused the Deficit Crisis and Who Should Pay to Fix It?

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Abstract

Rapidly rising deficits at both the federal and state and local government levels, along with long-term financing problems in the Social Security and Medicare programs, have triggered a one-sided austerity-focused class war in the US. Similar class conflicts have broken out around the globe. A coalition of the richest and most economically powerful segments of society and conservative politicians who represent their interests has demanded that deficits be eliminated by public-sector austerity - severe cuts at all levels of government in spending that either supports the poor and the middle class or funds crucial public investment. 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. The right-wing coalition seeks to replace that project with a modernized version of the 'free-market' capitalism of the 1920s. 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 post-war period to today's neoliberal, free-market model, a shift initiated under Ronald Reagan and continued under the presidents who succeeded him. 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 can be resolved by raising taxes on upper-income households and large corporations, cutting war spending, and adopting a Canadian or European style health care system. There is no need to accept austerity. Calls for austerity 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 Codes: E60; E62; H60.

1. Introduction.

We have reached what may be a crucial point in the evolution of the political economy of the United States. Rapidly rising deficits at both the federal and state and local government levels, along with long-term financing problems in the Social Security and Medicare programs, have triggered a one-sided class war. The richest and most economically powerful segments of society, in concert with conservative political forces, have demanded that the deficits be eliminated by public-sector austerity - 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. This has been accompanied at the state and local level by attacks on public-sector unions whose membership now exceeds that of collapsing private-sector unions. Simultaneously, a right-wing coalition of the rich, large corporations, and conservative politicians demands huge tax cuts for wealthy households and corporations.[1] For example, the Republican controlled House of Representatives recently proposed $4.2 trillion in regressive tax cuts that 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 calls for sustained regressive tax cuts under any and all fiscal circumstance to force all spending other than on defense and programs that enrich corporations to implode.[2] Similar austerity pressures have developed around Europe as well. Austerity-focused class warfare has begun in much of world.

The current austerity war is an attempt to destroy the economic system created in the US and elsewhere in the aftermath of the Great Depression and World War II. This economic model is called social democracy, or democratic capitalism, or regulated capitalism, or the mixed economy. In the US, the foundations of the new model were built in the 1930s with the creation of FDR's New Deal. Social democratic systems rely heavily on markets, but market activity is subject to the guidance and ultimate control of large and powerful democratic governments that represent the interests of the majority. The government is expected to: invest in infrastructure

[1] In this paper, the term "right-wing coalition" refers to an alliance among wealthy individuals, corporations and political conservatives. Starting in the late 1970s, this coalition began to include an increasing percentage of Democratic politicians.

[2] Note that while Republicans claim to abhor deficits, their desire for tax cuts for their supporters has always trumped concern with deficits. As Herbert Stein, chairman of the Council of Economic Advisors under Nixon, argued in an excellent book called *The Fiscal Revolution in America* (AEI Press, 1996, revised edition), Republicans have never opposed a tax cut for their constituents no matter what the fiscal implications.

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 fulfill these obligations and limit inequality; and ensure that the economy generates adequate employment at rising wages through macroeconomic policy. The government is also expected to provide a supportive environment for the union movement so that it can serve as an effective counter-weight to business and the wealthy in the workplace and in the political arena. History suggests that unless countered by labor and other progressive social forces, the interests of large corporations and the rich will eventually dominate the political process. In this paper the term New Deal refers primarily to the general social democratic model that began to develop in the 1930s, rather than more narrowly to FDR's specific policies.[3]

Conservatives argue that austerity programs will raise the growth rate, lower unemployment and thereby lower the deficit. But in fact they generate the opposite results. Cuts in government spending reduce total spending on goods and services. This lowers employment and income in the economy, which in turn lowers tax revenue and increases deficits. *The adoption of austerity programs across the globe threatens to sink economies deeper into recession or even depression, perhaps triggering yet another global financial crisis*. However, I will not focus on this pressing danger of austerity here. We need a serious jobs-creation program over the next several years, but this program cannot be built on the deep cuts in public spending and regressive tax cuts demanded by the right-wing coalition.

This paper makes three main points. First, today's austerity war has a deeply-rooted history. It is the culmination of at least eight decades of right-wing efforts to destroy the general social democratic economic model initiated through the creation of the New Deal.

Second, our current government debt crisis is the result of right-wing economic policies implemented since the Reagan administration. These policies not only led to a deterioration in economic performance, they 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. It has tripled since Reagan took office. Rising deficits are an integral part of the economic system created by Reagan and his followers. Slow growth and tax

[3] The form of social democracy created in the US was much weaker than many of the social democratic systems in Europe.

cuts generated rising deficits, and in the peculiar logic of right-wing economics, these deficits trigger demands for additional regressive tax cuts. Conservative economists argue that tax cuts on business and the rich increase the rate of economic growth. The fact that their thesis has repeatedly been demonstrated to be false is politically irrelevant. Conservative politicians use a strategy in which rising deficits are a means to exert financial and political pressure to cut government spending on productive investment and shrink the social safety net - cornerstones of the New Deal. At least untill now, attempts to slash social spending on major New-Deal-type programs 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. However, the current debt crisis is severe enough that it has created conditions in which fundamental New Deal programs may well be destroyed.

Third, rather than attack the causes of the deficit crisis - slow growth under the right-wing economic model, the radical deregulation of financial markets, endless regressive tax cuts and excessive defense spending on wars of choice, both Democrats and Republicans have instead proposed substantial spending cuts. The Democrats offer moderate austerity and the Republicans demand unrelenting austerity designed to destroy the entire New Deal project. Both parties also propose regressive tax cuts that will increase deficits, ratcheting up the pressure for more austerity. Democrats propose substantial tax cuts while Republicans demand huge tax cuts.

This increasing political pressure to destroy the foundations of the New Deal is bizarrely paradoxical. The right-wing coalition is on the verge of succeeding in its eighty-year quest to defeat the New Deal, not in spite of, but *because* it produced three-decades of economic failure and exploding deficits. It is the huge rise in government debt generated by the right-wing model that created the recent financial and political crisis that in turn spawned a wide-spread demand for austerity. The right-wing coalition appears to have succeeded through failure; the worse the economy performs under its leadership and the more the deficits grow, the greater the likelihood it will achieve its ultimate goal.[4]

[4] There is another important paradox associated with the deficit crisis. Financial markets are thought to be the ultimate enforcer of austerity. If the government does not quickly resolve both intermediate and long-run deficit problems, it is argued, it will lose the "confidence" of financial markets. When that happens, interest rates on our huge public debt will spike, causing interest payments to rise to such a high percentage of GDP that there will be no choice but to drastically slash spending. Almost all the deficit reduction work will have to be done through spending

2. Understanding Today's Austerity War Requires an Economic and Political History Lesson.

To understand the kind of political economy that today's right-wing coalition wants to achieve in the US, consider the boom of the second half of the 1920s. In that era 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.

This kind of extreme 'free-market' economic system is inherently subject to system-threatening booms and crashes. A financial crisis developed in late 1929 that eventually became a financial collapse accompanied by a severe depression. The unemployment rate hit 25% in 1933, while real GDP collapsed by 27% from its 1929 level. This economic disaster led to serious social and political unrest that called the very existence of capitalism in America 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 programs that became known as the New Deal. They included strict regulation of financial markets, creation of the Social Security program, support for the rising industrial union movement, large public employment programs, 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; real GDP in 1936 and 1937 exceeded its 1929 value. But it was too weak to restore full-

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cuts because financial markets do not like high taxes on corporations or the rich. Financial markets are dominated by corporate behemoths that are run by and for the richest people in America.

This is paradoxical because financial markets recently self-destructed as the result of a frenetic pursuit of profits and bonuses in a largely unregulated environment, and had to be rescued from insolvency by the very governments they now threaten to wreak havoc upon. Giant financial firms seem to have a kind of structural blackmail power over governments. No matter how much excessive risk they take in pursuit of short-run profits and bonuses, governments believe they have to bail them out or their collapse will bring the rest of the economy down with them. When they do implode and trigger a deep recession that causes government deficits to rise, financial markets get control over government economic policy and use it on behalf of the rich. The most extreme cases of this paradox have occurred in smaller countries like Greece, Ireland and Portugal and the not so small economy of Spain, where the IMF, the EU and large banks demand extreme budget cuts and privatization of public assets at fire sale prices in return for loading these heavily-indebted countries with even more debt.

employment and general prosperity. That required the central planning and huge government spending of World War II.

The economic role of government grew substantially after World War II. Federal spending was about 3% of GDP in 1929, but this increased to 16% in the 1950s. Social Security was expanded, Medicare and Medicaid were created, and various income security programs were instituted that expanded the social safety net. Union membership peaked at 34% of all workers in 1954. Unions were especially strong in America's dominant industries and their contracts influenced wages and working conditions in non-union companies. They became an important if junior partner in the Democratic Party. Unions not only provided the Democrats with financial support, they also mobilized millions of families to vote for Party candidates. They were the most important constraint on the power of corporations and the rich in both in the political arena and in the economy, and the most important force pushing for government economic policies in the interest of the poor and the emerging middle class. Indeed, unions and the New Deal largely created the great post-war bulge in the ranks of the American middle class. Later, when the union movement weakened, there was no other organized force able and willing to perform this function.

US elites were split on the question of whether to accept the main components 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 abhorred the New Deal because, in their view, it interfered with the freedom of private property through regulation of industry, the confiscation of private wealth through income taxation (which did not exist prior to 1916), and the destruction of the perfect efficiency of the idealized vision of the free market system they revered. Corporations hated unions because they believed that they interfered with the right of owners to run their businesses as they saw fit, eroded efficiency, limited freedom of contract, lowered profits, and opposed corporate interests in the political process. The coalition hated Social Security and unemployment insurance because they believed economic security should be gained through work and property ownership, not through government handouts, unless, of course, they are on the receiving end of the handouts. They opposed a government commitment to pursue full-employment because fear of job loss helps sustain business's power over their workers.

In other words, the coalition wanted to restore the 1920s regime. Their goals were clear: end government regulation of business, cut or eliminate taxes on corporations and the rich, destroy the union movement, slash government social spending, restore the share of the top 1% of the income distribution to pre-depression levels, and get government back under elite control.

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.[5] The right-wing forces that hated the New Deal:

> 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, p. 269)

The right-wing coalition's effort to defeat or defang social democracy began in the 1930s and continues to this day. It had many victories along the way. The Taft-Hartley law passed in 1947 was a major achievement. It banned important union weapons such as sympathy strikes and secondary boycotts, permitted state right-to-work laws that outlawed union shops, and attacked radical union leaders through mandatory loyalty and anti-communist oaths. Hamstrung by Taft-Hartley and with only limited success in organizing the anti-union South and white collar workers, union membership rates began a slow rate of decline from their early 1950s peak. Still, organized labor remained a formidable force for many decades.

The Goldwater presidential campaign in 1964 was perhaps the high water mark of anti-New-Deal efforts until the late 1970s. The right-wing coalition's problem was that the ever-expanding role of government in the economy was very popular not only because it helped restrain the ravages of the Great Depression, but also because it created a very prosperous

[5] Kim Phillips-Fein, *Invisible Hands: The Businessmen's' Crusade Against the New Deal*, W.W. Norton, 2009.

economy from WWII 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 - from a peak of 24% in 1928, the income share of the top 1% fell to around 10% by the late 1940s, where it remained until Ronald Reagan took office.[6] 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. President Eisenhower expressed mainstream Republican acceptance of substantial portions of the New Deal in a 1954 letter to his brother:

> Should any political party attempt to abolish Social Security, unemployment insurance, and eliminate labor laws and farm programs, you would not hear of that party again in our political history. There is a tiny splinter group, of course, that believes you can do these things. Among them are H. L. Hunt (you possibly know his background), a few other Texas oil millionaires, and an occasional politician or business man from other areas. Their number is negligible and they are stupid. (In Phillips-Fein, p. 56)

Note that the positions Ike describes as "stupid" are key objectives of today's Republican Party.

Programs 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 also approved the transformation of Old Age Security Assistance into a much larger and fully national Supplemental Security 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 - or even many current Democrats - Nixon looks like a full-throated Social Democrat. (Hacker and Pierson, pp. 96-97)[7]

The mid to late 1970s marked a turning point in the status of the right-wing coalition in the political process. The decade of the 1970s was economically turbulent. Jumps in oil prices hit

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[6] See http://www.stateofworkingamerica.org/charts/view/155.

[7] J. Hacker and P. Pierson, *Winner-Take-All Politics: How Washington Made the Rich Richer and Turned Its Back on the Middle Class*, Simon and Shuster, 2010.

the economy both early and late in the decade. As a result, there were two spikes in the rate of inflation. Since the Keynesian policy model adopted in the US 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 and employment at the expense of inflation, or restrict spending to stop inflation at the cost of rising unemployment and slower growth.[8] In the wake of the first OPEC oil price hike in 1973, it chose the latter course. The unemployment rate rose from 4.9% in 1973 to 8.5% in 1975, a rate that was shockingly high by the standards of the Golden Age. Inflation did decline from 1975 through 1977, but then rose again near the decade's end with the second OPEC price increase. Meanwhile, the fall in the growth rate, reinforced by rapidly rising imports, lowered profits and stock prices. All this created growing discontent with the economic status quo. Meanwhile, social unrest was stirred by racial conflict over integration, the anti-Vietnam-war movement, and the so-called 'culture wars' - student radicalism, the women's movement, pro-abortion struggles and a youth rebellion evidenced by 'drugs and sex and rock and roll.'

These developments led to a political alliance between resurgent right-wing economic forces and the rapidly increasing ranks of cultural conservatives. For example, the religious right became increasingly influential. As a result, business and other conservative forces saw a dramatic increase in their ability to raise money to elect friendly politicians, organize massive grass-roots pressure on all politicians, and spend money on an expanding right-wing ideological infrastructure of think tanks and university influence. They gained increasing control of the media - television, radio and newspapers - and used this influence 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. Corporate Political Action Committees became increasingly influential. Wealthy right-wing families such as the Ohlins, the Pews, the Coors, the Kochs and the Mellon-Scaifes 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 their funds. Republicans were overpowering

[8] In fact, these were not Keynes's preferred policies. For an explanation of the more radical policies Keynes actually supported, see James Crotty, "Was Keynes a Corporatist? Keynes's Radical Views on Industrial Policy and Macro Policy in the 1920s," Journal of Economic Issues, September 1999, pp. 555-78.

Democrats in the money wars of the late 1970s. This development came in the wake of a mass desertion of the Democratic Party by Southern conservatives. Meanwhile, the percentage of American workers in unions had fallen to 23%, further weakening support for New Deal programs.

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 post-war political economy.

> 1977 and 1978 marked [the start of] the rapid demise of the liberal era and the emergence of something radically different. … By 1978, at a time of unified Democratic control of the House, Senate and White House, the precursors of the Reagan revolution were already visible. Congress passed a tax bill whose signature provision was a deep cut in the capital gains tax - a change that would largely benefit the wealthy. This followed hard on the heels of a decision to sharply raise payroll taxes, the most regressive federal levy. … The United States began its long dramatic move away from the established practice of using taxes as an instrument for tempering market-generated inequalities associated with the outsized earnings of those at the top. At the same time, Congress and the President embarked on a major shift in economic policy, embracing the argument that excessive regulation had become a serious impediment to growth. (Hacker and Pierson, pp. 99-100)[9]

By 1980, the country had come to a cross roads. The existing set of government institutions and policies, in combination with the increasing globalization of production, investment and finance, and rising foreign competition, were no longer generating the widespread prosperity the public had come to expect - though the 1970s turned out to be better than the 1980s for the bottom two-thirds of the income distribution. 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 model situated in a globalized 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

[9] The transformation of the Democratic Party continued in the early 1980s. "Forced to deal with a much more organized and assertive business community and facing powerful financial incentives to seek accommodation, the Democratic Party apparatus reached out to corporate donors as never before. … Many in the Party were increasingly eager to identify themselves as "business Democrats" - an identify they reinforced by voting in large numbers for the massive business tax cuts of 1981 (Hacker and Pierson, p. 177).

percentage of Democrats had abandoned the whole New Deal project, reinvented themselves as business-oriented 'centrists.'[10]

Progressive academics and politicians did offer 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 (which, in the absence of a third OPEC price shock, would have petered out in a relatively short period) could have been met with temporary wage-price controls. Instead, Fed policies drove interest rates through the roof and created massive unemployment and the devastation of our industrial base.[11] Financial chaos could have been ended by a reconstitution of effective financial market regulation to deal with the changes that had taken place over the period, rather than by the deregulation and globalization of finance actually adopted.[12] We could have instituted industrial policies to facilitate the expansion of our domestic manufacturing system and the creation of more well-paying jobs, rather than decimate our industrial base through high interest rates, a rising value of the dollar, and globalization. We could have adopted a Canadian- or European-style health care system rather than accommodate the growth of the most cost-ineffective system in the industrialized world. We could have adopted policies that made it less attractive to US-based transnational corporations to flee the country for cheap labor in the under-developed world. We could have strengthened the union movement rather than adopt policies that led to its decline. We could have increased the tax base through 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 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 to levels that matched their peak in the late 1920s.

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[10] Many Democrats have aligned themselves with extreme right-wing Republicans in the current austerity wars. For example, when the Republican-controlled House recently rejected a proposed bill to raise the federal borrowing limit in order to force President Obama to accept even more cuts in social programs, 88 Democrats voted with them and seven more voted "present" (The Wall Street Journal, "House Soundly Rejects Increase in Debt Limit," June 1, 2011.

[11]The second inflation spike was met by Paul Volcker's iron-fisted monetary policy that raised real interest rates to historically high levels, which caused the exchange value of the dollar to spike. Both effects combined to decimate the Midwest manufacturing base, creating what was called a "rust belt." The unemployment rate rose to almost 10% in 1982 and 1983 and remained at 7% or higher for seven straight years, further debilitating the union movement

[12]The decision to radically deregulate financial markets taken in the 1980s accelerated a process that eventually culminated in the financial catastrophe that erupted in 2008.

The main point is that, in contrast to Margaret Thatcher's dictum that there is no alternative to unregulated, globally-integrated capitalism, 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 favored by the right-wing coalition that was gaining political and ideological power.

The election of Ronald Reagan as President in 1980 represented a major victory for right-wing forces. He famously ridiculed the New Deal idea that the government could play a useful role in the economy: "Government is not a solution to our problem," he said, "government *is* the problem." In concert with a complaint Congress controlled by 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 neoliberalism or global neoliberal capitalism. He restricted the growth of government spending on the poor and middle class and simultaneously instituted large tax cuts focused on corporations and the very wealthy.[13] Reagan attacked the union movement. He struck the first blow when he fired the air traffic controllers when they went on strike in 1981. But he also packed the labor regulatory system with anti-union individuals and supported the appointment of pro-business, anti-labor Federal judges. 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. The share of income captured by the top 1% of the income distribution increased by about 50% during the Reagan years. Moreover, the freedom of capital investment, trade and finance to roam the globe with little hindrance from government cross-border restrictions increased qualitatively during the Reagan years. Globalization gave mobile industrial capital a huge advantage over immobile domestic labor 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. It also made it easier for US firms to produce both capital and consumer goods elsewhere and then import them back into the US for sale. The US experienced

[13] Gains from these tax cuts in the bottom half of the income distribution were erased by increases in Social Security and Medicare taxes.

massive trade deficits from the 1980s onward. 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. Reagan thus made substantial progress in pursuit of a new 1920s regime.

Since Reagan not only cut taxes but also increased defense spending by about 1.5% of GDP, he created the largest federal budget deficits since the end of World War II. The largest-post-war deficit prior to Reagan was 4.2% of GDP in 1976. Indeed, there were only three years since World War II in which the deficit was 3.0% or more of GDP until the Reagan administration, and they were all in the aftermath of the first OPEC oil price hike. But from 1982 through 1987, annual deficits averaged 5.9 % of GDP and from 1982 through 1989 they were never less than 5.6%. Indeed, the deficits were so large that Reagan supported several tax laws that increased revenues, the most important of which was enacted in 1986. The 1986 law cut the maximum tax rate on corporate income, but also eliminated many tax loopholes. The immediate impact was to raise corporate tax revenue. However, it should come as no surprise that 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. "If you take a good look at the tax code now, you'll see that it is chock-full of new tax breaks, far more expensive than the ones eliminated with such fanfare [in 1986]" (Hacker and Pierson, p. 109).

The general direction of the policies adopted in the Reagan years continued during the presidency of George Bush senior. Right-wing forces continued to grow stronger and Democrats continued their rightward drift. Bill Clinton campaigned as a progressive in the 1992 presidential election, but governed as a pro-business centrist.[14] The Democrats lost the House and Senate in 1994. They had controlled the House since the mid 1950s. The House leadership - men such as Newt Gingrich, Dick Army, and Tom Delay - were by far the most radical right-wing group to control the House in the post World War II era. This was the kind of Republican Party that Eisenhower predicted could never get elected. Moderate Republicans were now an endangered

[14] Bob Woodward's book *The Agenda: Inside the Clinton White House* (Simon and Schuster 1994) describes this shift in detail.

species, while the Democratic Party was 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 the1990s that drove the rate of unemployment below 5% for the first time since 1970. In 2000, the unemployment rate was 4.0%, yet inflation remained at modest levels. And he orchestrated a modest increase in the tax rates on upper incomes 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 that was kept alive after 1997 by an epidemic of phony corporate accounting designed to hide the fact that corporate profits were in decline. Second, he supported and achieved substantial additional financial market deregulation that directly contributed to the financial market collapse in 2008. Third, he seriously weakened the welfare system. Fourth, Clinton continued the globalization 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 by helping establish the World Trade Organization. Fifth, inequality rose significantly on his watch. The income share of the top 1% of the income distribution rose from 15% to 22% during his presidency.[15]

By the end of Clinton's presidency, union membership was down to 13.5% of the workforce. While other social groups that lent support to Democratic candidates had grown since the 1970s, including the women's and environmental movements, none of them focused on political actions in support of the economic interests of the bottom two-thirds of the income distribution with the intensity and effectiveness of unions. The forces attempting to destroy the New Deal were meeting ever weaker resistance.

George W. Bush took office in 2001, just as the bubbles that sustained growth in late 1990s deflated, sending the economy into recession. Under his presidency, the Republican Party intensified the war against the New Deal so successfully that there is some possibility that final

[15] See http://www.stateofworkingamerica.org/charts/view/155.

victory may be in sight. Bush oversaw the passage of very large regressive tax cuts that hemorrhaged trillions of dollars of government revenue. In 2007, Citizens for Tax Justice estimated that the top 1% would receive 38% of the cuts over a decade.[16] In fact, the top 1% did receive 38% of the cuts in 2010.[17] Bush also started wars of choice in Iraq and Afghanistan, which have been very costly to date, and will ultimately cost trillions of dollars. Revenue was also constrained by the extremely weak growth of the economy under Bush. For example, in 2008, inflation-adjusted median family income was lower than it had been a decade before, the first time this had happened in the post World War II era. Tax cuts, costly wars and a sluggish economy alone would have turned Clinton's surpluses into large deficits. But financial markets imploded in 2008, kicking the weak economic recovery into a tailspin. The economic collapse slashed government revenue and automatically triggered greater spending on programs such as unemployment compensation and Medicaid. Fearing that the global financial system would itself collapse unless drastic action was taken, the government committed about $12 trillion to support financial markets. It also undertook a substantial deficit-financed stimulus program to try to prevent the deep downturn from turning into a bottomless depression.

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. A reasonable person might think that the policies chosen to reduce or eliminate these deficits would be designed to attack their underlying causes. But that's not what happened. The debate between Democrats and Republicans is over how to deal with the deficit crisis is based on the blatantly false assumption that there are large deficits because “we” - the American people - are greedy and have demanded levels of government spending that we will not and cannot pay for. As a former Republican Senator from Utah and co-chair of President Obama's committee to find solutions to prospective shortfalls in Social Security revenue put it: Social Security "is like a milk cow with 310 million tits." Since the problem is caused by the American people sucking the government dry, the argument goes, the obvious solution is to drastically slash excessive government nondefense spending by enough to eliminate the deficits. Raising tax rates is anathema to the Republicans,

[16] Citizens for Tax Justice, "The Bush Tax Cuts: The Latest CTJ Projections," March 2007.
[17] A. Fieldhouse and E. Pollack, "Tenth Anniversary of the Bush-Era Tax Cuts," Economic Policy Institute Policy Memorandum 184, June 1,2011.

and President Obama has proposed only modest tax increases for those with the highest incomes. In effect, almost all the deficit reduction work is expected to come through nondefense spending cuts, a long-term objective of the right-wing coalition. 2007 was the last year before the crisis hit the economy and caused government spending to rise dramatically. The $1.3 trillion that would be needed to eliminate the 2010 deficit is 47% of *all* government spending in 2007, including Medicare, Medicaid, Social Security and defense. To insist that deficit reduction come almost exclusively through spending cuts is tantamount to demanding the destruction of the social safety net and public investment.

To make matters worse, in 2010 President Obama and Congress agreed to extend the Bush tax cuts for two more years at an estimated revenue loss of $850 billion. The top 1% of taxpayers is expected to get 25% of the tax cuts, while the bottom 40% get just 9%. President Obama is committed to the perpetual extension of these cuts on the first $250,000 of income for all families.[18]

So instead of solving our fiscal problems by eliminating the causes of the deficit, the political process - dominated by a coalition of right-wing Republicans and conservative Democrats that dances to the tune of the oligarchs who fund them - used the deficit crisis to unleash an austerity war against the American people.

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" (p. 322).

3. The Main Effects of the Right-Wing Economic Model Were Slower Economic Growth, Increased Inequality, and Rising Deficits.

[18] Citizens for Tax Justice, "Compromise Tax Cut Plan Heavily Tilts in Favor of the Well-Off," December 10, 2010. Obama vowed to limit these cuts to the first $250,000 of family income - that is apparently his definition of the upper end of the "middle class." But because he gave in to Republican demands in 2010 to remove the income limit, there is no reason to believe he will not extend them after 2012 since the Republicans now have greater influence in Congress.

Note that there are good reasons to continue to stimulate our broken economy through deficit-financed spending on public investment and social programs, but not to cut rich people's taxes. The reductions to the tax burden of the bottom half of the income distribution in the Bush-Obama tax cuts are so modest that this group would be much better served by fixing the problems in the economy that caused the deficit explosion.

The rate of economic growth has slowed substantially and the degree of inequality has skyrocketed since the economic regime change that began in the late 1970s. While there may be causes in addition to the shift in economic models that contributed to this decline, the facts of decline are quite clear. 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.[19] Figure 1 presents data on market-generated incomes; it does not include the effects of government transfer payments such as Social Security or unemployment compensation. 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 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%.[20] 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%.[21] The Bush expansion made the late 1920s look egalitarian.

Figure 2 presents data on the growth of real family income by fifths or quintiles. The income measure used here includes government transfer payments but excludes capital gains, which accrue primarily to those in the highest income brackets. Two facts stand out. First, the rate of growth of real family income was much higher during the period in which New Deal programs were expanding than it was as the foundations of the New Deal began to erode after the late 1970s. For the bottom 80% of the income distribution the differences between the periods are stunning. Second, the distribution of income gains was much more unequal in the latter period. In the first period the highest rate of growth was in the lowest quintile and the lowest growth was in the highest quintile. In the post-1979 era, the poorest quintile actually

[19] This paper argues that higher growth is needed to improve conditions in the labor 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 over-utilize 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, Robert Pollin, James Heintz and Heidi Garrett-Peltier, "The Economic Benefits of Investing in Clean Energy," Center For American Progress, June 2009.

[20] Center on Budget and Policy Priorities, "Testimony of Robert Greenspan President, Center on Budget and Policy Priorities Before the Senate Committee on Budget," May 9, 2011.

[21] Center on Budget and Policy Priorities, "Top 1 Percent of Americans Reaped Two-Thirds of Income Gains in Last Economic Expansion," September 9, 2009.

suffered a decline in real family income, the second poorest quintile had near zero growth, and the highest quintile had by far the highest growth rate.

The use of quintiles hides the fact that the rise in inequality is concentrated at the very top of the income distribution. For example, 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.[22] 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.[23] The top 0.01% received 6% of market income in 2007, which was higher than the previous peak in 1928 and 1929.[24] The spectacular rise in the share of income received by the very rich helps explain why there was no political backlash against the sluggish growth rates generated by the new economic model. Inequality was rising fast enough to generate fabulous rates of income growth for economic and political elites even as the overall rate of economic growth declined. Since these elites used their wealth to control the political process, there was no effective opposition to the evolving right-wing economic model. Our political system had again, as in the late 1920s, become an oligarchy.

Figure 3 shows the effects of regime change on a typical American family. It focuses on the real or inflation-adjusted value of income for the median family - the one in the middle of the income distribution. Medium income more than doubled from 1947 to 1979, reflecting the enormous improvement in the economic conditions of ordinary Americas in the New Deal era. But income growth slowed dramatically as the New Deal model began to erode. Median income in 1993 barely exceeded its 1979 value. It then increased by almost 17% in the Clinton expansion. Median income actually declined by 3% during the presidency of George W. Bush. After rising by 2.4% a year in the period from 1950 to 1979, median family income increased by a meager 0.04% annually in the 1979 to 2009 period. The rate of change would have been

[22] See http://www.stateofworkingamerica.org/charts/view/82.
[23] Hacker and Pierson 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).
[24] T. Piketty and E. Saez, "Striking it Richer: The Evolution of Top Incomes in the United States (Updates with 2007 Estimates)," August 5, 2009. At: http://elsa.berkeley.edu/~saez/saez-UStopincomes-2007.pdf.

negative if not for the growth in hours worked per family after 1979. Real GDP grew at 2.75% a year in the neoliberal era and labor productivity grew by about 1.6% annually (after growing 2.5% per year from 1953-1979), but because of the structure of the new economic model, poor and middle class Americans failed to share in this growth.

4. The Right-Wing Economic Model and Wars Caused the Deficit Crisis.

Since the right-wing economic model relentlessly pursues regressive tax cuts and reduces the economic growth rate, it has a strong structural tendency to restrain the growth of government tax revenues. While it is committed to reducing government spending on the social safety net and public investment, it supports increased defense expenditures and projects that are, in reality, handouts to corporate America. Moreover, proposals by conservative politicians to defund or privatize popular spending programs such as Social Security and Medicare have, until now, triggered a powerful political backlash that makes them difficult to implement. George W. Bush's attempt to privatize Social Security was met with such resistance that he withdrew his proposal. In practice, *at least until now*, the model restrains revenue growth more effectively than it lowers spending. **This combination of attributes makes rising deficits a structural attribute of the right-wing model.**

The historical record confirms this assertion. Federal government debt in the hands of the public as a percentage of GDP is the variable used to measure the extent of government indebtedness. This ratio peaked at 112% in 1946 just after the war ended. During the early post World War II 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 post-war 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 percent. During the presidency of George Bush senior it rose to 48.1%, almost double what it had been in 1981. The debt ratio fell from 49.3% to 34.7% in the Clinton years, as the rate of economic growth accelerated and tax rates on the rich were modestly increased. The federal government even ran surpluses in the final three years of his presidency.

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 surpluses were projected to be $5.6 trillion.*[25] These estimates took increasing problems with Social Security and Medicare and Medicaid funding into account. At the time of these estimates in 2001, the total debt held by the public, accumulated from the birth of the nation, was only $3.3 trillion. We appeared to be on the verge of eliminating all federal debt.

But rather than applaud this prospect, many conservative economists and politicians expressed concern that these surpluses could be dangerous since they would drain the Treasury bond market, which plays an important role in the financial system. From their perspective, the best way to deal with the "problem" of rising surpluses, of course, was to cut taxes. Federal Reserve Chairman Alan Greenspan argued that it would be better to slash taxes than to pay off the debt: "In 2001, with the government running a surplus, Mr. Greenspan lent support to President Bush's tax cuts, to the consternation of Democrats" (Wall Street Journal, "Former Fed Chief Greenspan Favors Clinton-Era Tax Rates," June 4/5, 2011).

The actual and prospective surpluses were thus converted into huge deficits by the massive Bush tax cuts and other policies. *In fact, the decade from 2001-2011 saw a cumulative $4.7 trillion deficit - a $10.3 trillion deterioration from the CBO's 2001 projection.* The Bush Administration understood that the trillions of dollars in tax revenue likely to be lost over a decade by such large tax cuts would generate substantial budget deficits. In fact, these tax cuts resulted in $3 trillion is lost revenue from 2001-2010.[26] 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,

[25] Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2002-2011," January 31, 2001.
[26] A. Fieldhouse and E. Pollack, "Tenth Anniversary of the Bush-Era Tax Cuts," Economic Policy Institute Policy Memorandum 184, June 1, 2011.

> 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. (New York Times, "Stating the Obvious," May 27, 2003)

In the year George W. Bush took office, the debt to GDP ratio was 32.5%. When he left office in 2008, the ratio was 40.3%, but the deficit was about to explode. President Bush had cut taxes and fought expensive and unnecessary wars. Joseph Stiglitz and Linda Bilmes estimate the ultimate cost of the Iraq war alone to be $3 trillion.[27] He also left an economy about to implode. The disastrous financial crisis made possible by radical deregulation triggered an economic collapse serious enough to potentially generate a depression. In the first year of President Obama's term, as the economic crisis deepened, 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.

The size of the annual deficit is the sum of interest payments on existing debt plus the "primary" surplus or deficit - the difference between revenues and all expenditures other than interest payments. When the debt to GDP ratio becomes very large, interest payments may become so big that the budget will remain in substantial deficit even if there is a large primary surplus. For example, in the CBO projections of January 2011(which assume the Bush tax cuts end after 2012), the primary budget is in surplus after 2017, but interest payments keep rising, hitting almost $800 billion in 2021, causing a projected deficit of $763 billion that year. This is the legacy left by the administration of George W. Bush. The deficit cannot be eliminated just by bringing revenues and spending into balance; we would have to cut spending and/or raise revenues by enough that the primary surplus covers large interest payments, and these payments will increase substantially if interest rates rise above their current low levels. Thus, the soaring deficits created by the Bush administration will continue to generate pressure for austerity for a very long time, even if the primary budget is eventually balanced. This is part of the perverse genius of the "starve the beast" strategy.

[27] "All told, the bill for the Iraq war is likely to top $3 trillion. And that's a conservative estimate" (Linda Bilmes and Joseph Stiglitz, Washington Post, "The Iraq War Will Cost Us $3 Trillion, and Much More," March 9, 2008.)

Figure 4, based on a Center on Budget and Policy Priorities analysis of CBO data, assumes the Bush-Obama tax cuts will expire after 2012. **It shows that the current and prospective deficit problems were exclusively caused by four 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.**[28] "The economic downturn, President Bush's tax cuts and the wars in Afghanistan and Iraq explain virtually the entire deficit over the next ten years."[29] Note that excessive spending on discretionary nondefense spending, federal employee compensation, Social Security and Medicare, or other social programs do not appear on this list because they played no role in creating the deficits. Yet these are the programs the right-wing coalition insists must be cut to eliminate the deficit problem. In fact, the only responsibility of ordinary American people for the deficit problem was that they elected public officials who implemented and sustained the right-wing economic model and waged wars of choice. However, their culpability is diminished by two factors. First, the explanation of the causes of the crisis and the policies needed to end the crisis provided by our conservative corporate-controlled media is cut to fit the right-wing coalition's perspective on these matters. Therefore, most Americans do not understand the basic facts of the matter. Second, the political science literature documents that politicians only respond to the expressed preferences of the upper third of the income distribution.[30]

Clearly, the rational response to this problem would be to: eliminate all the Bush tax cuts - which even Alan Greenspan thinks is a good idea;[31] raise taxes on the rich and corporations above Clinton-era levels and perhaps modestly on the middle class as well; end the wars and cut the defense budget; tightly regulate financial markets to stop the economic damage caused by our bubble- and debt-driven economy; and, most important, replace our current right-wing economic model with one that increases the economic growth rate and lowers unemployment. Indeed, since

[28] These numbers include the effects of changes in interest payments caused by the four factors.
[29] Center on Budget and Policy Priorities, "Economic Downturn and Bush Policies Continue to Drive Large Projected Deficits," May 10, 2011.
[30] See Hacker and Pierson, chapter 4.
[31] Alan Greenspan “now says… he would support going back to Clinton-era tax rates” (Wall Street Journal, “Former Fed Chief Greenspan Favors Clinton-Era Tax Rates,” June 4/5, 2011).

the creation of an adequate economic model will require an increase in public expenditures, we need to raise public-sector revenues, not reduced them via more regressive tax cuts.

5. What Should Be Done to Resolve the Deficit Crisis Over the Next Decade?[32]

To address the deficit problem over the coming decade, we need to restrain expenditures as well as raise tax revenue, but other than in defense spending, the gains from sensible spending cuts are limited. Excessive nondefense spending has not been a major problem. Indeed, discretionary nondefense spending was a smaller percentage of GDP in 2008 than it had been when Ronald Reagan took office, and there were fewer federal civilian employees that year than there had been in 1967, a period in which population has grown by over 50%. To lower deficits and inequality as well as fund necessary government programs, we need to generate much higher government revenues. Total federal tax revenue in 2010 as a percentage of GDP was at a 60 year low.[33] Most people do not realize that by international standards, the US is a very lightly taxed nation.[34] If the US had the same tax to GDP ratio as the median OECD country in 2009, we would have had $1.4 trillion in extra revenue that year. Raising tax revenue to the OECD median would eliminate current and future deficits.

Both our low tax revenues and the limited progressivity of our tax system are caused by a combination of low official tax rates on individual and corporate income, and a vast swamp of loopholes written into the tax code over decades on behalf of wealthy individuals and corporations. These loopholes, called "tax expenditures," make effective tax rates - the ones actually paid - much lower than official maximum tax rates. By raising rates and cutting loopholes, we could generate much greater tax revenue from both the individual and corporate income tax, which would eliminate the pressure to slash crucial government spending.

Figure 5 shows 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 actual taxes paid divided by "adjusted gross income" or AGI. AGI is total income minus deductions, but many deductions are simply loopholes written into the tax code to lower the effective tax rate

[32] We treat long-term budget problems in section 6.
[33] New York Times, "Health Care Costs and the Tax Burden," June 7, 2011.
[34] Of course, European and Scandinavian countries with much higher tax revenues also provide much better public services than does the US.

on upper income families. In 2010, total revenue lost to individual tax expenditures was in excess of $900 billion. Since the loss of revenue from loopholes is proportionately much higher at upper income levels, Figure 5 substantially overestimates the progressivity of federal taxes. Nevertheless, it demonstrates that 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 for the super-rich. *The top 400 filers, whose average income is $345 million, pay about the same tax rate as those in the $50,000 to $74,700 range.* This seemingly absurd anomaly reflects the stranglehold the super-rich have over government tax policy. In a society that valued restraints on excessive inequality and adequately supported government social programs, we would expect to see effective tax rates rise substantially after, say, $200,000 and dramatically as income levels rise into the millions of dollars. Effective marginal income tax rates on families making hundreds of millions of dollars or more should be in the vicinity of their nominal level under Eisenhower, which was 91%.

Of course, lower rates on realized capital gains than on earned income, and deductions for interest payments and charitable contributions brought the effective income tax rate for the richest Americans well below the nominal top rate even in the early post World War II era. Still, the effective federal tax rate - including income, estate, social insurance and corporate taxes, was, at 70% in 1960, more than twice what it was in 2004 for the top 0.01% of income recipients.[35] 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. [36]

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%. Post-war 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 stayed between 1% and 2%

[35] T. Picketty and E. Saez, "How Progressive is the U.S. Federal Tax System? A Historical Perspective," Journal of Economic Perspectives, 21 (1), Winter 2007, pp. 3-24.
[36] Center on Budget and Policy Priorities, "Tax Rates for Richest 400 Taxpayers Plummeted in Recent Decades, Even As Their Pre-Tax Incomes Skyrocketed," February 23, 2010.

since then.[37] Many of the most profitable large corporations pay no taxes and even receive substantial subsidies from the government from time to time. For example, Boeing reported $9.7 billion in pretax US profits in 2008 to 2010, yet paid no taxes and received $3.5 billion in tax rebates. From 2006 to 2010, GE reported $26.3 billion in pretax US profits, paid no taxes and received $4.2 billion in tax rebates.[38]

The CBO budget projections of January 2011provide information that can be used to assess the potential impact on the budget in the coming decade of eliminating the Bush-Obama tax cuts and reducing our troop levels in Iraq and Afghanistan.[39] 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) will be $11.6 trillion and the debt to GDP ratio will rise to over 95% by 2021. But if all the tax cuts are allowed to expire in 2012 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.[40] "By that one simple step, Congress would put the deficits and debt on a sustainable path for the next decade."[41] If we also reduce the troops 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 is falling. These two changes alone would cut the prospective decade-long deficit in half, reducing it to manageable proportions, without gutting important government programs.*

But there are many additional ways to raise revenue while decreasing inequality.[42] 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

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[37] Center on Budget and Policy Priorities, "Six Tests for Corporate Tax Reform," February 28, 2011.
[38] Citizens for Tax Justice, "Statement of Robert McIntyre Before the Senate Budget Committee," March 9, 2011.
[39] Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2011 to 2021," January 2011.
[40] 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.
[41] Center on Budget and Policy Priorities, "Economic Downturn and Bush Policies Continue to Drive Large Projected Deficits," May 10, 2011.
[42] 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. It can be accessed at http://grijalva.house.gov/uploads/The%20CPC%20FY2012%20Budget.pdf.

mentioned in this paper were simultaneously enacted, we might exhaust their ability to pay. However, the objective of ending the deficit crisis without destroying essential government programs can be achieved using a subset of the tax increases mentioned in the paper.

First, raise individual tax rates for the well-to-do above those used in the Clinton years, and restore the 20-plus tax-rate trigger levels used before 1992 to increase progressivity at upper income levels. The current tax code has only 6 rate-switch points. The top marginal rate of 35% is used for all income levels above $373,650. This destroys progressivity for the rich and super-rich, which is where it is most needed. Consider just one example. If we raised the tax rate on the AGI of the top 1% of taxpayers by 5%, and on the top 2%-5% of taxpayers by 3% of AGI, this would generate $1.2 trillion over a decade.[43] Second, eliminate just 15% of the more than $900 billion annual loss of revenue through individual tax expenditures and generate nearly $1.4 trillion in revenues 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 $1.2 trillion over a decade - and substantially lower inequality.[44] 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.[45] There is no valid reason not to tax dividends and capital gains at the same rate as earned income.

Third, raise the effective corporate income tax by eliminating all loopholes. This would generate $1.6 trillion over a decade.[46] Fourth, institute a very small financial transactions tax on stock and derivative sales. A small tax would not materially affect long-term investors, but because trading in these markets is dominated by the massive computerized churning of securities by institutional investors, the tax would generate $1.5 trillion over ten years while cutting financial market gambling substantially.[47] Indeed, if all four of these changes were made,

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[43] Joseph Stiglitz, "Principles and Guidelines for Deficit Reduction," The Roosevelt Institute, Working paper No. 6, December 2, 2010.
[44] US Senate Joint Committee on Taxation, "Background Information on Tax Expenditure Analysis and Historical Survey of Tax Expenditure Estimates," February 28, 2011, p. 25.
[45] Citizens for Tax Justice, "New IRS Data Pegs Cost of Special Low Tax Rates on Capital Gains and Dividends at $92 Billion in 2005 alone," August 10, 2007.
[46] Citizens for Tax Justice, "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," March 9, 2011.
[47] Dean Baker, "The Deficit-Reducing Potential of a Financial Speculation Tax," Center For Economic and Policy Research," Issue Brief, January 2011.

and the cuts in defense spending discussed above were instituted, the effect would be to generate a zero net deficit over the coming decade - not counting interest savings or inflation adjustments. Moreover, Nobel laureate Joseph Stiglitz argues that the government could save $1 trillion over a decade by 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."[48]

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 programs that fund productive government investment and assist the poor, the middle class, the sick and the elderly is a lie.

6. The 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, it cannot contribute to the deficit, all claims to the contrary notwithstanding. The Social Security Trust fund has run surpluses since 1985 that were invested in US Treasury bonds. The claim by right-wing propagandists 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. Yet no one accuses mutual funds who hold US Treasuries of causing our deficit problem.

Social Security is probably the most successful government program ever. The poverty rate among the elderly fell from 35% in 1959 to 9% in 2009 largely because of Social Security.[49] Yet it is not excessively generous. The average annual social security payment to retirees is around $14,000, and more than 75% 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."[50] 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 percent 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%.[51] Yet on average, defined contribution plans and other private savings are totally

[48] Joseph Stiglitz, "Principles and Guidelines for Deficit Reduction," The Roosevelt Institute, Working paper No. 6, December 2, 2010.
[49] See http://www.stateofworkingamerica.org/charts/view/181.
[50] Monique Morrisey, "Beyond 'Normal': Raising the Retirement Age is the Wrong Way to Go," Economic Policy Institute Briefing Paper 287, January 26, 2011.
[51] See http://www.stateofworkingamerica.org/charts/view/191.

inadequate to their task. In 2007, the median value of all retirement accounts for those 55 to 64 years old was about $100,000.[52] As a result of the financial market crash it is probably around $90,000 now. A 5% return on assets worth $90,000 is only $4,500 a year.

The Social Security System is not in crisis. In 2010, the 75 year projected shortfall was estimated to be 0.6% of the cumulative GDP for that period. Even if nothing was done to deal with this shortfall, so that at some point in the intermediate future the combination of the Trust Fund and social security taxes would not be large enough to fund the expected payout levels, future recipients would still receive larger inflation-adjusted Social Security payments that today's recipients because real wages, the source of the payments, rise over time. 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 base their proposal on the fact 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 gained 5 years), and the age for full payment has already been increased by two years.[53] Social Security taxes are regressive in that they 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 that is increased from time to time. If the cap on earnings, now at $107,000, was lifted, so that Social Security taxes were collected on all wages and salaries, 95% of the projected shortfall would be eliminated. 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.[54] The system can be sustained or even improved by a dramatic increase in the cap and a modest increase in the payroll tax. Of course, faster real wage growth would cut the prospective funding shortfall substantially.[55]

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[52] Congressional Research Service, "Retirement Savings and Household Wealth," April 8, 2009.
[53] Monique Morrisey, "Beyond 'Normal': Raising the Retirement Age is the Wrong Way to Go," Economic Policy Institute Briefing Paper 287, January 26, 2011.
[54] Congressional Research Service, "Social Security: Raising or Eliminating the Taxable Earnings Base," September 24, 2010.
[55] In December 2010 the President and Congress enacted a one year reduction of worker contributions to Social Security equal to two percent of earnings. This is expected to cut payments into the Social Security Trust Fund by $112 billion in 2011. The New York Times reported that the President is considering extending this program and

There *is* a long-term crisis brewing in both the publically-funded and privately-funded provision of health care in the US. In 2010, 17.3% of GDP was spent on health care in the US 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 better health outcomes than in the US. In 1970, Canada and the US both paid about 7 percent of GDP for health care. In 2009, Canada spent 6.9% of GDP less than we did, yet had health outcomes as good or better than ours.[56]

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 US would save more than $10 trillion over a decade, ending the Medicare-Medicaid crisis*. If we just adopted a single-payer system based on Medicare, with no other changes, we could save as much as $4 trillion over a decade. According to the Physicians for a National Health Program, "A national single-payer program would save over $400 billion a year on bureaucracy and paperwork alone. Plus it would use proven, effective cost-control techniques like negotiating drug prices and hospital budgets."[57] 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 sum, 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 programs or destroy them through privatization as the right-wing coalition demands. There are alternative solutions that will preserve and improve both programs. We have not seriously considered these solutions because they clash with the goals of the US oligarchy and the right-wing political coalition.

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widening it to include employer contributions, which would double the rate of revenue loss for the Social Security Trust Fund ("Payroll Tax Cut Idea Joins Debt Talks," June 15, 2011). This seems like a peculiar way to deal with a crucial program that is under fiscal duress. The lost revenue, in concert with ongoing labor market weakness, has already led to more pessimistic projections of future program 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 95% estimated last year (Wall Street Journal, “Key Seniors Association Pivots on Benefit Cut,” June 17, 2011). Deliberately draining the Social Security revenue stream obviously aids those who want to weaken the program.

[56] Financial Times, "Healthcare: Transparently Opaque," February 21, 2011.

[57] "Doctors' Group Hails Reintroduction of Medicare for All," CommonDreams.org, February 15, 2011.

7. The Austerity War: Moderate Democrats Push Moderate Austerity While the Right-Wing Coalition Wants to Eliminate, Cripple and/or Privatize Most Government Programs.

The State and Local Government Battle[58]

The austerity war is being fought at both the federal and state and local levels of government. The ferocity of the right-wing attack on New Deal programs is quite evident in the response of conservative state governors to the fiscal crisis.

> Republicans like [Indiana governor] Mr. Daniels aren't simply proposing painful medicine to the US's budget woes. They are promising to hack into programmes that pay for social security and healthcare for the elderly that have become part of the fabric of US life. In doing so, 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. (Financial Times, "Republicans despair in hunt for competitive candidate," May 23, 2011)

Just as is the case with respect to the federal deficit, 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 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.

Between 2007 and 2009, state revenues fell by 13%.[59] Such a steep revenue loss is unprecedented in the post World War II era. State revenues never fell by more than 6% in the post-Clinton recession, and only fell by 2% in the deep recession of the early 1980s. 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 substantially cut corporate taxes in response to the crisis, even in the face of exploding deficits. Even New York's 'liberal' Democratic Governor Andrew Cuomo refused to extend a popular surcharge on the richest 2.8% of taxpayers, which will cost an estimated $1.2 billion in lost revenue in 2012 and $4 billion in

[58] Most of the data in this section comes from R. Pollin and J. Thompson "The Betrayal of Public Workers," The Nation, March 1-14, 2011, and "States broke? Maybe they cut taxes too much," McClatchey Newspapers, March 28, 2011.

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

2013. Governors justify business tax cuts on the grounds that this will help raise business investment. 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. 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. In 2010, federal grants covered about one-third of the gap, but those funds are drying up. Thus, the austerity war is now raging. The deficits are ammunition for right-wing governors and legislators who want to slash government spending to successfully achieve their long-term objectives. States are cutting funds for programs such as health care for the poor, home care for the infirm, and support for education at the elementary, high school and college levels. For example, Arizona cut health care for 280,000 low-income people, and the University of California cut support for higher education back to its 1999 level, even though there are 31% more students in the system now. More than 467,000 state and local jobs have been lost since the official end of the recession in June 2009, including 188,000 jobs in schools. At a similar point after the 2001 recession ended, 249,000 jobs had been added.[60]

The most important austerity targets are public employees and their 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 union ranks, success would help accomplish the long-sought objective of crippling the union movement in America.

A key argument used in support of public-sector union destruction is that it is a necessary condition to achieve state fiscal solvency. This argument was shown to be specious in Wisconsin. The fact that unions offered major concessions on wages and benefits did not prevent

[60] Associated Press, "Usually a Job Engine, Localities Slow US Economy," June 6, 2011.

Governor Walker from pushing a bill through the legislature that was likely to destroy public-sector unions. The destruction of unions is the primary goal.

The biggest long-term fiscal problem, it is argued, is caused by excessive compensation of public employees in the form of salaries, and, especially, health care and pension costs.[61] Ironically, public employees, not Wall Street bankers, are depicted in the 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 under-compensated via salary and over-compensated via benefits. The net result is that, on balance, they earn slightly less than their private-sector counterparts.[62]

There *is* a problem with 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 need faster economic growth under a new national economic model, higher government contributions funded by progressive tax increases (and adding taxes on services as well as on goods, and goods sold over the internet), and some increase in employee contributions collectively bargained. Additional annual fund contributions of about 4% of current state spending would accomplish the goal.[63] Keep in mind that one-third of all state and local government employees are not eligible for Social Security. Public pensions and private saving are all they have to pay for their retirement.

House Republicans Declare All-Out War on the New Deal

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[61] 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.

[62] 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/. Note that although the future of the US economy is said to depend on the efficiency of our educational system relative to those of our global competitors, the right-wing coalition is attempting to make public education a decreasingly attractive career for college graduates.

[63] The rise in security prices since the bottom of the market in early 2009 has moderately reduced the problem of unfunded liabilities. Faster growth and lower unemployment would greatly improve pension fund conditions.

The radical budget proposal from House Budget Committee Chairman Paul Ryan in April 2011 that was subsequently passed by the House demonstrates conclusively that the Republican Party is committed to total victory in the austerity war and to the total destruction of all New Deal programs. The bill calls for nondefense spending cuts of $4.5 trillion dollars over ten years (not counting reduced interest payments). Cuts in low-income programs, at $2.9 trillion, would be almost two-thirds of the total. $2.2 trillion would come from Medicaid and other low-income health care programs. An additional $400 billion would come from unspecified cuts in discretionary programs serving lower income Americans.[64] 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." In other words, spending on many of the most important programs and services provided to the public by the federal government as a percentage of GDP would be cut by 65% by mid-century.

The House bill calls for the privatization of Medicare, letting seniors rely on insurance companies for their health security. The government would give seniors a voucher or grant to help pay for private insurance. The CBO estimates that by 2022, the average annual out-of-pocket cost health care costs would double from $6,150 to $12,500, and *by 2030 the voucher would pay for just one-third of the cost of a Medicare-equivalent private insurance policy*. Large numbers of seniors would be priced out of adequate health care. As Paul Krugman put it: the Republicans “don’t want to make Medicare sustainable, they want to destroy it under the guise of saving it.”[65] 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 percent from its 2010 level; by 2030 it will be 49% lower.[66] Since the right-wing coalition has been trying to kill Social Security since the 1930s, it will be interesting to see what the House eventually proposes to do

[64] Robert Greenstein, "Chairman Ryan Gets Nearly Two-Thirds of His Budget Cuts From Programs For Lower-Income Americans," Center on Budget and Policy Priorities, April 20, 2011.
[65] New York Times, "Vouchercare is not Medicare," June 6, 2011).
[66] Robert Greenstein, "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, April 7,2011.

with this core program. 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.

Now one might agree that this seems like a brutal, regressive and immoral policy - after all most religions teach that society has a special obligation to look after the needs of the poor, but still find comfort in the fact that it would eliminate the deficit problem. However, this position would fail to take into account 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. True to this strategy, the House bill makes all of the Bush tax cuts permanent at an estimated cost of nearly $4 trillion over a decade. In addition, the House budget proposes a series of additional 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 that are left unspecified" in the House budget. Note a single cut is identified. However, as we saw with President Reagan's corporate tax cut in 1986, the lower rates are likely to be permanent and 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% since they are already in tax brackets of 25% or less.[67] 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.

The total revenue loss over a decade is projected to be $4.2 trillion, but since the vague loophole-closing aspects of the bill are unlikely to be adopted, and if adopted are unlikely to survive, the lost revenue could be up to $7 trillion. *At the $7 trillion level the bill would add an additional $2.5 trillion to the cumulative deficit over the next decade, not reduce it*. The House budget proposal would thus slash taxes on corporations and the rich, push the degree of inequality well beyond its late 1920s level, and destroy the economic functions of the federal

[67] Center on Budget and Policy Priorities, "Under House Budget, "Tax Reform" Places Top Priority on High-Income Tax Cuts and Ignores Deficit Reduction," May 26, 2011.

government.[68] The House bill has been surprisingly well received by many respected political and media figures. A common response is that while the bill may have flaws, it is a serious and even courageous effort to confront the deficit disaster. For example, Alan Greenspan, the sage of Wall Street, said: “I like the Ryan budget in all aspects. And I think that essentially that sort of thing is what I would vote for if I were voting” (Wall Street Journal, “Former Fed Chief Greenspan Favors Clinton-Era Tax Rates,” June 4/5, 2011). The Center on Budget and Policy Priorities, on the other hand, 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 unthinkably large spending cuts. As Speaker Ryan insisted: "this isn't a budget. This is a cause."[69] Note again that the right-wing coalition includes a substantial percentage of Democrats. "Many Democrats also have voiced support for lowering tax rates, particularly for corporations."[70]

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.[71] 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.

President Obama Offers Austerity Light

President Obama accepts the need for austerity, accepts the thesis that most of reduction in deficits will have to come from spending cuts, and even accepts the idea that a major tax cut is appropriate in the midst of a deficit crisis serious enough to generate demands for the destruction of most New Deal programs. With severe problems in the job market, a government stimulus program focused on targeted spending projects with large multiplier effects - such as infrastructural investment, green jobs, and transfers to state and local governments - is

[68] In their relentless effort to unburden the rich from tax obligations, the Republicans even removed the surtax on incomes over $250,000 that was part of the health care reform bill. This proposal would save rich households about $400 billion over a decade.
[69] New York Times, "The Budget Battles: Prosperity for Whom?," April 5, 2011.
[70] New York Times, "Tax Plan Aims for Cap," March 17, 2011.
[71] Center on Budget and Policy Priorities, "Statement by Robert Greenspan on Senate Republican Leaders' Proposed Balanced Budget Amendment," March 31, 2011.

appropriate, but major spending cuts and regressive tax cuts are not. Obama spent substantial political capital on a health care reform process that failed to address the major cost problems with the system, such as too much reliance on private insurance companies and out of control drug prices that could have been dealt with through direct government bargaining with drug companies as in Canada. He appointed a bipartisan commission to recommend solutions to the Social Security problem dominated by people who exaggerate the problem, want to substantially cut payments and/or raise the age limit for full coverage, and rule out progressive solutions such as raising the earnings cap dramatically.

The president has proposed a budget that would cut about $4 trillion over 12 years relative to a scenario in which all the Bush tax cuts remain in place. In other words, rather than let the Bush-Obama tax cuts of 2010 expire after 2012 as is now the law, he wants to continue the tax cuts for everyone, but apply the lower rates only to the first $250,000 of household income. However, there is no reason to cut tax rates below those that existed under the Clinton presidency, and every reason for a progressive or even a moderate Democrat to raise rates on incomes above a few hundred thousand dollars, with rapidly rising rates for higher income levels, in order to raise more revenue and reduce our absurd level of inequality. 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 $250,000 cap will save a trillion dollars, but keeping the rest of the tax cuts will cost several trillion dollars in lost tax revenue, making the pressure to cut spending even stronger. The president proposes unspecified spending cuts of $2 trillion, which will have to have a substantial impact on important spending programs that had no role in creating the current deficit crisis. For example, Obama has frozen federal workers' pay for five years, even though their pay played no role in deficit creation. Federal workers are simply sacrificial lambs in a political immorality play. The president intends to make two dollars in spending cuts for every one dollar in tax increases. Add $1 trillion in interest saving and you end up with a $4 trillion cumulative decline in the deficit, but only relative to the insane policy of retaining all the Bush tax cuts that *were* a major cause of the deficit problem.

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 kick in to force compliance with the limit. In the absence of new tax cuts, the most likely event to set off the trigger would be a new recession, which would be made worse by the effects of the automatic tax hikes and spending cuts on aggregate demand. The trigger could turn a modest downturn into a severe recession. Second, if Medicare spending grows faster than per capita income growth plus .05% per year, automatic cuts to the program 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.[72]

If you want to look at the glass half-full, you might take comfort in the fact that Obama proposes only a further erosion of New Deal programs while the Republicans want to destroy them. But there is no comfort to be taken in the fact that President Obama: is making the deficit worse through unnecessary tax cuts; has no believable plan to end our many wars in the near future;[73] was an obstacle to serious reregulation of our financial system; is willing to go part of the way with the Republicans on shrinking the general social safety net; is open to substantial cuts in Social Security and Medicare, and has refused to support the only adequate reform of our health care system. What the American people need at this dangerous conjuncture is a progressive Democratic Party led by a fighter - a new FDR - who will help organize and lead a vigorous counter-attack 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 oligarchic funders, and a president who seems quite comfortable in his current position as the Great Compromiser.[74]

8. Concluding Comments.

It is only eleven years since the CBO projected the total elimination of federal government debt in less than a decade, yet we now confront a projected debt to GDP ratio in

[72] For an analysis of Obama's proposals, see the Wall Street Journal, “Obama Stokes Deficit Fight,” April 14, 2011, and the New York Times, “Obama Urges Cuts and Taxes on the Rich,” April 13, 2011.
[73] In addition to Iraq and Afghanistan, the US is engaged in serious military operations in Pakistan, Yemen and Libya.
[74] This not to deny that there are many courageous progressive Representatives and even some Senators in the Democratic Party. Unfortunately, they are a minority with little power.

excess of 95% by 2021 (assuming the Bush-Obama tax cuts remain in place), compared to 26% when Reagan took office and less than 33% in 2001, when George W. Bush became president. The facts are clear. The spike in debt over the last decade was caused by exceptionally slow growth, large regressive tax cuts, several wars of choice, a severe economic downturn triggered by a deregulated financial system, and attempts to minimize the damage from that downturn and financial collapse through government stimulus programs. Yet, turning reality on its head, both political parties agree that the crisis was caused by a long-standing demand by the American people for more government services than they were willing to pay for.

Both parties seem to agree that serious tax increases are off the table and spending cuts must bear the brunt of austerity policy. President Obama wants very large tax cuts relative to the Clinton era. The Republicans want to enact regressive tax cuts that will cost at least $4.2 trillion over a decade, but could be as large as $7 trillion, and make severe cuts to the social safety net focused on low income families, including the privatization and funding-privation of Medicare. The parties thus agree that we should cut spending on the social safety net while simultaneously raising the pressure for more spending cuts through tax rate reductions. Austerity mania prevails even as the rates of unemployment and under-employment remain at semi-depression levels. As of April 2011, the unemployment rate was 9.0%, the employment to population ratio was 5.4 percentage points below 2001, and the percentage of long-term unemployed, which was 11.8% in 2001, was 43.4%.[75] The Bureau of Labor Statistics' broadest measure of "labor underutilization," which includes the unemployed, those who work part-time but need full-time jobs, and those who have dropped out of the labor force, was 15.8% in May 2011

Thus, the long-run battle to restore the 'natural' order of our economy and society as it existed in the 1920s could be entering its final 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 late 1920s, government spending on the poor and middle class is under unprecedented assault, and corporations and the

[75] Even recent college graduates have been hard hit: only 56% of the graduating class of 2010 have found employment; starting salaries are down 10%, and only half the jobs of those who have found work require a college degree (New York Times, "Many with New College Degree Find the Job Market Humbling" May 18, 2001).

very rich again control politics.[76] 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 'liberal' papers such as the New York Times generally follow the more 'responsible' austerity story adopted by President Obama and the Democrats, while influential cable outlets like Fox News, along with right-wing talk radio and conservative newspapers such as the New York Post relentlessly transmit 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.

It is possible to be cautiously optimistic about the current political moment. The last time the right-wing economic model was dominant was in the 1920s, and it took the disaster of the Great Depression to set in motion a political process that replaced it with the nascent social democracy of the New Deal. The economic catastrophe of the early 1930s made it clear that the then-current political and economic system was such a disaster for most Americans that it had to be replaced by a new model focused on the well being of the majority, not the economic elite.

We have not yet experienced a disaster of equivalent magnitude, primarily because of government intervention to prevent it. Nevertheless, most Americans face stagnant real incomes, a disastrous labor market, precarious retirement prospects, and the threat of a severe retrenchment in government programs that are crucial to their health and welfare. This dismal economic reality has generated anger with the current economic and political situation that is a potential spur to progressive political action. Polls consistently show that, while many Americans support a limit on federal debt as well as generic or unspecified cuts in government spending, a majority also supports higher taxes on corporations and the rich, and opposes specific spending cuts in Social Security, Medicare, Medicaid and other government programs 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.

[76] Their degree of control was substantially augmented by the recent Supreme Court decision in the Citizens United case.

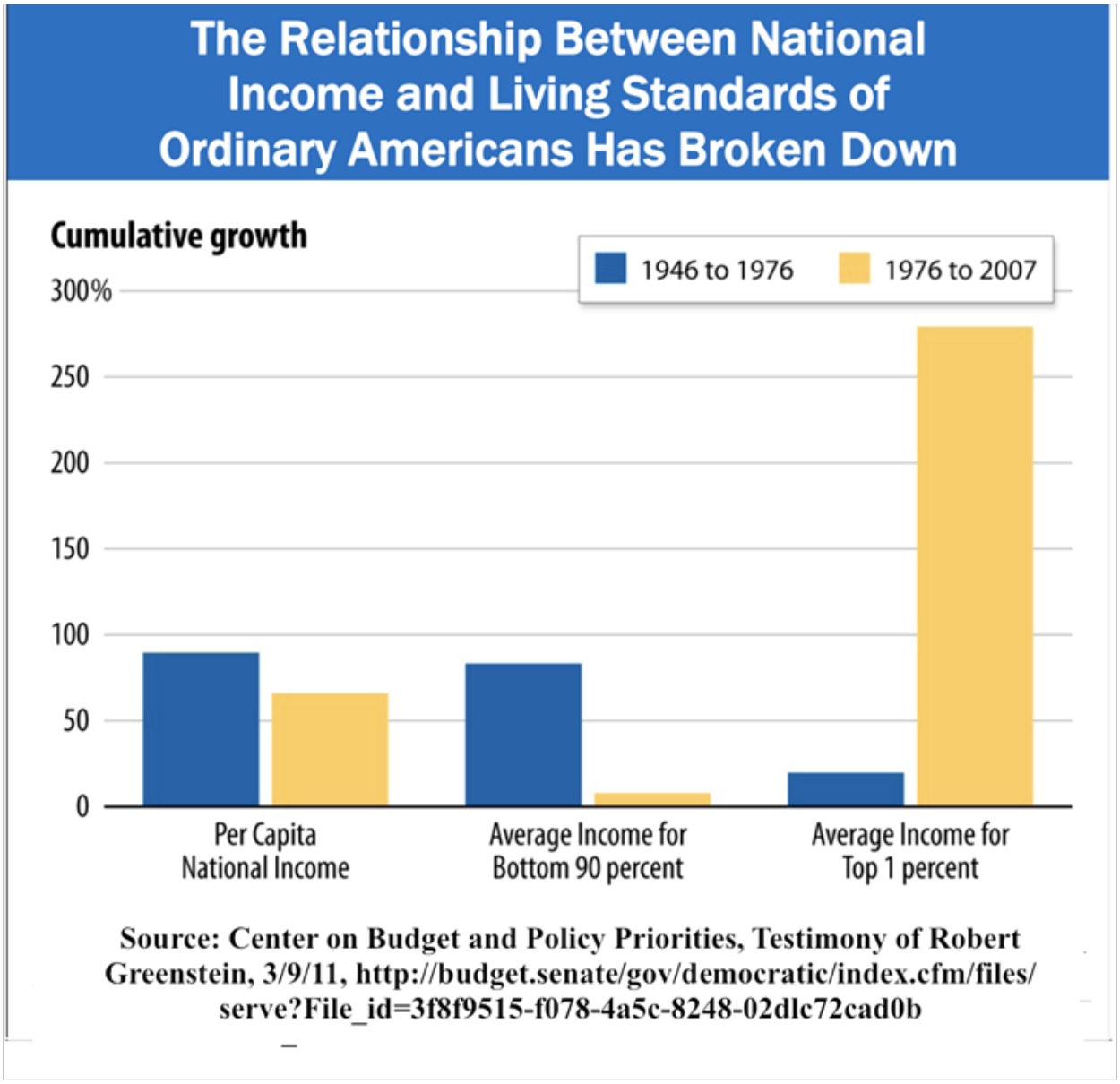
Moreover, the extreme right-wing policies of the past few years have frightened many Americans. In response, large numbers of people have been willing to participate in various forms of political resistance. As mentioned above, George W. Bush's proposal to privatize Social Security initiated a powerful backlash so strong that he had to back down. More recently, there has been such widespread opposition to the House bill to privatize Medicare that many Republicans fear their party will suffer in upcoming elections. Equally important, large numbers of Americans have engaged in organized political resistance to vicious attacks on public workers and large cuts to social programs of all kinds in states governed by right-wing governors and legislatures. The surprisingly strong and well-organized resistance to the radical conservative policies of Governor Scott Walker in Wisconsin has received the most media attention, but similar movements have occurred in other states as well. These resistance movements have received strong support from the general public as reflected in polls. In addition to organizing opposition to the policies of these governments, fight-back groups have initiated recall movements against several governors and numerous state legislators that are thought to have a reasonable prospect of success.

Unfortunately, the right-wing coalition has been so successful over recent decades that the long-run challenges facing the country today are daunting. 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, one 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 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.

However, 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, Iceland and Spain. As mentioned in the Introduction, the class-based austerity war is global in scope, but so are the struggles against austerity. Success in the fight to defeat the short-run and intermediate-

run attacks may well be achievable, and this success could lay the groundwork for victory in the longer-run struggle.

FIGURE 1



Source: Center on Budget and Policy Priorities, Testimony of Robert Greenstein, 3/9/11, http://budget.senate/gov/democratic/index.cfm/files/serve?File_id=3f8f9515-f078-4a5c-8248-02dlc72cad0b

FIGURE 2

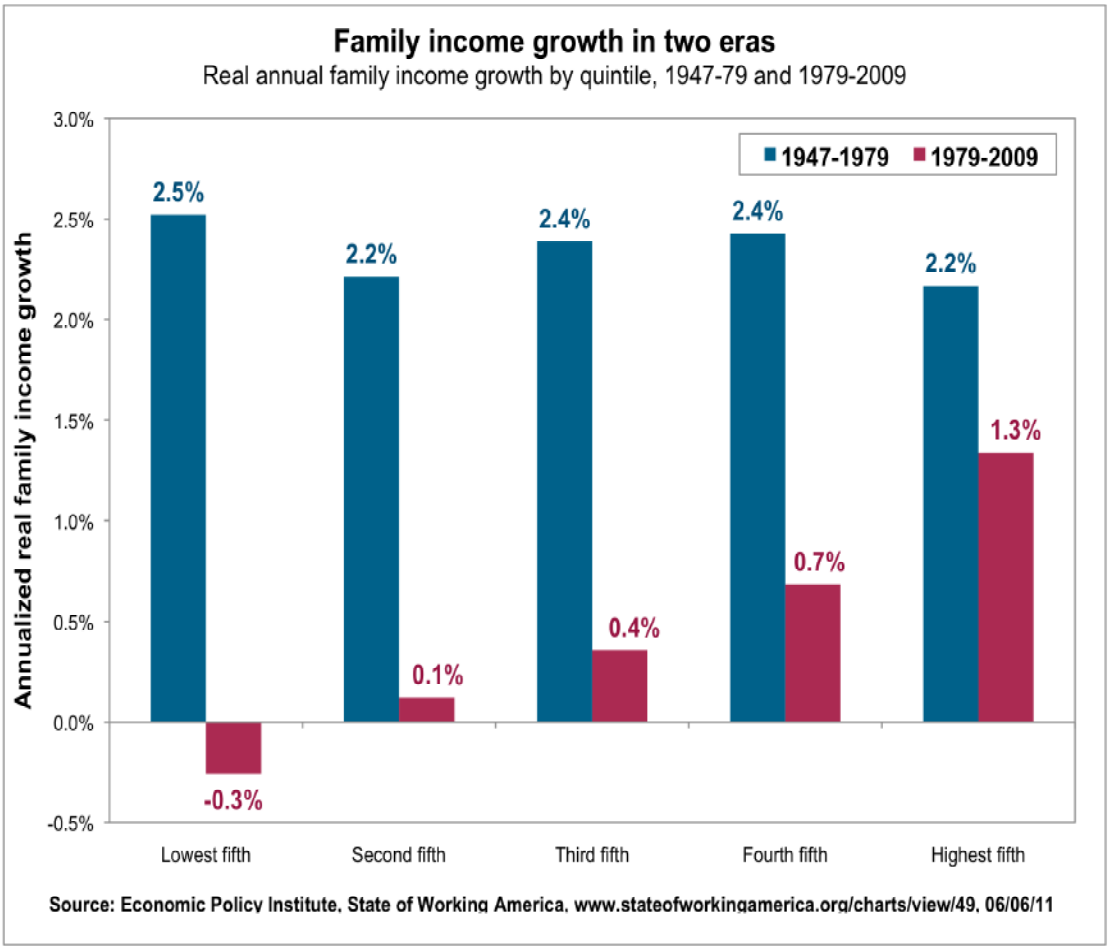

Family income growth in two eras
Real annual family income growth by quintile, 1947-79 and 1979-2009
1947-1979
1979-2009
Annualized real family income growth
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
-0.5%
2.5%
-0.3%
2.2%
0.1%
2.4%
0.4%
2.4%
0.7%
2.2%
1.3%
Lowest fifth
Second fifth
Third fifth
Fourth fifth
Highest fifth
Source: Economic Policy Institute, State of Working America, www.stateofworkingamerica.org/charts/view/49, 06/06/11

FIGURE 3

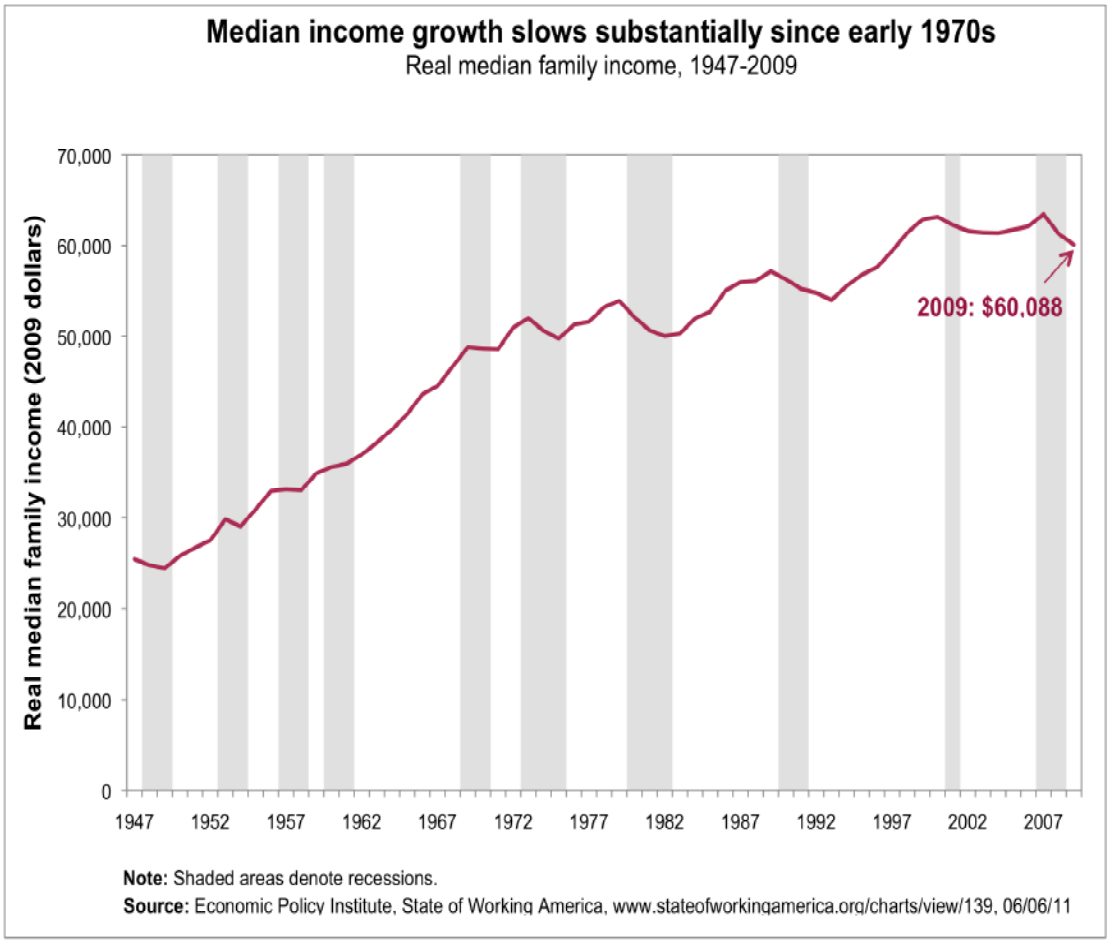

Median income growth slows substantially since early 1970s
Real median family income, 1947-2009
Real median family income (2009 dollars)
70,000
60,000
50,000
40,000
30,000
20,000
10,000
0
1947
1952
1957
1962
1967
1972
1977
1982
1987
1992
1997
2002
2007
2009: $60,088
Note: Shaded areas denote recessions.
Source: Economic Policy Institute, State of Working America, www.stateofworkingamerica.org/charts/view/139, 06/06/11

FIGURE 4

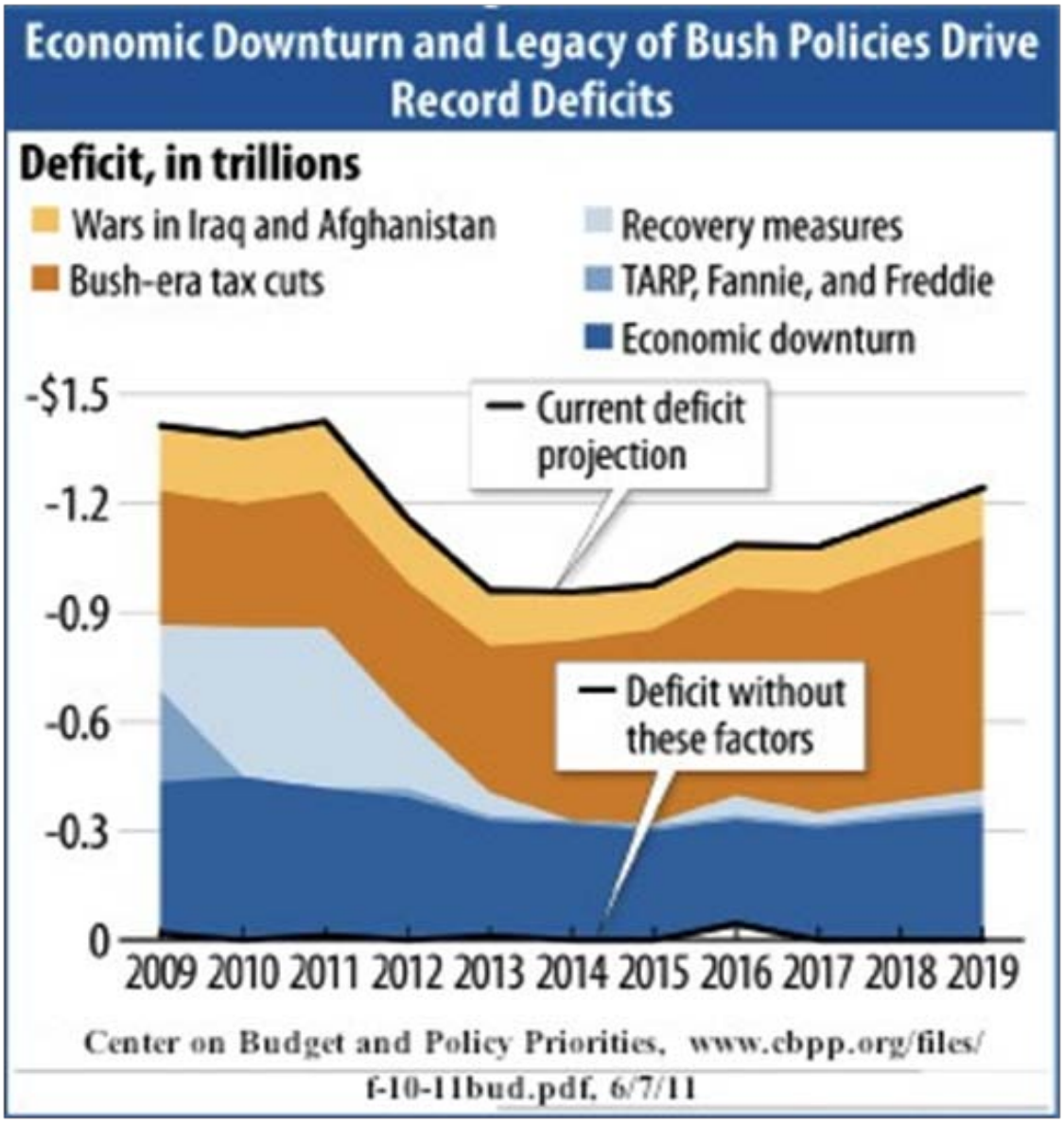
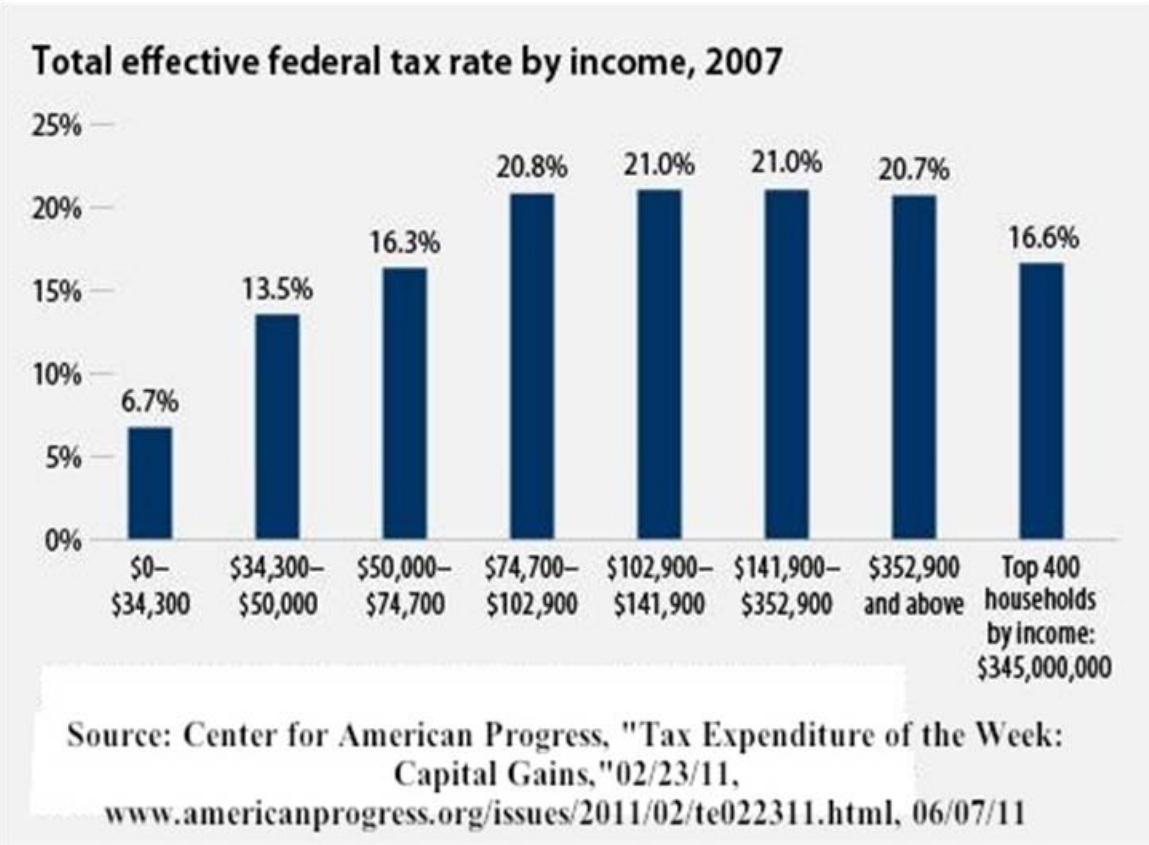

Economic Downturn and Legacy of Bush Policies Drive Record Deficits
Deficit, in trillions
Wars in Iraq and Afghanistan
Bush-era tax cuts
Recovery measures
TARP, Fannie, and Freddie
Economic downturn
-$1.5
-1.2
-0.9
-0.6
-0.3
0
Current deficit projection
Deficit without these factors
2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019
Center on Budget and Policy Priorities, www.cbpp.org/files/f-10-11bud.pdf, 6/7/11

FIGURE 5



Source: Center for American Progress, "Tax Expenditure of the Week: Capital Gains,"02/23/11, www.americanprogress.org/issues/2011/02/te022311.html, 06/07/11

FIGURE 6