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The Political Economy of Austerity in the United States

IN THE FACE OF FAILED ECONOMIC PERFORMANCE AND intellectual disarray, it is surprising that austerity continues to have such an influence on economic thinking and policies. This article traces the history of austerity policies in the United States, seeking to account for the power that such ideas continue to have. Austerity policies are slowing the economy and preventing necessary public investments that can help support future economic growth. Understanding the continuing power of these ideas and policies is one part of creating a better informed policy debate, and advocating for policies that can help restore economic growth and promote social equality.

In the spring of 2013, policy analysts and scholars calling for macroeconomic austerity were on the defensive. In Europe, austerity policies in the European Union were contributing to a second Eurozone recession and political turmoil in many member states. The United Kingdom, where austerity budgeting has been a cornerstone of the Conservative–Liberal Democratic alliance, was suffering its fifth year of substandard economic performance (Chorley 2013). Economic forecasts for the entire zone, and for specific countries, held little promise that austerity would encourage future growth.

In the United States, austerity advocates were in similar disarray. While the US economy was growing, the pace of growth, and especially of job creation, was very slow. May's employment report showed a tepid job growth of 175,000; at that level, some economists were estimating it would take six years to get back to the prerecession unemployment rate. Economic slowness was widely attributed to reductions in federal spending stemming from federal budget cuts enacted under a bipartisan sequestration agreement, which the Congressional Budget Office estimated would take a full percentage point off of GDP growth in 2013.

The intellectual foundations of austerity also were crumbling. This occurred most dramatically with the discrediting of a cornerstone of austerity advocates—the work of Harvard economists Carmen Reinhart and Kenneth Rogoff (2010), who had claimed that going over a 90 percent debt-to-GDP ratio would be a tipping point that could damage the US economy for decades (Coburn 2012, 29–32). Economists at the University of Massachusetts at Amherst found computational errors and questionable analytic design in this research, concluding that "contrary to Reinhart-Rogoff, average GDP growth at public debt/GDP ratios over 90 percent is not dramatically different than when debt/GDP ratios are lower" (Herndon et al. 2013), with countries over the 90 percent level still showing positive growth. The combination of bad economic performance and discredited intellectual support led *New York Times* columnist and Nobel Laureate in economics Paul Krugman to declare that the evidence, both analytic and from economic performance, had left austerity advocates defeated in an "epic rout" (Krugman 2013a).

Given the practical policy failures and intellectual reversals of austerity, with a recently re-elected Democratic president facing continuing economic weakness and inadequate job growth, the budget proposals put forward by the Obama administration for the new fiscal year might have been expected to emphasize economic stimulus, job creation, and a clear rejection of austerity policies. But instead, while calling for some new spending programs, the Obama budget called for another "balanced" $1.8 trillion in deficit reduction, including cuts in Social Security and Medicare (Office of Management and Budget 2013, 6). Progressive organizations reacted negatively to the budget, with some accusing President Barack Obama of "fracturing the Democratic Party" with the entitlement proposals (Kaplan 2013).

To understand how austerity continues to dominate the policy debate, it is important first to understand how the current debt was generated—mostly under the policies of Republican presidents. This seems like a paradox, as Republicans often are the most strident advocates of austerity policies. But a closer examination of how Republican ideas on the economy and debt have evolved shows that their economic ideology is aimed more at attacking the size of government, and that they have been willing, sometimes even advocating, growth in the national debt in order to cripple the government's long-term ability to expand social programs.

WHERE DID THE CURRENT DEBT COME FROM?

In December 2000, as President Bill Clinton prepared to leave office after his second term, a startling announcement was made: the United States was running budget surpluses, not deficits, and the administration projected that the entire outstanding debt of the United States could be paid off by fiscal year (FY) 2009.[1] When Clinton took office, the FY1992 budget deficit was $290 billion; budget projections in that year forecast continuing deficits (and accumulating debt), with a projected deficit in FY2001 alone of $513 billion. Instead, the budget forecast as Clinton left office was for a surplus of $256 billion, the fourth annual surplus in a row.[2]

How did this turnaround occur? Some pointed to a deficit reduction bill passed shortly after Clinton took office,[3] which used a combination of spending reductions and tax increases to set overall net federal spending on a slower growth path. But most analysts give the primary credit to economic growth after 1996, which produced a combination of higher tax revenues and lower government spending on automatic stabilizers such as unemployment insurance. Lower deficits also meant less government borrowing, which lowered net interest costs as a budget component. As the economy grew, the higher marginal tax rates that the 1993 budget bill created generated more revenue than had been forecast, while not slowing economic growth (Kliesen and Thornton 2001).

At this point, the biggest worry about the national debt was that there wasn't going to be any. In fact, conservatives viewed the prospect of ongoing budget surpluses and a potential end to US government debt as a political threat. Federal Reserve Chairman Alan Greenspan, while saying that paying off all federal debt would be "highly desirable," worried about what would happen if the government continued to run budget surpluses. True to his conservative roots, Greenspan feared that ongoing budget surpluses would eventually mean the federal government would accumulate private assets through investing the surplus. Greenspan testified to Congress, warning that such accumulation was undesirable

> because it would be exceptionally difficult to insulate the government's investment decisions from political pressures. Thus, over time, having the federal government hold significant amounts of private assets would risk suboptimal performance by our capital markets, diminished economic efficiency, and lower overall standards of living (Greenspan 2001).

But when Greenspan testified in January 2001, Bill Clinton no longer was president. Instead, Republican George W. Bush had taken office in a very close and bitterly contested election in which the Supreme Court stopped vote counting in Florida, effectively giving Bush the victory even though he trailed in the popular vote nationally.

Bush took office when the economy was clearly slowing, and the economic slowdown plus the projected budget surpluses, combined with long-standing policy positions held by Republicans (discussed in more detail below), led him to propose very large tax cuts, on the order of $1.6 trillion over 10 years, heavily tilted to wealthier taxpayers through lower marginal rates, sharp reductions in the estate tax, and changes in contributing to tax-qualified retirement plans.[4] Greenspan at first was dubious about the size of the cuts, but eventually supported them, giving their legislative prospects a major boost.[5]

Table 1: Component Sources of Federal Deficit, 2009–2019 (estimated)

Bush-era tax cuts	41%
Economic downturn (lost revenue)	25%
ARRA (stimulus)	9%
Other recovery measures	7%
War costs	9%
TARP, Fannie, Freddie	2%

Note: Analysis based on CBO data, debt service costs associated with each component are included in totals
Source: Ruffing and Friedman 2013

The Bush tax cuts were, and remain, the single largest contributor to the reversal of the debt's downward glide path under Clinton. Table 1 shows analyses and projections for contributions to the federal deficit from FY2009 through FY2019.

Even now the Bush-era tax cuts are the source of over 40 percent of annual deficits, and therefore to the long-term buildup of federal debt. Although all the tax cuts were set to expire at the end of 2012, the Obama administration eventually negotiated a deal with congressional Republicans preserving the vast majority of the cuts, which resulted in their continuing impact of future deficits and debt accumulation.[6] The new tax provisions kept 82 percent of the Bush-era tax cuts, or $2.77 billion of the total $3.4 billion (Huang 2013).

The second biggest contribution to America's future deficits, and therefore continuing debt accumulation, stems from the economic downturn—the "Great Recession"—that began in December 2007. Recessions, of course, add to government deficits, through the loss of tax revenue from declining economic activity and from automatic stabilizers kicking in (Ghilarducci et al. 2012). Stabilizers are designed to partially offset diminished private sector demand, so the economy does not fall into depression. These factors, also paid for by borrowing, account for 25 percent of the cumulative deficit between FY2009 and FY2019. Stimulus spending to fight the recession adds another

9 percent to the overall deficit, and other measures to aid recovery account for an additional 7 percent.

But the tax cuts and recession were not the only sources of the growing deficit and debt during the Bush presidency and after. Under Bush, the United States entered two wars after the 9/11 terrorist attack, first in Afghanistan and then in Iraq. Between FY2002 and FY2009, direct spending on these two wars amounted to $1.47 billion, and was financed by borrowing, as the tax cuts had severely reduced the revenue coming to the government. Some analysts compute the cost of the wars as much higher, by adding the borrowing costs to the total; using this procedure, Stiglitz and Blimes (2008) estimated the total cost of the war at closer to $3 billion.[7] Although many direct war costs have now largely ended, they still have an impact on deficits and the debt going forward, through interest and principal payments on money borrowed to pay for the wars.

Another factor that has received much attention, but in fact adds little to future deficits, comes from costs associated with bank bailouts and the collapse of the housing bubble in 2008. Table 1 shows these costs as "TARP, Fannie, and Freddie," referring to the Troubled Asset Relief Program (TARP) that absorbed much of the financial damage from banks' exposure to bad investments based on the real estate bubble and on the complex financial engineering that banks engaged in during that bubble. Some of these costs spilled over to two government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, that supported the securitization market for housing debt. Although these financial failures, especially by the banks, took a severe toll on the overall economy and made the recession much deeper and harder to cure, their direct budgetary impact is modest. Much of the harm done by the failure of the financial sector shows up not in the federal budget, but in the direct economic costs of the recession, which was severely amplified by the banking sector crisis.

THE FINANCIAL CRISIS, THE GREAT RECESSION, AND RESISTANCE TO KEYNESIAN ECONOMICS

So the combination of continuing the Bush tax cuts, the costs of the recession, and two unpaid wars are driving America's future deficits and debt. Austerity advocates are wrong when they claim the Obama administration went on a government spending binge, driving up debt to unsustainable levels and adding significantly to the size and cost of government. In 2012, Republican presidential candidate Mitt Romney described Obama's policies as a "debt and spending inferno," and similar language is used nearly daily by Republicans and others who call for austerity (Barbaro 2012).

But the increase in deficits and the growth in overall debt were driven significantly by the Great Recession. The financial crisis that brought the economy almost to a halt in late 2008 both amplified and was itself amplified by the slowing economy. Many banks had significant financial exposure to the mortgage market, especially through securitized instruments, highly leveraged positions, and a false confidence that their risks were hedged by insurance that turned out to be wholly inadequate to cover their positions.

The roots of the crisis were laid down in the late 1990s and in the 2000s as banks increasingly made exotic mortgage loans with little or no attention to underwriting standards. Instead of holding these mortgages on their own accounts, banks increasingly sold them to investment houses that "securitized" the loans by slicing them into ever more exotic instruments supposedly evaluated at different risk levels. This allowed partial payments from a single mortgage to be allocated across many different bonds simultaneously. Never highly regulated to begin with, these instruments became more attractive to banks themselves when the US Treasury Department in 2002 reduced the size of capital reserves needed to back these securities. Banks increased their leverage, borrowing money and using such securities as reserves (Financial Crisis Inquiry Commission 2011).

Many of the exotic securities were rated as highly creditworthy by the private rating agencies that evaluate debt for investors. These firms compete for business with each other, and this competition put pressure on them to give high ratings to many securities, as they feared the loss of business to competitor firms. The ratings turned out to have little relationship to the real value of the securities; by some estimates, over 90 percent of AAA ratings given to such bonds in 2006 were later downgraded to the level of junk bonds (Ashcraft and Schuermann 2008, table 31).

The rapid spread of exotic financial instruments, combined with highly misleading ratings, meant that banks literally did not understand their own financial positions. As the economy slowed, the highly leveraged positions of financial firms became untenable because they did not have the cash to pay back money they had borrowed. Many sold assets to raise cash, but as each one sold into a declining market, prices dropped further and more calls for repayment came in, accelerating the downward spiral.

The September 2008 bankruptcy of Lehman Brothers shook the financial markets and the economy to the core. By the end of 2008, the Dow Jones stock average suffered four of its eight largest single-day declines since the Great Depression. As the ripple effects spread and uncertainty grew, lending by banks virtually dried up as they were unwilling to lend when their own financial positions were uncertain (Financial Crisis Inquiry Commission 2011). The lack of credit brought corporate and private investment to a standstill, freezing economic activity for small businesses and households.

The collapse of the private credit market was the main vehicle for the financial crisis crossing over into the real economy and spurred the government to act through TARP in the last months of the Bush administration. President Obama inherited this battered financial sector and a real economy where demand, output, and employment were plummeting. Real GDP was falling at around a 6 percent annual rate and the economy lost 779,000 jobs in January 2009, the worst month in what turned out to be an annual job loss of 4.7 million, 3.5 percent of all jobs and the largest percentage loss of employment since 1945 at the end of World War II (Barker and Hadi 2010).

Faced with this collapsing economy, the Obama administration, officials at the Federal Reserve, and many private economists called for a large stimulus program, following the lessons taught by Keynesian economics in response to the Great Depression. The investment bank

Goldman Sachs called in December 2008 for an immediate $600 billion stimulus and argued that it would need to be in place for several years, saying that the bank “could justify stimulus totaling $2 trillion” given the economy’s weakness (Pethokoukis 2009). Christina Roemer, the designated nominee to head the Council of Economic Advisers for the incoming Obama administration, had a similar recommendation totaling $1.8 billion, but this amount was rejected by Obama adviser Larry Summers, who argued that such a large amount would never be enacted by Congress. The amount recommended to the president-elect ultimately was less than half that amount, between $600 and $850 billion (Scheiber 2012).

But getting congressional approval for even that amount of stimulus turned out to be extraordinarily difficult. While many of Obama’s economic advisers were Keynesians who accepted the need for a massive stimulus (Summers’ objection to the larger amounts were more political than economic), many economists came out against stimulus, especially on such a large scale. Much of economics since the 1980s argued against any possible positive effect for government stimulus, arguing through the model of “rational expectations” that increased government spending would be offset as workers and businesses adjusted their future ideas about the economy and changed their behavior accordingly. (For example, in this view stimulus spending would depress private savings and investment because businesses and households would assume corresponding tax increases in the future, and adjust their spending downward.) Thus a stimulus could have at best a temporary effect, and not change the permanent growth path of the economy, which would revert to a “natural” rate of unemployment and output.

The rational expectations approach to macroeconomics had come to dominate much of academic analysis since the 1970s. In 2011, Thomas Sargent’s winning of the Nobel Prize in economics represented the latest in a series of awards given to an economist associated with this line of analysis and policy recommendations.[8] The hostility of this school to Keynesian economics is well-known. As early as 1980 Robert

Lucas (a Nobel laureate in 1995) was expressing contempt for Keynesian approaches, saying that it was hard to find “good, under forty economists who identify themselves or their work as Keynesian . . . [;] at research seminars, people don’t take Keynesian theorizing seriously anymore; the audience starts to . . . giggle” (Lucas 1980). In 2009 (as the economy was in free fall), John Cochrane of the University of Chicago’s business school said about Keynesian analysis and stimulus proposals, “It’s not part of what anybody has taught graduate students since the 1960s. . . . [Keynesian approaches] are fairy tales that have been proved false. It is very comforting in times of stress to go back to the fairy tales we heard as children but it doesn’t make them less false” (Staley and McKee 2009).

OPPOSITION TO DEFICIT SPENDING AND THE GROWTH OF GOVERNMENT: “STARVING THE BEAST”

The Republican Party and affiliated think tanks and organizations brought these conservative macroeconomists into the stimulus debate. John Cochrane and 2004 Nobel laureate Edward Prescott were some of the over 200 economists who signed a full-page ad sponsored by the conservative and libertarian Cato Institute (2009) against the stimulus. Appearing in the January 29, 2009 edition of the *New York Times*, the ad said that

> Notwithstanding reports that all economists are now Keynesians and that we all support a big increase in the burden of government, we the undersigned do not believe that more government spending is a way to improve economic performance. More government spending by Hoover and Roosevelt did not pull the United States economy out of the Great Depression in the 1930s. More government spending did not solve Japan’s “lost decade” in the 1990s. As such, it is a triumph of hope over experience to believe that more government spending will help the U.S. today. To improve the economy, policymakers should focus

> on reforms that remove impediments to work, saving, investment and production. Lower tax rates and a reduction in the burden of government are the best ways of using fiscal policy to boost growth.

But although these economists' views were compatible with Republican political positions, the vehemence and popularity of anti-stimulus and anti-government views were driven more by other beliefs and ideas. Opposition to significant increases in the size and scope of government, whether deficit spending or regulation, has been a hallmark of the modern Republican Party. A hallmark of that opposition has been a focus on the size of the federal deficit and the need to bring it down through austerity measures, for both economic and political purposes.

The political roots of this view go back to the presidential campaign of Barry Goldwater in 1964 against President Lyndon Johnson. Goldwater was a strong advocate of limited government, states' rights, and lower taxes. He called for the federal government "to withdraw from a whole series of programs that are outside its constitutional mandate—from social welfare programs, education, public power, agriculture, public housing, urban renewal" (Goldwater 1960, 53). He was anti-union and opposed mandatory Social Security participation, speculating about ending the program all together. After being crushed by Johnson in the election, he lost influence over his party but set the stage for conservative intellectuals and political operatives, along with a cluster of fringe figures associated with anti-Communism, conspiracy theories about international finance, and opposition to civil rights laws, to build toward a takeover of the Republicans (Perlstein 2001).

There was (and remains) a kind of dualism in the Republican Party, combining intellectually-based analyses and critique of American liberalism with a long-standing streak in American political culture that holds a highly conspiratorial view of politics. This is what Richard Hofstadter in the 1950s called the "paranoid style," invoking conspiracies between elites and the poorest clients of the welfare state, squeezing out the freedoms of those in between (Hofstadter 1965). Originally allied in the post–World War II period with the political attacks exemplified by McCarthyism, this conspiratorial frame of mind remains a major feature of today's Republicanism in the "Tea Party" (Zernike 2010) and media commentators like Glenn Beck and Rush Limbaugh.

Goldwater gave political voice to the idea that a growing federal government was not only economically inefficient but, more important, was a threat to American freedoms. In an attempt to calm views of Goldwater as an extremist, Milton Friedman, in the *New York Times Magazine,* tried to legitimate Goldwater's economic ideas, linking them to the larger threat to freedom posed by a growing federal government:

> Throughout history, the great enemy of freedom has been concentrated power—private or governmental. If freedom is to be secure, power must be limited and it must be dispersed. The most effective way simultaneously to disperse private power and to limit governmental power is to rely primarily on voluntary exchange through a free market—competitive capitalism—to organize economic activity (Friedman 1964).

Goldwater's devastating loss in 1964 (38.5 percent of the vote, winning only six states and 52 electoral votes) was followed by Richard Nixon's remarkable 1968 turnaround victory. Although Nixon profited enormously from the disaffection of whites due to Democratic support of the civil rights movement,[9] Nixon himself was not a committed small government advocate. Among other big government steps, he implemented wage and price controls and took America off of the gold standard, saying "we are all Keynesians now" (Perlstein 2008),[10] and expanded federal government power, through such steps as creating the Environmental Protection Agency by executive order.

The real victory of smaller government ideology (at least rhetorically) came with Ronald Reagan's 1980 presidential election victory. Reagan had been an important figure on the conservative right since his days as a spokesman for General Electric in the 1950s, when he traveled the country giving a stock speech on business, economics, and freedom. This eventually morphed into Reagan's 1964 nationally televised speech in support of Goldwater, during which Reagan drew a line opposing "those who would trade our freedom for the soup kitchen of the welfare state," linking the fight against an expanding welfare state to the international fight against Soviet Communism (Reagan 1964).[11] Reagan became the new leader of Republican conservatism, winning election as governor of California and almost beating Nixon for the 1968 presidential nomination.

Reagan took office after one-term Democrat Jimmy Carter, at a time of "stagflation," high inflation with slow economic growth, driven by high oil and commodity prices. Fighting an inflation rate that reached 13.5 percent, the Federal Reserve under then-Chairman Paul Volcker drove interest rates to 20 percent, inducing a sharp recession that cut economic demand and inflation. Reagan took a strong anti-union line, firing over 11,000 striking air traffic controllers in August 1981 and banning them from further federal employment. And he routinely rhetorically attacked federal government spending and programs. His macroeconomic ideas relied a good deal on the fringe ideas of Arthur Laffer, an economist who argued that cutting tax rates would actually increase government revenue through their effect on stimulating economic growth.

Conservative economists advocated tax cuts in part to control the size of the federal government and less as a theory of economic growth. In 1978, Milton Friedman said that anti-deficit conservatives were "concentrating on the wrong thing, the deficit, instead of the right thing, total government spending" with the result that "fiscal conservatives have been the unwitting handmaidens of the big spenders" (Friedman 1978, 11). Friedman and others believed that cutting revenues would eventually force the government to slow spending because government bond markets would make additional borrowing too costly.

But in practice, the Republicans could not reconcile their desire to cut taxes with the continuing popularity of many government spending programs. Taxes were cut under Reagan (primarily in a bargain with a Democratic Congress), but spending was not, with the result that federal debt rose from 26.1 percent of GDP in 1980 to 41 percent by the time Reagan left office. A split emerged between Republicans who wanted to cut the debt and those who wanted to cut taxes; Reagan's successor, George H. W. Bush became a one-term president in part because he accepted tax increases to reduce deficits, making a deal with Democrats after Republicans in Congress refused to accept any tax increases. The political message was clear—reducing deficits through revenue increases was not a winning position.

Buttressed by theorists like James Buchanan, whose work on public choice economics earned him a Nobel Prize in 1986, conservative economists began to focus on tax cuts as the way to control government spending. These ideas remained in uneasy intellectual alliance with supply-side economics, something that many conservative academic economists never believed, but the two ideas together—both of them supporting tax cuts, but for different reasons—gave the Republicans a consistent policy platform. A gradual intellectual inversion had taken place—as Bruce Bartlett notes, "Instead of being viewed as the height of fiscal irresponsibility, cutting taxes without any corresponding effort to cut spending was now seen as the epitome of conservative fiscal policy" (Bartlett 2007, 9).

The formation in 1985 of Americans for Tax Reform (ATR), headed by conservative activist Grover Norquist, staked out what seemed at the time a very extreme position—as currently stated, ATR's mission statement "opposes all tax increases as a matter of principle." ATR called on elected officials and candidates to sign a pledge saying they would never raise taxes, no matter what the circumstances. Over time, Norquist's position would become the dominant one in the Republican Party and provide much of the political support for austerity policies. ATR and Norquist became associated with the catchphrase "starve the beast," which meant starving the government of revenues in the belief that this was the only way to slow spending. They were in tension with supply-side economists who emphasized the (alleged) economic growth effects of tax cuts, and who downplayed the importance of deficits. Both factions emphasized cutting taxes, but for very distinct policy purposes.[12]

PEROT, CLINTON, AND GINGRICH: THE VANISHING DEBT AND DEFICIT AND GOVERNMENT DEADLOCK

The next wave of national attention to deficits and debt came from a third party movement in the 1992 election, represented by Ross Perot, an eccentric Texas billionaire who focused on rising US debt and exploited the dissatisfaction with George H. W. Bush's acceptance of tax increases. Perot didn't announce his candidacy until February 1992 but by June he led the three-way race in some national polls, topping both Bush and Democrat Bill Clinton. Perot concentrated his attention on opposing the North American Free Trade Agreement (NAFTA), on the rising federal debt and its threats to the economy, and on generalized critiques of corruption in Washington, arguing that the two main parties had been captured by lobbyists and special interests. Although his erratic behavior drove his poll numbers down, he recovered somewhat to get 18.9 percent of the popular vote (but no electoral votes). His calls for a balanced budget amendment to the Constitution were a mainstay of his campaign, and he linked high federal debt to trade imbalances and economic decline.

Bill Clinton took office with only 43 percent of the popular vote but with Democratic control of Congress. Pressure from the Perot campaign and from political elites led Clinton to emphasize deficit reduction over expanded social spending, as yields on 10-year US Treasury bonds rose from 5.2 percent in October 1993 to 8 percent in November 1994. Clinton's economic advisers, led by former Goldman Sachs cochairman Robert Rubin, convinced him to reduce spending plans promised during the campaign, in part because Federal Reserve Chairman Alan Greenspan was putting on pressure for deficit reduction.[13]

Clinton's deficit reduction program included significant tax rate increases, raising the top marginal rate to 39.6 percent, along with increased gasoline taxes, an uncapping of the payroll tax for Medicare, and increased taxation of Social Security benefits. By now, the anti-tax position of the Republican Party had solidified, and Clinton's plan was passed with no Republican votes in the House or Senate; some Democratic senators also voted against the bill, leaving Vice President Al Gore to break a tie vote to ensure passage.

The Republicans had now united around the twin goals of reducing federal deficits and no new taxes. They also wanted to protect or increase defense spending, meaning that their plan for deficit reduction effectively had to come from entitlements, principally Medicare, Medicaid, Social Security, and from other domestic nondefense spending. The congressional atmosphere was highly polarized—as freshman Representative Marjorie Margolies-Mervinsky (D-PA) came forward in the House to cast the decisive vote in favor (reversing her vote at Clinton's request), Republicans lined the House chamber and jeered "bye-bye Marjorie," alluding to their planned use of the pro-tax vote against Democrats in the midterm elections.

This polarization represented tactics led by Newt Gingrich (R-GA), an aggressive conservative who had decided that Republican congressional leadership was too accommodating and bipartisan. He argued that the route for Republican majorities in Congress was to disrupt and polarize the House. Gingrich launched aggressive ethics investigations against senior Democrats and distributed talking points to members, calling on them to use terms like "radical," "sick," and "traitors" when describing Democrats. Gingrich adopted the anti-tax stance of Norquist's Americans for Tax Reform and built those ideas into the "Contract with America" (along with fierce attacks on Clinton's proposed health care reforms).

Republicans scored a historic victory in the midterm elections of 1994, with a swing of 54 votes and a Republican takeover of the House for the first time in 40 years. (Margolies-Mervinsky was indeed one of the Democrats voted out of office.) The anti-tax and anti-government positions of the Republican right were now firmly at the center of their political agenda. The Contract with America called for a balanced budget amendment to the Constitution, capital gains tax cuts, a freeze on all new federal regulations, and cuts in welfare programs.

The Republicans, emboldened by their legislative victory, forced a showdown with the Clinton administration over the 1995 budget, making austerity the centerpiece. After Clinton refused to make deep cuts in Medicare, Medicaid, and nondefense spending, Gingrich pulled out a new weapon—refusal to raise the federal debt ceiling.

Aside from Denmark, the United States is one of the only countries that legally requires a separate vote by the legislature to raise the debt ceiling—the total amount the country can borrow. Because taking a separate vote to borrow more money is politically costly, the Democrats in 1979 adopted the "Gephardt Rule," saying that when a final budget was enacted, the debt ceiling was "deemed" automatically raised to cover the authorized spending. Between March 1962 and the budget crisis of 1995, the debt limit was raised 77 times, with the Gephardt Rule operating after 1979.

Failing to raise the borrowing limit has potentially dramatic consequences for the value of US debt and overall economic health, as it raises the specter of default, which would cause higher interest rates. Many analysts assumed that the limit would always be raised because of these negative effects, but newly elected House Speaker Gingrich removed the Gephardt Rule and then threatened not to raise the debt ceiling if Clinton would not adopt his budget proposals. The debt limit was combined with other budget demands by Republicans and Clinton called their bluff, shutting down parts of the government in November 1995 and reserving some revenues for essential services and to keep paying interest on the debt. Clinton's position won in public opinion polls and Republicans agreed to restart the government, then compromising on the debt limit in January 1996 when financial markets weakened and they were threatened with blame for that by business and financial interests.

THE POLITICS OF POLARIZATION

The polarization of the 1990s continued in later years, with Republicans digging in on refusing tax increases while successfully pushing for deep tax cuts when they won the presidency under George W. Bush in 2002, and attempting to radically change entitlement programs through a failed attempt to privatize Social Security. (As we have seen, those tax cuts were, and remain, the major source of America's debt problem.) Barack Obama sought to stimulate the economy when he took office during the Great Recession, but also adopted positions agreeing that significant changes would be needed to get long-term debt under control.

In 2010, in order to signal his commitment to long-term debt reduction and also to get political credibility on the debt issue, Obama created the National Commission on Fiscal Responsibility and Reform, better known as the Bowles-Simpson Commission after its cochairs, Democrat Erskine Bowles (former chief of staff to President Bill Clinton) and former Senator Alan Simpson (R-WY). Both men were well-known advocates of deficit and debt reduction.

Although appointing a commission is often thought of as a way to dodge political decision-making, Obama was using this bipartisan commission (whose membership was dominated by people who had a public commitment to deep debt reductions) to signal his interest in significant debt reduction. (The Senate had failed to enact legislation to create a similar commission earlier in the year.)

The commission worked to find an agreement acceptable to its required supermajority of 14 of the 18 members, which would then go to Congress for a single up or down vote, but it became clear that an agreement was unlikely. Liberal members fought to protect Social Security and Medicare, while Republican members refused to consider significant, or sometimes any, revenue, in any proposal. In November, Bowles and Simpson released their own "chairman's draft" proposal, hoping to generate public opinion that would push the commission to an affirmative vote.

The draft proposal had approximately two dollars in spending cuts for every dollar in new revenues, and also went very broadly into tax policy, calling for deep cuts in tax expenditures for home mortgages and health care, an increase in the Social Security retirement age, along with sharp reductions in high-income personal income tax and corporate tax rates. The proposal was widely criticized by progressives, who wanted to protect Social Security, disagreed with the ratio of spending cuts to tax increases, and saw no reason for the proposal's emphasis on cutting tax rates for wealthy taxpayers.

The final package was tilted to spending cuts over revenue increases, with some of those revenue increases coming from cuts in the home mortgage and health care deductions. But Republicans on the commission, led by incoming House Budget Chairman Paul Ryan (R-WI), voted against the plan, both because of proposed new revenues and because it accepted the new health care law—"Obamacare"—as a basis for controlling rising health care costs. For all the talk of a bipartisan deal, Republican opposition to taxes and health care reform meant they would not agree. (Progressive House Democrats on the commission also voted against the package, while other Democratic members supported it, but if Ryan and the two other conservative House Republicans had voted in favor, the package would have been approved.)

Obama continued to call for a long-term deal on debt reduction, sometimes termed the "Grand Bargain" by Washington insiders. Some advocates for such a bargain explicitly aimed at revising the federal tax code into such a negotiation, raising the stakes even higher. And while debt-reduction advocates continued emphasizing economic arguments, other elite commentators emphasized that ongoing high debt would hurt America's leadership in foreign economic and security policy, saying that high debt would cause "profound consequences, not just for Americans' standard of living but also for US foreign policy and the coming era of international relations" (Altman and Haass 2010).

But although there was (and remains) strong elite opinion in favor of significant debt reduction, overall public opinion presented a more complex picture. In April 2011, Gallup reported a poll where 17 percent of Americans ranked the federal budget as the "most important problem" facing the country, the highest ranking for the budget since the question was first asked in 2001. But Gallup pointed out that the poll was conducted during the final negotiations that avoided a government shutdown, so the budget issue was dominating news and commentary at that time, which might have amplified the results (Jones 2011).

Other polling noted a difference between overall concerns about the budget problem and people's willingness to endorse solutions to it. In 2011, polling by the Pew Research Center for the People and the Press found a split between those who wanted the deficit cut (49 percent) and those who wanted spending increased to help economic recovery (46 percent), a division that was similar to 2009. But when asked which programs should be cut, the only 1 of 18 categories to get a plurality in support was "aid to world's needy"; for the other 17 categories, the polling showed support for stable or increased spending. Democrats and young people were in favor of more spending, while Republicans and older people were more cautious (Pew Research Center for the People and the Press 2011).

The debt was one of the key issues in the 2012 presidential primaries and campaign for the eventual Republican nominee Mitt Romney, whose campaign embodied Republican orthodoxy. Romney, like other Republican candidates, pledged not to raise any taxes, and he refused to consider a deficit reduction deal even if it had 10 dollars in spending cuts for every dollar in tax increases. He also endorsed a version of supply side economics that claimed it was possible to get "even more revenue for the government with lower [income tax] rates" (Romney 2012). This combination of absolutely no tax increases, coupled with proposals to cut taxes for businesses and high-income taxpayers while reducing social spending, is now Republican orthodoxy.

Right after Obama's victory, another in a series of showdowns over spending occurred, with the so-called fiscal cliff at the end of 2012. In 2010, a short-term compromise extended the Bush-era tax cuts for two years, but they were all set to expire at the end of 2012.[14] Other tax provisions, including extended unemployment insurance and Social Security payroll tax cuts, also were ending.

In addition, significant budget cuts would go into place in January 2013, resulting from another short-term step Congress took in 2011 during a protracted battle over raising the debt ceiling. To accommodate Republicans and keep the United States from defaulting on its debt, Congress gave itself until the end of 2012 to agree on $1.2 trillion in budget cuts. If they could not reach an agreement, cuts would come from nondiscretionary spending (both domestic and military) through an automatic budget process—"sequestration." This highly unusual move was considered by most analysts to be nothing more than a device to force serious budget negotiations. Most commentators felt Congress would never actually let the sequester take place, and the agreement was again criticized by progressives who argued that Obama had given up too many spending cuts in order to get the debt ceiling increase.

But at the end of December 2012, no agreement on alternative cuts had been reached, so the sequester was set to kick in, adding to pressures on the weak economy. Republicans eventually allowed a debt ceiling increase until May 2013, and Obama accepted most of the Bush-era tax cuts. But the sequester, derided as a gimmick when passed, actually went into effect on March 1 after last-ditch attempts to negotiate some other package of cuts failed. Republicans continued to hold two positions in these negotiations—no new taxes and sharp reductions in spending, especially for entitlement programs. And by only offering a short-term extension of the debt limit, they all but guaranteed another crisis when the limit was reached.

PROSPECTS FOR THE FUTURE

Another in a series of seemingly endless budget confrontations will occur as a result of the expiration of the debt ceiling extension in May 2013, although faster economic growth and some administrative steps by the Treasury Department made it likely the limit would not actually be reached until the fall. But Republicans, especially in the House, signaled their appetite for another budget battle, using the debt ceiling expiration as leverage. This is in spite of repeated admonitions from large businesses and the banking sector that even threatening default on the debt would have serious negative impacts; this shows how tightly the combination of no taxes plus major cuts in entitlements has gripped the Republican Party.

House Republicans passed a bill in May 2013 that would in effect allow the debt ceiling to expire, prioritizing US payments on the debt to pay bondholders first and then Social Security recipients next (Weisman 2013). While many analysts feel the bill was unworkable and probably not legal, it signaled that the threat of overall US default is having less and less impact on a significant part of the Republican Party. Warnings of the potential catastrophe posed by default have been shrugged off by some Republican leaders, with Senator Tom Coburn (R-OK) saying default might be "a wonderful experiment" (Koba 2013). And instead of the sequestration cuts forcing a budget compromise, House Republicans have adopted the overall sequestration spending level as their new budget ceiling. But rather than spreading the cuts equally between defense and domestic spending, they advocate a budget that would raise defense spending by over 5 percent, producing even deeper cuts in nondefense spending.

There is a major contradiction between the intellectual and economic analysis case for austerity and the politics and actual policies the United States is adopting. The intellectual and analytic case has been collapsing. The discovery of computational errors and dubious research designs has falsified the Reinhardt-Rogoff claim that a 90 percent debt-to-GDP ratio will substantially slow growth. An International Monetary Fund report undercut analyses that supported austerity-driven growth, saying "the idea that fiscal austerity triggers faster growth in the short term finds little support in the data" and noting that if all countries simultaneously engage in austerity, often accompanied by currency depreciation and slower domestic growth in each, "simultaneous fiscal consolidation by many countries is likely to be particularly costly." The IMF recently estimated that current US austerity measures will cost between 1.25 and 1.75 percent of GDP in 2013 (International Monetary Fund 2013).

But in fiscal policy, the battle is between continuing budget cuts combined with some tax increases over the medium and longer term, as proposed by the Obama administration, and more radical spending cuts with no revenue increase (and proposed tax cuts) advocated by Republicans. For the next several years, there are four main policy options facing Washington.

1. Increase Revenues and Social Spending

Progressives have been arguing the case for an alternative budget approach, and providing the details and analysis to support it. The House Progressive Caucus issued a "People's Budget" that included cuts in defense spending, increases in social and infrastructure spending (front-loaded to help stimulate the economy faster), calling for more aggressive cost control in health care, and strengthening Social Security. The proposal included new revenues, including expiration of most of the Bush tax cuts, taxing capital gains as ordinary income, higher taxes on the wealthy (including a reformed estate tax), and taxes on the financial sector (including a modest tax on financial transactions.) The Economic Policy Institute analyzed the proposal, finding that it would stimulate faster economic growth while producing a budget surplus in 2021, with the debt-to-GDP ratio stabilized at 64 percent (Fieldhouse 2011).

There is a good deal of economic analysis that supports this approach to budgeting. Thomas Piketty and Emanuel Saez have conducted a series of analyses showing that much higher marginal tax rates (over 50 percent, and perhaps as high as 70 to 90 percent) can be applied to top-income earners without hurting economic growth (Piketty et al. 2011). A financial transactions tax of 3 cents on every dollar traded could raise $352 billion over 10 years (Eisinger 2013). And several economists have made the case for borrowing now to fix degrading infrastructure, when borrowing costs are at a low point, rather than waiting until interest rates rise (Boushay 2011; Summers 2013).

But the political deadlock in Washington makes such progressive plans very unlikely. Rather than pushing for more public investment and higher taxes on financial markets and the wealthy, the Obama administration is negotiating with congressional Republicans about further cuts in spending, even though there is over $2.3 trillion in spending cuts already enacted for the next decade.

2. Cut Taxes, Entitlements, and Social Spending

In spite of the intellectual weakness of austerity, Republicans continue to push for further spending cuts without any new taxes or revenues to pay for them. House Republicans have adopted the sequester's overall spending caps as permanent, limiting total spending going forward. But they are shifting the cuts to nondefense spending.

The budget proposed by House Budget Chairman Paul Ryan and on track to be enacted, would cut spending for nondefense discretionary programs by over $1 trillion over the next 10 years—the lowest percentage of GDP since 1962, the first time those data were gathered. This would hit every nondefense function—including tax collection, environmental protection, education, scientific research, and public safety (Freidman 2013).

Combined with the Republicans' virtually universal position against any revenue increases, these budget proposals set the stage for intense battles in the coming years. They most likely will reach a head when the debt limit is about to expire, as that is a time when something must be enacted or the United States will face default. But there also will likely be continuing threats of, and sometimes actual, government shutdowns as spending authorizations expire.

3. A "Grand Bargain"—Reviving Bowles-Simpson

Some commentators continue to call for a "grand bargain" along the lines of the Bowles-Simpson proposals (*Washington Post* 2013). Increasingly, these proposals for a debt and budget plan are coupled with calls to revise the federal tax code. But the original Bowles-Simpson proposal broke down on three dimensions, and none of those factors have changed. In Bowles-Simpson, Republicans refused to accept two dollars in spending cuts for one dollar in revenues, and they have since taken a much harder line, rejecting even hypothetical proposals that had ten dollars in spending cuts for every dollar of new revenue. They also refused to accept "Obamacare" as the basis for controlling health care spending under Bowles-Simpson, since they are committed to repealing it. (Since taking control of the House, by

June 2013 Republicans had voted 37 times to repeal some parts or all of "Obamacare.") Some Democrats in turn refused Social Security cuts, although the Obama administration has offered them as part of trying to restart budget negotiations.

Proposals to rewrite the federal tax code would throw Washington into a lobbying frenzy, but it is very hard to see any basis for a final deal as long as Republicans refuse to consider any proposals that would raise revenues. Elite commentators will no doubt keep calling for a "Grand Bargain," but their ability to move this idea in the current policy debate is very limited.

4. Muddling Through

Given the extreme deadlock on budget and fiscal issues (along with virtually everything else facing Congress), there is little prospect of any major fiscal policy change. But deficits, and therefore debt-to-GDP ratios, are forecast to drop more rapidly than anticipated as already enacted spending cuts kick in and the economy grows (albeit more slowly than it should.) Health care costs may begin to moderate (there is some promising early evidence that Obamacare is having an impact, although some of the drop in health spending is also tied to slow economic growth.)

In May 2013, the Congressional Budget Office estimated that the annual deficit in 2013 will be 4 percent of GDP, down from 10.1 percent in 2009, and on track to fall to 2.1 percent in 2015. It would then rise to 3.5 percent in 2023 as baby boomers retire and increased associated costs kick in (Congressional Budget Office 2013). That level compares to an annual average deficit of 3.1 percent between 1973 and 2013, leading some analysts to argue that the budget and debt problem is largely solved and requires no more significant cuts.

However, simply holding down deficits and debt-to-GDP ratios is not enough to restore America's economic health, and it will not support the necessary investments needed for healthy and equitable future growth. Increased public investment is needed to get the economy back on a higher growth path and to provide the infrastructure, education, environmental, health care, and research needed to address the nation's structural problems. But national politics gives little hope of reaching a consensus on new spending, much less on holding to our current levels. Some analysts fear that the United States is accepting high unemployment and slow growth as "the new normal," where the deadlock in economic policy means prolonged growth below potential GDP, leading to trillions of dollars in lost output and millions of lost jobs (Delong and Summers 2012).

Although austerity advocates may have lost the intellectual battle, in the United States they have won the war, or at least achieved a stalemate. It is difficult to identify political forces that can gather enough power to reverse American austerity. If the greatest economic crisis since the Great Depression could only produce an inadequate stimulus package and continuing policy gridlock, it is hard to see what could shake things up, short of a major depression or other crisis. And given the continuing political strength of austerity advocates, policies in such a crisis might in fact turn toward austerity (at least for lower- and middle-income people), not away from it. Analysts who can show the failures of austerity and outline alternative policies to restore equitable prosperity must continue to put their ideas forward, but it is likely to be a long battle.

NOTES

1. Of course, reducing cumulative outstanding debt takes years of annual budget surpluses without deficits, as each annual deficit adds to the total outstanding debt due to borrowing and the need to pay future principal and interest.
2. The White House press release of the forecast noted, without irony at the time, that the "last time the United States had four surpluses in a row was over 70 years ago, during 1927–30," the years immediately preceding the Great Depression (The White House 2000).
3. The Omnibus Budget Reconciliation Act of 1993 (OBRA93), which passed Congress without a single Republican vote, due to their objections over tax increases.

4. A subsequent tax bill in 2003 lowered taxes on investment income, with benefits again concentrated significantly on wealthy taxpayers.
5. Passage of the tax bill required a provision that the entire law "sunset" 10 years after enactment in order to evade Senate budget rules that prevented significant additions to the long-term deficit. This provision set the stage for the "sequester" battle under President Obama.
6. The agreement on preserving the cuts was fueled by an Obama campaign pledge to preserve them for taxpayers under $250,000 annual income, and the continuing weakness of the economy. The resulting deal only raised tax rates for those with over $450,000 in taxable income, and simply restored the top rate under Clinton, on a smaller base.
7. The authors also include the long-term medical costs for injured veterans, restocking costs for military hardware, and other associated costs.
8. The others include Milton Friedman (1976), Robert Lucas (1995), Robert Mundell (1999), Edward Prescott (with Finn E. Kydland, 2004), Edmund Phelps (2006), and Thomas Sargent (with Christopher A. Sims, 2011).
9. In 1968, George Wallace, the breakaway Democratic segregationist governor of Alabama, ran on a third party ticket for president, winning 9.9 million votes and carrying five Southern states with 46 electoral votes.
10. Nixon did get in a possibly anti-Semitic shot in announcing the gold standard decision, saying it was necessary to "protect the dollar from the attacks of international money speculators" (Perlstein 2008, 602)—although the decision was prompted by Great Britain's attempt to cash in $3 billion for 40 tons of gold from US reserves in the face of a stagnating economy.
11. Reagan regularly used supercharged rhetoric in policy debates. In a speech often quoted by Republicans admirers, he lamented government policies where the result would be that "one of these days we are going to spend our sunset years telling our children and our children's children, what it once was like in America when men were

free" (Reagan 1964). It was a speech against the proposed Medicare legislation.

12. Although this article concentrates on economic ideas, the American conservative movement has a much broader scope, especially in its focus on opposition to federal power, civil rights and anti-discrimination laws; favoring gun rights, arguments against environmental and economic regulation, and a religiously dominated drive against abortion and reproductive choice. One of the major elements of conservative success in recent years has been uniting these previously fragmented ideas and groups under a general anti-government banner (Brinkley 1994).
13. As his spending plans were frustrated, Clinton reportedly lashed out in a meeting, saying "You mean to tell me that the success of the economic program and my re-election hinges on the Federal Reserve and a bunch of f***ing bond traders?" (Woodward 1994)
14. When passed in 2002, the estimated lost revenue losses were limited to 10 years to circumvent Congress's own rules about not adding to long-term deficits. Most Republicans, and many Democrats, thought at the time this 10-year limit was a fiction because they assumed future Congresses wouldn't allow such large tax cuts to expire.

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