

Federal Debt: Who Ran up the Bill? Who'll Pay It?¹

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ABSTRACT

The current debate about deficit and debt is a major diversion from discussing their real sources. These include a recession driven by financial speculation and fraud from which only profits, not working people, have recovered; a bloated military budget and mission; a costly, mostly private, healthcare system, which at much greater expense than the rest of the industrial world, now excludes 50 million people and produces poorer health outcomes; a tax burden, personal and corporate, at the low end of rich countries generally; and an economic strategy based on globalization which has created the most economically unequal income and wealth distribution since the high-flying 1920's, as well as slower growth, inadequate job creation, minimal wage improvements and greater international indebtedness.

We must change this destructive, corporatist global strategy. The alternative is one that aims to create decent jobs for all who want one and at the same time, produce goods and services that we need, like environmental cleanup, efficient and renewable energy sources, infrastructure repair, and a variety of social services like childcare. This route not only will raise the standard of living of ordinary people, but is far less costly than unemployment.

If we let the corporate and financial sectors, and the politicians in both parties they fund, carry out their plan, we will lose what is left of our social welfare protections and turn over major public assets to private hands for their profit. Social Security and Medicare are probably the most lucrative targets, but there are others, like public education, water systems and buildings. The aim of this paper is to collect the evidence that will help public understanding and stir a counterattack.

Politicians and political commentators have managed the alchemy of converting our economic problems, like recession and health-care costs, into their symptoms, a debt/deficit problem. They describe it as driven largely by entitlements and other profligate social welfare spending. And so dangerous that the problem must be addressed immediately, regardless of its consequences to an economy in recession. Some even propose that cutting public spending is just what the economy needs to grow.²

This paper first defines the issue, summarizes these views and critiques them, and then proposes an alternative description of current conditions, which are far more serious than mere Federal debt. The debt issue will be *politically* difficult, especially as the Bush tax cuts were extended until just after the [2012] election, and will add over \$5 trillion dollars to the projected 10-year deficit, including interest on the added debt, if they are made permanent.³ This burden has been added with hardly a peep from those so worried about the debt, like the Deficit Commission, created by the Obama Administration.

First, let's define federal deficits and debt. Government has a deficit when it spends more than it collects in revenues--which are mostly taxes. The deficit is the amount by which spending exceeds revenues over any time period, usually a year. Deficits thus require government borrowing to bridge the gap. That borrowing is debt, measured at a point in time. If the years of deficits are not offset by years of surpluses, then debt rises. The debt amounted by May 2012 to \$11.0 trillion in publicly-held debt. It has tripled from \$3.5 trillion in 2000. This excludes debt held by government agencies, like the Social Security Administration and the Federal Reserve. If this debt were included, as it often incorrectly is,⁴ then debt is nearly \$16 trillion.⁵

Those who say the government's budget is just like yours—that both are obliged to balance--are wrong on two major counts:

1. *Neither* is obliged to balance. Households borrow, for example, to buy a house or pay for college, preferably not to finance gambling or living expenses.

2. Federal financing is utterly unlike yours: the government not only has the power to tax, but that of creating money. Your family has neither the power to decide unilaterally what income you should receive nor to print money if income falls short. If you do it, it's counterfeiting; when the Federal Reserve does it by its legal authority, it's monetary policy. [President Obama made this error in a weekly address: "Government has to start living within its means, just like families do. We have to cut the spending we can't afford so we can put the economy on sounder footing, and give our businesses the confidence they need to grow and create jobs."⁶]

Given this financial inferiority of families, let's look at [comparative debt](#) by economic sector. The width of the colored bands in the graph measures the debt of each sector relative to output. Household and financial sector debt both are far larger than Federal debt. So why do politicians and pundits worry primarily about public debt, which has contributed to our modest recovery, but not about household debt, which is holding it back by limiting consumer spending? Many families are still in serious financial trouble, with depleted savings, outstanding loans, and weak housing prices. Additionally, many face unemployment or are re-employed at jobs with lower wages than the ones they lost. Their limited spending makes putting people back to work unprofitable for many firms. A Federal Reserve survey found that between 2007 and 2010, median family income declined nearly 8%, and median net nearly worth 39%.⁷

Deficit hawks believe that our [historically high Federal debt](#) as a fraction of our total national output, called gross domestic product [GDP], is unsustainable. [In the first quarter of 2012, the ratio of publicly-held debt to output was about 70 percent.]⁸ The Baseline Scenario [see previous link] projected by the Congressional Budget Office [CBO] primarily assumes the Bush tax cuts lapse, and the new healthcare law goes into effect. Under this scenario, the debt ratio levels off in a few years, and begins declining. The major assumptions of the Alternative Fiscal Scenario on the same graph are that the Bush tax cuts continue and that changes in the healthcare law designed to constrain costs do not. Under the latter scenario, the CBO projects that the debt ratio quickly reaches 109 percent of output, the historical peak, in 2026 and then rises indefinitely, reaching 200% by 2027.⁹

Some commentators compare our situation to Greece and Italy today.¹⁰ This comparison is false. The debt of Greece and Italy is in euros, which those countries cannot issue or depreciate. To get euros to pay interest on their debt or to pay it off, indebted countries in the euro system *must* borrow or improve their trade balance. If they could depreciate their currency, which means to reduce its price, they could get the money they need: foreigners would buy more of their goods, and residents would buy fewer foreign goods. Otherwise, they must earn more euros by reducing their costs--mostly wages--to improve competitiveness. That lack of power over their currency is what constrains their economic policy and leaves them prey to creditors. The US debt is in dollars; the US government can issue what it needs, so default would be the result of irrational policy, like proposals to freeze our debt limit. Further, the dollar is a world currency. Others, both governments and the private sector, keep dollars as reserves and assets.

But many commentators are worried. At some point, they believe, even before the date at which the ratio of debt to GDP rises above 100%, currency markets will force a change in fiscal

policy by betting against the dollar, driving down its value. How would private investors and foreign governments do this? By selling their dollar holdings. They would be reassured only by our slashing our deficits and pushing up interest rates. Instead of our choosing to move toward budget balance, a precipitously falling dollar would require achieving balance immediately, that is, an austerity policy, sparing no category of Federal spending, it is said, as well as requiring higher taxes.

Higher interest rates would slow growth and worsen the debt problem as tax revenues lag. Large Federal borrowing would take over the private capital needed to finance investment, and thus reduce the American standard of living.¹¹ Global financial markets would be roiled, and foreign governments able to exploit US crisis.¹² Some lament that US response to international crisis would be limited. “There will be fewer resources available to undertake wars of choice along the lines of Iraq and what has become a war of choice in Afghanistan.”¹³ [Those “wars of choice,” which have pushed up military spending even as tax rates were reduced, are a significant part of the problem.]

The solution? The co-chairs of the Deficit Commission propose to reduce deficits by nearly \$4 trillion through 2020. Their plan is “sharply reduce tax rates,” both individual and corporate, supplemented by reduction of loopholes; cap revenue at 21 percent of GDP, and reduce spending below 22 percent. Nearly 70 percent of their remedy is spending cuts; in contrast, 31 percent is tax and other revenue increases. They propose to “ensure lasting Social Security solvency.”¹⁴ However, they erroneously report “the program is spending more on beneficiaries than it is collecting in revenue.”¹⁵ Their remedy? A series of cuts to Social Security: raise the retirement age; raise taxable earnings; and cut benefits, beginning the transition in 2017 for all future recipients with applicable average lifetime earnings above \$15,000. This would turn an inadequate retirement program into an inadequate anti-poverty program for the elderly.¹⁶

HOW DID WE GET HERE? The question is, why do we have deficits that will continue even when the economy recovers? Keynesians are treated these days as deficit-happy, but the architect of recession-policy, the British economist, John Maynard Keynes, believed that the government budget should be in balance at full employment.

A bipartisan explanation¹⁷ comes from the President of the Council on Foreign Relations, Richard N. Haass and his co-author, Roger C. Altman, who have been officials of the Bush 2 and Clinton Administrations, respectively. To summarize, Haass and Altman point to the recent origin of our current indebtedness—in fact, the last 10 years. According to them, our fiscal

conservatism, except during WW II, was destroyed by a move toward greater political partisanship. The biggest impact was the 2001 and 2003 tax cuts; the prescription-drug benefit added a huge cost, as did the wars in Iraq and Afghanistan.

In Congress, the Democratic center of gravity moved left, and the Republican one moved right. This caused the historically bipartisan support for fiscal restraint to vanish. In particular, both the individuals and groups working to lower taxes and those working to expand entitlements were strengthened. These anti-tax and pro-spending forces joined with President George W. Bush to terminate the strict budget rules of the 1990s.¹⁸

This ignores history. The [debt in this graph](#) is gross rather than only that held by the public, but the conclusion would not be changed if it were publicly-held debt. Note that debt ratios were falling or roughly constant, except for World Wars I and II and the Depression, regardless of which party governed, until the Reagan Administration, then the Bushes, followed by the Obama Administration. The financial crisis caused a recession, which reduced federal tax receipts, and expanded spending, like unemployment insurance.

Regardless of party, the debt burden declined or was stable after WW II until the Reagan Administration, contracted again with Clinton, and rose again with Bush 2 and Obama. Reagan's contribution to the debt was even greater than Bush 2's. It is difficult to measure the Obama Administration's direct contribution to the \$4.7 trillion addition to the publicly-held debt during the last 3½ years.¹⁹ He came to office with two wars, the Bush tax cuts, and the recession. However, he added \$100 billion to military spending, extended the Bush tax cuts for two years, and put together a poorly designed stimulus.

The big postwar debt increases began, then, with Reagan, justified by the conservative supply-side fallacy that tax cuts always pay for themselves with higher tax revenues from enhanced growth. Clearly, it is not Democratic or Republican Administrations generally, but primarily Republicans from Reagan on. Altman and Haass are right that something has changed, but it is the Republicans, not the Democrats, who began massive, non-recession deficits. In fact, we can point to a specific political program that helps explain tax policy, called "starve the beast," the beast being government, specifically, social welfare spending. Here is Michael J. New, writing in the libertarian *Cato Journal*:²⁰

The most influential academic proponent of starve the beast is Milton Friedman [the conservative economist]. Friedman (2003) argued that, if taxes are cut, 'the resulting deficits will be an effective restraint on the spending propensities of the executive branch and the legislature.' The argument started in the late 1970's, and Reagan was a proponent: "If you've got a kid that's extravagant, you can lecture him all you want to about his extravagance. Or you can cut his allowance and achieve the same end much quicker."

Bush 2 was also a proponent: “President Bush said ... that there was a benefit to the government's fast-dwindling surplus, declaring that it will create ‘a fiscal straitjacket for Congress.’ He said that was ‘incredibly positive news’ because it would halt the growth of the federal government.”²¹

If Congressional Democrats had been partisan and Left, populist, or even part of the “Democratic wing of the Democratic Party” as Paul Wellstone would say, they’d have rejected Bush’s tax cuts and wars, too, along with Obama’s extension of them. It is useful to remember, as pundits describe Democrats as moving Left, that President Nixon said “we are all Keynesians now,” and proposed a type of guaranteed income, the negative income tax, to be sure, a very modest one, based on an idea of Milton Friedman. And here is the Republican candidate, Thomas Dewey, in a 1944 election speech: "If at any time there are not sufficient jobs in private employment to go around, the Government can and must create job opportunities, because there must be jobs for all in this country of ours."²² How likely is it that either party today would agree with Dewey? Which mainstream Party would adopt that principle that the government has an obligation to offset insufficient private job creation with public job creation?

Some Democrats during those Bush 2 years either agreed with him or were intimidated, and a minority voted for tax cuts, though they did not repeat their capitulation to the Reagan Administration. They were nearly unanimous in opposition to the 2003 cuts. Both parties are now fundamentally corporate parties. Democratic Administrations weakly support some social issues like abortion or homosexual rights, but are rather conservative on economic issues, except perhaps during election campaigns. The Clinton Administration after all, was the dismantler of New Deal financial protections like Glass-Steagall as well as its welfare program, Aid to Families with Dependent Children. It also tried to begin the privatization of Social Security, though reports are that Clinton’s affair with Monica Lewinsky saved us.²³

Conservative politicians present themselves as deficit cutters, but the Bush 2 Republican Congress overturned a statute that required spending cuts to finance tax cuts. Reinstated when the Democrats returned to a majority in 2007, the rule has been made even worse by current House Republicans, if the intent is to cut the deficit. Though spending increases must now be offset with spending cuts elsewhere,²⁴ tax increases to pay for new spending are prohibited. *Tax cuts need no offsets*. Paul Ryan, the House Budget Committee chairman, said, “We didn’t come here to raise taxes. We came here to cut spending and the rules should reflect that.” The new rules thereby allow the House to extend the Bush tax cuts, now set to expire in late 2012, as well as the estate tax and the alternative-minimum tax without having to find equivalent savings.²⁵

The Bush 2 Administration, not the Democratic Congress, also initiated the Medicare drug benefits. And it was the Republican/Libertarian Fed Chair, Alan Greenspan, who worried that the surpluses of the Clinton years would run down the debt too much. He therefore lent his considerable prestige to endorse the Bush tax cuts, and then recommended *spending* cuts when deficits piled up.²⁶

Markets have yet to signal the concern our officials show about debt and deficits. A recent [5/31/12] Treasury auction of 10-year Federal debt sold at an interest rate of about 4.2 percent,²⁷ one of the lowest rates of the postwar period.

To craft a solution appropriate to a problem, we need to understand its sources as well as evaluate its importance. What are the *real* sources of our deficits/debt? It is not “liberal” spending initiatives. The share of output our government absorbs is small compared to the rest of the developed world. In the last decade, the U.S. ranked 24th out of 26 countries in the Organization for Economic Cooperation and Development (OECD) in government spending at all levels as a share of economic output.²⁸ Let’s see how much this share has grown over time. According to our CBO, non-interest federal spending was 19.2 percent of GDP in 1977. Thirty years later, in 2007, a year before our financial problems began, it was 17.9 percent of GDP.²⁹ Given the way CBO measures federal spending, it is necessary to add in Social Security and part of Medicare for an accurate measure. Over this same period, Social Security was constant, at 4.2 percent; Medicare rose from 1.1 to 3.1 percent.³⁰ So over the past thirty years, the government's share of output rose from 24.3% to 25.0%, less than 1 percentage point. This is a remarkably small change, considering rising per capita output, and thereby increased ability to finance government, along with a rising population that one might expect would require more social services. This experience suggests that the growth of government spending does not explain the deficit.

[The ten-year projected deficit is entirely explained](#)³¹ by: 1. the serious recession caused by financial excesses [officially, it is over, but not for the millions of jobless];³² 2. the Bush and other tax cuts, including estate taxes; 3. the wars in Afghanistan and Iraq, along with enhanced military spending; 4. burgeoning medical costs [not shown in the previous graph]; and 5. the financial sector bailout. In fact, if these issues were all in hand, we’d have big budget surpluses.

- 1 The most obvious problem as well as the most neglected one is the **recession**. We are still facing a jobs crisis, which tends to create deficits. Recessions increase spending, like unemployment compensation, food stamps, discretionary stimulus outlays and interest costs on the enlarged deficit. They simultaneously reduce tax revenues, as incomes of individuals

and businesses fall. According to the CBO, the deficit for 2011 was \$1.3 trillion;³³ each additional million jobs reduce the deficit by \$54 Billion.³⁴ Using the unemployment report for May, 2012, we are short [9.9 million jobs](#). We need this number to restore the prerecession unemployment rate of 5 percent.³⁵ This estimate adds the trend increase in working age population to jobs lost but not yet replaced.³⁶ That 5 percent target is close to the CBO's so-called "natural rate of unemployment" (5.2 percent), which determines what the deficit would be if the economy were operating at high-employment. So a return to that still high unemployment rate would alone reduce the deficit by \$535 B—41%. Consumers, as we saw, have record levels of debt relative to income and losses on their houses, so are in poor condition to support recovery with their spending. Federal austerity would make the recession worse.

- 2 **Tax cuts:** [The Bush tax cuts](#) alone will cost an average of \$366 billion each year over the next 10 years or about \$3.7 trillion³⁷ over the 10-year budget period. If these lapse after 2012, the debt will barely grow as a share of GDP for the rest of the decade.³⁸ In fact, a recent *Times* headline was "Do-Nothing Congress as a Cure"—pointing out that if there is no action to extend them at the end of next year, "75 percent of the deficit problem over the next five years"³⁹ would be solved. We collected no estate taxes *at all* in 2010.

Government debt is a safe and rewarding asset for holders, including banks, corporations and many of us. Most people, especially the rich, would rather have the government borrow from them to cover expenses than pay taxes for that purpose. As a consequence of this preference, added to the use of tax reduction as a way of raising after-tax income for households with lagging income, we have one of the industrial world's lowest tax burdens. In 2009, [we ranked 26th out of 28 OECD countries](#)⁴⁰ in taxes as a share of our output. US taxes in pre-recession 2007 were 28.3 percent of GDP.⁴¹ These measures include state and local taxes, too. Corporate taxes as a share of GDP are similarly toward the bottom of the scale. An official who served in the Reagan and Bush 1 Administrations has observed that "The G.O.P. says global competitiveness requires the United States to reduce its corporate tax rate. But the United States actually has the lowest corporate tax burden [2008] of any of the member nations of the Organization for Economic Cooperation and Development."⁴² [\[In 2009, all but one.\]](#) Though we rank low in government share of output, tax revenues at the Federal level were even lower, and were insufficient, even before the recession began, to yield budget balance.⁴³

3 Military spending. To deficit hawks, who believe our most important problem is the debt/deficit, “imperial overstretch” cannot be an issue as our two wars account for only 10-15 percent of the deficit and much less than that of the debt. Military spending could bear minor cuts, but “it is not reckless American activity in the world that jeopardizes American solvency but American profligacy at home that threatens American power and security.”⁴⁴ However, according to Joseph Stiglitz & Linda Bilmes, “This was the first time in American history that the government cut taxes as it went to war. The result: a war completely funded by borrowing.”⁴⁵ Their estimate of the total cost of the Iraq war is upwards of \$3 trillion.⁴⁶

Nor do suggestions for spending cuts extend to our more than a thousand [foreign military bases](#), large and small, which add \$36.4 B to the trade deficit as well as to the government deficit, nor the total military budget, which rivals those of the rest of the world combined, and includes 234 golf courses⁴⁷ worldwide. In Iraq and Afghanistan, air conditioning alone costs us \$20 billion each year.⁴⁸ According to Defense Secretary Gates,⁴⁹ just the number of people in military bands is larger than the number of State Department Foreign Service officers. For 20% of what we spend on the military [c \$845B], we could cover the higher education costs paid by current students.⁵⁰

If we include such military-related items funded outside the Pentagon budget as veterans programs; the “intelligence” budget; military-related foreign aid; homeland security; and spending related to nuclear weapons in the Energy Department’s budget, the 2010 military budget totaled over one TRILLION dollars.⁵¹ The 2010 deficit was \$1.3 trillion. [However, reducing military spending would not reduce the deficit by an equivalent amount because a cut in spending not offset by other spending would reduce income and therefore tax revenues.]

4 Medical costs. [Insurance premiums](#) are rising far more rapidly than inflation or earnings. For Altman/Haass and others, the medical cost problem is one of a larger aging population driving up costs. [The real problem is quite different](#). If aging is our problem [blue line in the linked graph], our budget deficit as a percent of GDP, adjusted for inflation, rises, but not explosively. In contrast, if health care costs continue to rise at current rates [tan line], that ratio rises dramatically. [Let’s look at an alternative](#). “If the United States paid the same amount per person for health care as any other wealthy country we would be looking at huge budget surpluses, not deficits,” according to Dean Baker.⁵² “Every other wealthy nation insures everyone for about 10 percent of GDP. Our system leaves out some 50 million

people, and costs 17 percent of GDP. That's a difference of seven percent of GDP, far more than the structural budget deficit.”⁵³

[Not only does the US, private and public, spend more on health care](#), but “our government [alone] spends more on health care than the governments of Japan, Australia, Norway, the United Kingdom, Spain, Italy, Canada or Switzerland.”⁵⁴ Medicare, Medicaid, and CHIP [Children’s Health Insurance Program] make up 21 percent of the federal budget.⁵⁵ And our health outcomes, like life expectancy or infant mortality, are worse.⁵⁶ Rock singer Paul Hipp has a delightful rant about our World Health Organization health care ranking, [“We’re Number 37”](#).

5 It is difficult to know the impact of the **financial sector bailout** on the recorded debt or even its total size. Much of the bailout doesn’t appear in the debt as the Fed created money to finance its purchases, for example, of mortgage-backed securities, and loans. One estimate as of May 2012 is nearly \$300 Billion⁵⁷ that was disbursed and not yet repaid. Think of what these funds could have accomplished if they had been used for social purposes instead of this enormous subsidy to the financial system!⁵⁸ A financial blogger provides an interesting [correlation of bailout and debt](#), showing a rise in debt per capita simultaneous with the bailout, though of course this does not prove that the bailout caused the rise. Privately-held debt rose by more than a trillion dollars in 6 months in 2008. Before then, even with military buildup and tax cuts, debt had risen at a pace of \$200 to 300 Billion a year. At their peak in 2009, the Fed’s special lending facilities had loaned more than \$2 trillion, though total lending was far larger.⁵⁹

So—is there a debt problem? No. The most serious danger of the debt to our economy is posed by that [share of it financed by foreign borrowing](#), that is, lent to us by either governments, or especially private creditors, who hold our debt in part because it is profitable or safe and might decide it isn’t. As of April 2012, foreigners, both official and private, owned over \$5.1 trillion of U.S. debt, or approximately 47 percent of the debt held by the public.⁶⁰ The treasury securities owned by foreign governments like China, the largest holder, have risen from about 10 percent of the debt in the early 1990’s to 34 percent in April 2012⁶¹ More than \$1 trillion was held by private foreigners, like corporations.

Foreign-held debt does make a difference, because if foreign holders begin to convert their dollars into other currencies, or even buy a smaller fraction of newly created trade debt, the dollar would depreciate, making foreign goods and capital more expensive for Americans. Foreign borrowing stems largely from our chronic trade deficit, which requires borrowing

foreign currencies, and paying dollars for them, to make payments. An example would be that when you travel to Paris, you need euros, and buy them with dollars. If the value of the foreign goods or services Americans buy exceed the value of foreign purchases requiring dollars, foreign residents accumulate a surplus of dollars. Their surplus is our trade deficit in any one year, and is our foreign debt over years of deficits. [Dollars may also accumulate in foreign hands as a result of foreign asset acquisition by American corporations.] The trade deficit not only contributed to our foreign debt, but also reduced the effect of the Federal stimulus. Some of the extra spending bought foreign goods and services rather than domestically produced ones, which would have put more people to work. Gradual dollar depreciation would help to improve the trade balance and encourage domestic production.

The trade deficit is not mentioned by most debt critics. Yet ironically, it is primarily by cutting back *this* deficit that we can begin to deal with a major problem of our debt. Slashes in spending only help marginally by slowing down the economy and thereby cutting imports--a very costly remedy, especially for the additional jobless workers.

Though the debt problem is a consequence of the recession, the Bush and other tax cuts, two wars and a growing military budget, and a costly private health system, these are not the primary focus of efforts at deficit reduction. Rather, the old conservative and now increasingly liberal refrain is "entitlement reform," that is, some version of benefit cuts and/or increases of their dedicated taxes. Speaker John Boehner has said, "Listen, we've got to stop spending money that we don't have, and since the beginning, the Majority Leader and myself, along with Sen. McConnell and Sen. Kyl have been clear: tax hikes are off the table."⁶² With "everything on the table" except tax cuts, the debt seems to be a stalking horse for a final push against Social Security, [which hasn't added a penny to the deficit](#) [even after [the payroll tax was reduced](#) as a stimulus to household spending] along with reductions in other social programs. Even during these years of recession, the size of the Trust Fund has increased, and helped to reduce the deficit, except for 2011, when payroll taxes collected were just sufficient to pay benefits. These are funds from a tax paid even by wage-earners too poor to pay income taxes, and that deficit hawks are proposing to use for deficit reduction. Medicare costs reflect the problems of our private health care system generally.

So what are our most important economic problems besides the plight of the unemployed? These include the trade deficit; the growth slowdown; and inequality. There are others as dire, such as global warming, which cannot be covered here.

The Trade Deficit. We have had a chronic trade deficit since 1971. It became enormous during the Reagan era. The dollar was allowed to appreciate sharply in value, driving up the foreign price of our manufactures so that they became uncompetitive, and making imports and outsourcing more attractive. As a consequence, [we are increasingly in debt to the rest of the world](#). In 2010, the United States was second to China in global merchandise exports⁶³ and just edged out Germany. The US share of exports was just 9 percent compared to 11 percent for China. Of course, the picture is not quite so grim for the US with service exports, like financial services, included. We are still the number one importer, unless the European Union is treated as a unit.

There is no reason to believe that this trend will reverse itself without policy change. We have lost not only the market for old manufactured goods, but many of the new ones as well. In 2001 our previous trade surplus in high-tech goods shifted to deficit, which has continued into 2011. According to Andy Grove, former head of Intel [July 2010],

Such is the case with advanced batteries. ...finally we are about to witness mass-produced electric cars and trucks. They all rely on lithium-ion batteries. What microprocessors are to computing, batteries are to electric vehicles. Unlike with microprocessors, the [U.S. share of lithium-ion battery production](#) is tiny. That's a problem.The U.S. lost its lead in batteries 30 years ago when it stopped making consumer electronics devices. Whoever made batteries then gained the exposure and relationships needed to learn to supply batteries for the more demanding laptop PC market, and after that, for the even more demanding automobile market. U.S. companies did not participate in the first phase and consequently were not in the running for all that followed. I doubt they will ever catch up.

And we'll never have the well-paid factory jobs this industry could provide. [Lithium-ion battery production is one area of modest improvement: Because of investment subsidized by the stimulus program, the US has moved from "just a 2% share [of the world market] in 2008 to a 20% share in 2012."⁶⁴

Nor is our dependence on foreign borrowing indefinitely sustainable. Our trade deficit in 2008 was nearly \$700 billion, though the recession has reduced it significantly. Oil imports were over 1/5th of our goods imports that year. Yet unlike other countries, which are working to reduce their dependence, we retain our enthusiasm for fossil fuels, about 50 percent of which we must import, net of oil exports.

Slow growth: Not only the recession and rate cuts have limited tax revenues. [Growth during the Bush era](#) was inadequate even before the financial collapse of 2008. Even excluding the recession and ending in the peak year 2007, the 2001–2007 expansion was the weakest of the ten since 1948, thus reducing taxes that otherwise might have been paid, even at lower tax rates.

If ever there was a test of the alleged benefits of tax reduction for growth, this was it. And there aren't any.⁶⁵ The supply-side theory that [tax cuts always pay for themselves—wrong](#).⁶⁶

Foreign trade is one of the reasons for slow growth. If you have wondered why the economy was so sluggish during Bush 2, despite massive tax cuts, two wars, and a speculative binge, the [trade deficit](#) is part of the answer. In 2006, the trade deficit reached an historic peak as a fraction of output—nearly 6%. As we mentioned earlier, trade deficits re-direct spending from domestic to foreign suppliers.

Unfortunately, because growth is the way we deal with unemployment, the Bush era produced the weakest job creation of the postwar era, even before the recession.⁶⁷ As of May 2012, more than 4 million jobs have disappeared.⁶⁸ To restore these jobs and keep up with the growth of the working-age population would require nearly 10 million jobs [see point 1, p.7 for job effects of recession].

The decade just concluded is also the first in which the income of the average American declined. Even if we end at the peak year of the last decade, 2007, median household income was roughly \$300 less than in 2000.⁶⁹

For more than three decades, our growth has been largely dependent on rising debt, and on two major speculative bubbles brought on by the financial sector—the dot-com in the late 1990s, following by housing in the 2000s. What will replace them?⁷⁰ We live in the highly integrated, competitive world that our leaders pushed to create, but did not help us get ready for; nor did they bargain for rules protecting our economy or labor force from unfair competition. Infrastructure, education, innovation have all been neglected, except rhetorically. The American Society of Civil Engineers [ranks our infrastructure as Grade D](#).⁷¹ The public education system has deteriorated alarmingly. After leading the world for decades in 25- to 34-year-olds with university degrees, the country sank to 12th place in 2007.⁷² Though United States ranked sixth in overall competitiveness in 2009 in the assessment of 40 nations by the Information Technology & Innovation Foundation, it ranked 40th in “change” in “global innovation-based competitiveness”⁷³ during the previous decade.

Our only thriving sector is still finance, which is in need of severe pruning. Its share of domestic corporate profits has steadily increased, from 16 percent in the 1970's to a peak of 41 percent in the 2000 decade,⁷⁴ along with evidence of a malign effect on both investment and income inequality.⁷⁵ Despite the financial crisis, in the recovery, this sector is now receiving more than 30 percent of all domestic profits.⁷⁶ Our chronic trade deficit reflects this social neglect as well as a defective globalization strategy pursued by every postwar administration,

including that of Obama. Evidence of this faulty strategy is that imports of manufactured goods surged more than 100 percent between 1997 to 2007.⁷⁷

What productive gains there have been have largely been [captured by the very top](#)—even the top 0.1 percent of income receivers. Inequality is back to roaring 1920’s levels. This is unhealthy both economically and politically. If all the rich got for their wealth was art, mansions, and trophy spouses, they would not pose such a problem. But they reshape our political parties and belief system to serve their ideology and interests, which are better served by low taxes on their income than by social welfare spending. Warren Buffett, with immense income from dividends and capital gains, discovered that without using any tax dodges he paid far less as a fraction of his income than the secretaries or the clerks in his office. He has concluded,⁷⁸ “There’s class warfare, all right but it’s my class, the rich class, that’s making war, and we’re winning.” The [top 1% now own more wealth than the bottom 90%](#) of the population.⁷⁹

The [inequality of our wealth distribution](#) corresponds neither to Americans’ estimates of our actual wealth distribution nor to their ideal distribution. Surprisingly, that ideal is closer to Sweden’s than to ours.⁸⁰ The wealthiest 20 percent own about 84 percent of assets; but Americans estimate that they own only 59 percent, and would prefer them to have only 32 percent. Some preference for greater equality is held across all income and political groups.

The rich have also tended to invest for short-term profit, so that firms are forced to neglect the future. Our [tax system](#) encourages this by taxing speculative returns, i.e. certain capital gains, at a lower rate than wages and profits, so that [the wealthy pay lower rates than the average American](#). But perhaps even worse, their funds and those of the corporate and financial sectors are so enormous⁸¹ relative to acceptably profitable investments in the private sector that they fuel speculative asset booms instead of useful investment, and press for privatization of public functions. They look at the large, pre-existing markets for public goods like education, water supply, Social Security, limited-access highways, prisons, military activities formerly done by the Pentagon, and rental space in public buildings and see risk-free and highly profitable investment if they can induce governments to sell these assets, especially at bargain rates. For example, Wisconsin governor Scott Walker inserted a clause⁸² into his Budget Repair Bill that would sell off state-owned power plants without taking bids.

The Right has mounted a sustained assault on liberalism for several decades, the deficit/debt scam being the latest, and the liberal response has been defensive, at times even complicit, like the Deficit Commission, loaded with Social Security privatizers, Medicare cutters and deficit hawks who want to cut spending to finance further tax cuts for the rich. One co-chair,

Alan Simpson, predicted, “This is going to be beautiful politics – the brutal kind.” The other, Erskine Bowles, a director of Morgan Stanley, a Wall Street bank saved by the taxpayer bailout, said, “We’re going to mess with Medicare, Medicaid and Social Security because if you take those off the table, you can’t get there.”⁸³ Paul Ryan, whose “brave” deficit-cutting plan is the latest chapter, according to Paul Krugman [Nobel-Laureate in Economics], wants “to use the deficit, not end it,” and is yet another debt critic planning cutbacks and closing unspecified tax loopholes to finance further tax cuts. Krugman describes these as “Savage cuts in programs that help the needy, amounting to about \$3 trillion over the next decade.”⁸⁴ And “Huge tax cuts for corporations and the wealthy, also amounting to about \$3 trillion over the next decade.”⁸⁵

Without a counterattack, those likely to pay for the debt will be the same people who have suffered the most from the near financial meltdown crafted by Wall St. The few sources of creative renewal in the current political environment are in protests such as those by public employees. So far, however, despite their inspiring struggle, these project not alternative social and economic visions but merely efforts to protect existing systems safe from the depredations of the budget-cutters, or those who claim to be.

An alternative vision is that of a society that provides decent jobs for all who want them. The National Jobs for All Coalition believes that good jobs for all is the basis for a just society and a sustainable economy. [Our program of shared prosperity](#) would tie the creation of good jobs to unmet needs for infrastructure, like bridge repair, and public services, such as child and health care, mostly stay-at-home jobs that are difficult or impossible to outsource. It would provide as well a strategy for uniting various progressive movements to demand a response from the political system. Because unemployment is so costly and because the unemployed can provide needed services, public policy can employ the jobless directly at a rather small cost.⁸⁶ Philip Harvey has calculated that the stimulus funds of the Recovery Act of 2009, weighted down with ineffective tax cuts, would have been sufficient to provide jobs for all those needing work.⁸⁷ Moving toward a more just and sustainable economy is practical, effective policy. The choice is ours.

¹ Presented at the Columbia Seminar on Full Employment, Social Welfare and Equity May 2011 [revised June 2012]. This paper could not have been done without the work of some outstanding websites, like the [Center for Economic and Policy Research](#), the [Economic Policy Institute](#), the [Center on Budget and Policy Priorities](#), government sites, like the [Congressional Budget Office](#), as well as a few more conservative sites, like the Cato Institute. I am grateful to Professors Helen Lachs Ginsburg, Economics (Emerita), CUNY, and Martin Melkonian, Economics, Hofstra University, for their critical reading and suggestions. The numbers predate the December 2012 budget negotiations.

² These range from Alan Greenspan: “I believe the fears of budget contraction inducing a renewed decline of economic activity are misplaced.” WSJ

<http://online.wsj.com/article/SB10001424052748704198004575310962247772540.html> to Speaker John Boehner's "Government Spending Cuts Key to Success" <http://www.johnboehner.com/?p=1644>

³ <http://www.ctj.org/pdf/bushtaxcuts2013to2022.pdf>

⁴ For example, the Social Security Trust Fund owned \$2.5 Trillion in 2011, but will not claim any of this sum for years. The Trust Fund buys special-issue [not market-issue] bonds, paying about 2.4 percent in 2011.

⁵ Federal debt: <http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt.htm> When Pres. Clinton left office, there was a budget surplus of \$236 billion, about 2 percent of GDP. It was being used to pay down the debt.

⁶ <http://www.whitehouse.gov/the-press-office/2011/07/02/weekly-address-cutting-deficit-and-creating-jobs> Quoted by Paul Krugman, <http://krugman.blogs.nytimes.com/2011/07/02/barack-herbert-hoover-obama/>

⁷ <http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf>

⁸ Debt was \$11Tr. and GDP was about \$15.5 Tr. 2012, first quarter.

⁹ http://www.cbo.gov/sites/default/files/cbofiles/attachments/06-05-Long-Term_Budget_Outlook.pdf

¹⁰ "the problem is essentially the same from Iceland to Ireland to Britain to the US. It just comes in widely differing sizes." Niall Ferguson, <http://www.ft.com/cms/s/0/f90bca10-1679-11df-bf44-00144feab49a.html#axzz1PXyQskQL>; "First, financial trouble could come quickly," said former Sen. Alan Simpson, co-chair of the National Commission on Fiscal Responsibility and Reform. ...Mr. Simpson said, "It will be very swift and very dramatic like in Greece or Ireland or Portugal or Spain." http://www.esmonitor.com/USA/Politics/monitor_breakfast/2010/1119/Deficit-commission-co-chairs-warn-of-Greece-like-debt-crisis-in-US

¹¹ [The National Commission On Fiscal Responsibility And Reform](#), "The Moment of Truth," p. 11. This report was issued by the co-chairs, Simpson and Bowles, as it had the support of only 11 rather than the requisite 14 of 18 members.

¹² *Ibid.*

¹³ Roger C. Altman and Richard N. Haass, "American Profligacy and American Power," *Foreign Affairs*, N/D 2010

¹⁴ National Commission, op. cit. 14.

¹⁵ *Ibid.*, p. 48.

¹⁶ *Ibid.*, 49; 55. Sharp reductions are in store for those with earnings of \$63,000 or more [in 2010 prices] by 2050.

¹⁷ Altman and Haass, op. cit. [fn. 14]

¹⁸ *Ibid.*, 2

¹⁹ <http://www.treasurydirect.gov/NP/NPGateway>

²⁰ <http://www.cato.org/pubs/journal/cj29n3/cj29n3-7.pdf> Fall, 2009

²¹ <http://www.nytimes.com/2001/08/25/us/president-asserts-shrunken-surplus-may-curb-congress.html>

²² K.B. Williams, "Employment and Wage Policies," p. 31

http://fraser.stlouisfed.org/historicaldocs/pes/download/73736/pes_4_1946.pdf

²³ Erskine Bowles, a Deficit Commission Co-Chair, was Clinton's Chief of Staff at the time. [see Robin Blackburn on Lewinsky, <http://www.counterpunch.org/blackburn10302004.html>] Incidentally, at the same time, the Administration and Congress effectively extended federal deposit protection to investment banks. [Simon Johnson and James Kwak, *13 Bankers*, 134]

²⁴ <http://www.bloomberg.com/news/2011-01-05/house-republicans-to-weaken-anti-deficit-rules-to-ease-tax-cut-approvals.html>

²⁵ <http://www.ombwatch.org/node/11451>

²⁶ <http://www.ft.com/cms/s/0/1cd58e8c-9130-11df-b297-00144feab49a.html> and

<http://www.nytimes.com/2004/02/25/business/25CND-FED.html>

²⁷ <http://www.treasurydirect.gov/RI/OFNtebnd>

²⁸ http://www.americanprogress.org/issues/2009/10/pdf/oced_spending.pdf "Comparing Public Spending and Priorities Across OECD Countries," Figure 5

²⁹ http://www.cbo.gov/ftpdocs/108xx/doc10871/AppendixF.shtml#_blank, Table F-6. The CBO includes transfer payments like Social Security, unemployment insurance, food stamps, and Medicare, but net of the dedicated taxes for these functions.

³⁰ *ibid.*, Table F10.

³¹ <http://www.cbpp.org/files/12-16-09bud.pdf>

³² In May, 2012, nearly 13 million were officially unemployed, plus more than 14 million working part time but wanting full-time work or wanting work but not looking, for a variety of reasons, including discouragement—about 17 percent of the labor force.

³³ <http://www.cbo.gov/sites/default/files/cbofiles/attachments/06-07-ChangesSince2001Baseline.pdf>

³⁴ <http://www.ourfiscalsecurity.org/deficit-101/>

³⁵ December 2007, when the recession started. These are from monthly Bureau of Labor Statistics reports.

³⁶ <http://www.epi.org/publications/entry/7272/> Though the report is outdated, its formulation was used for the current data.

- ³⁷ <http://taxpolicycenter.org/UploadedPDF/1001438-tax-cuts-debate.pdf>
- ³⁸ <http://taxpolicycenter.org/UploadedPDF/1001438-tax-cuts-debate.pdf>
- ³⁹ <http://www.nytimes.com/2011/04/13/business/economy/13leonhardt.html>
- ⁴⁰ <http://www.politico.com/news/stories/0411/52661.html#ixzz1Ix5ym0eZ>
- ⁴¹ http://www.oecd-ilibrary.org/economics/oecd-factbook-2009/total-tax-revenue_factbook-2009-83-en These measures include state and local taxes, too.
- ⁴² <http://economix.blogs.nytimes.com/2011/05/31/are-taxes-in-the-u-s-high-or-low/> See also http://ctj.org/ctjreports/2011/06/us_one_of_the_least_taxed_developed_countries.php
- ⁴³ In 2007, with Federal spending at 25% of output, tax revenues were only 19% of output. ERP <http://www.gpo.gov/fdsys/pkg/ERP-2012/pdf/ERP-2012-appendixB.pdf> p.415
- ⁴⁴ Altman and Haass, *op. cit.*
- ⁴⁵ <http://www.washingtonpost.com/wp-dyn/content/article/2010/09/03/AR2010090302200.html>
- ⁴⁶ <http://threetrilliondollarwar.org/>
- ⁴⁷ <http://www.alternet.org/economy/82009/>
- ⁴⁸ <http://www.npr.org/2011/06/25/137414737/among-the-costs-of-war-20b-in-air-conditioning>
- ⁴⁹ <http://www.washingtonpost.com/wp-dyn/content/story/2010/09/06/ST2010090603042.html?sid=ST2010090603042>
- ⁵⁰ <http://lbo-news.com/2012/06/04/raid-the-pentagon-budget-do-good-works/>
- ⁵¹ Chris Hellman, “The Real U.S. National Security Budget: The Figure No One Wants You to See,” <http://www.tomdispatch.com/blog//175361/> See also <http://nationalpriorities.org/>
- ⁵² <http://www.cepr.net/index.php/blogs/beat-the-press/does-robert-samuels-worry-about-monsters-under-his-bed-at-night> and <http://www.cepr.net/calculators/hc/hc-calculator.html>
- ⁵³ <http://www.demandsideconomics.net/2011/03/robert-kuttner-asks-how-do-we-get.html>
- ⁵⁴ http://www.washingtonpost.com/blogs/ezra-klein/post/the-hard-truth-about-health-care-government-works/2011/05/19/AGcE95KH_blog.html
- ⁵⁵ <http://www.cbpp.org/cms/index.cfm?fa=view&id=1258>
- ⁵⁶ “...in 2006, the United States was number 1 in terms of health care spending per capita but ranked 39th for infant mortality, 43rd for adult female mortality, 42nd for adult male mortality, and 36th for life expectancy.” <http://healthpolicyandreform.nejm.org/?p=2610>
- ⁵⁷ <http://projects.propublica.org/bailout/list/index>
- ⁵⁸ The Fed lent to financial institutions at near-zero interest rates, funds which were then lent out at higher rates.
- ⁵⁹ <http://www.cepr.net/index.php/press-releases/press-releases/senate-ignores-fed-threats-passes-audit/>
- ⁶⁰ <http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt>
- ⁶¹ <http://www.lafollette.wisc.edu/publications/workingpapers/chinn2010-015.pdf>
- ⁶² <http://www.speaker.gov/News/DocumentSingle.aspx?DocumentID=248436>
- ⁶³ http://www.wto.org/english/res_e/statis_e/its2011_e/its2011_e.pdf
- ⁶⁴ <http://ceramics.org/ceramicstechnology/tag/lithium-ion-batteries/page/2/>
- ⁶⁵ Growth in real per capita GDP between 2000 and 2009 averaged 0.7 percent, the lowest since 1910. Doug Henwood, *Left Business Observer*, 11/10
- ⁶⁶ <http://krugman.blogs.nytimes.com/2011/06/22/reagan-and-revenues/>
- ⁶⁷ “President Bush has presided over the worst annual job creation record of any president since Hoover.... While President Bush has not lost jobs, he created jobs at an annual rate of only 0.7 percent through the end of 2007—a record slightly worse than his father, who previously held the second-worst record. When employment figures through April 2008 are included, Bush’s record is even worse, creating jobs at an annual rate of 0.58 percent.” http://www.americanprogress.org/issues/2008/06/two_conservatives.html
- ⁶⁸ There has been a decline in employment from 146.6 million [11/07] to 142.3 million [5/12] <http://www.bls.gov/news.release/pdf/empsit.pdf> 6/12.
- ⁶⁹ Harold Myerson, *Washington Post*, 1/5/11
- ⁷⁰ Some economists across the political spectrum agree that our at least our recession problem requires greater government intervention: “[Paul] Krugman, asked when the economy would return to full employment, replied, ‘Basically never’ — unless we get a huge stimulus comparable to the most recent ‘recovery to full employment’ from a global financial crisis ‘known as World War II.’ No surprise there. But [Martin] Feldstein quickly agreed. According to the former Reagan adviser, the American Recovery and Reinvestment Act of 2009 spending tried to fill a “GDP gap” of about \$1 trillion a year with about \$800 billion spread over at least three years. ‘So we never got liftoff. We never got a recovery,’ Feldstein said.” <http://www.politico.com/news/stories/1010/43219.html>
- ⁷¹ Report found at <http://www.ritholtz.com/blog/2010/09/us-infrastructure-report-card-d/>
- ⁷² College Board, “College Completion Agenda 2010, <http://completionagenda.collegeboard.org/reports> p.5

73 “Benchmarking EU and U.S. Innovation and Competitiveness,” <http://www.itif.org/publications/atlantic-century-benchmarking-eu-and-us-innovation-and-competitiveness>, p.2.

⁷⁴ S. Johnson, “The Quiet Coup,” <http://www.theatlantic.com/magazine/archive/2009/05/the-quiet-coup/7364/>

⁷⁵ S. Khatiwada, “Did the financial sector profit at the expense of the rest of the economy?”

<http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1101&context=intl>

⁷⁶ <http://blogs.reuters.com/felix-salmon/2011/03/30/chart-of-the-day-us-financial-profits/> and

⁷⁷ “Offshoring and the State of American Manufacturing” http://research.upjohn.org/up_workingpapers/166/ p.3

⁷⁸ <http://www.nytimes.com/2006/11/26/business/yourmoney/26every.html>

⁷⁹ <http://www.businessinsider.com/15-charts-about-wealth-and-inequality-in-america-2010-4?op=1>

⁸⁰ http://www.people.hbs.edu/mnorton/norton_ariely_in_press.pdf The study is based on a random online sample of several thousand Americans drawn from one million.

⁸¹ As of December [2011], the 1,100 non-financial U.S. corporations rated by Moody’s were sitting on record gross cash balances of \$1.24 trillion. <http://blogs.reuters.com/breakingviews/2012/04/03/corporate-cash-surplus-will-be-easy-to-misspend/>

⁸² <http://www.onthecommons.org/wisconsin-governor-walkers-secret-privatization-agenda>

⁸³ http://www.cjr.org/campaign_desk/social_securitys_code_words.php

⁸⁴ <http://www.cbpp.org/cms/index.cfm?fa=view&id=3451>

⁸⁵ <http://krugman.blogs.nytimes.com/2011/04/08/3-trillion-here-3-trillion-there/>

⁸⁶ This cost could be easily covered by a financial transfer tax, one affecting only speculation, not capital investment. See, for example, http://www.epi.org/index.php/american_jobs/paying_for_the_plan

⁸⁷ “There is, in fact, a far less expensive way to create jobs than the strategies adopted so far to combat the Great Recession. This alternative approach doesn’t require us to wait for the economy to recover in order to put people back to work. It puts people back to work as a way of nourishing the recovery. It’s a strategy for producing a job-led recovery rather than the jobless recovery we have been experiencing so far.” [Back To Work: A Public Jobs Proposal For Economic Recovery](#), Demos