May 14, 2012

James Pethokoukis posts on an austerity program that worked.

Now, we all all know "austerity" from deep spending cuts (not the tax hikes, of course) is killing Europe's economy and would do the same here in America, right?

Well, here's a story about austerity that critics such as President Obama, Paul Krugman, and Ezra Klein never seem to mention: From 1944 to 1948, Uncle Sam cut spending by a whopping 75% as World War II came to end. Spending as a share of GDP plunged to 9% in 1948 from 44% in 1944.

Superstar economist and devout Keynesian Paul Samuelson—later to become the first American to win the Nobel Prize in economics—predicted such shock austerity would cause "the greatest period of unemployment and industrial dislocation which any economy has ever faced." That dire, disastrous prediction was widely held by his fellow Keynesians, with one even predicting an "epidemic of violence."

Except the doomsayers were wrong, even though Washington obviously ignored Samuelson's call for gradual spending reductions. Despite cuts which dwarfed those seen in the EU today—not to mention those Republicans are calling for here at home—the U.S. economy thrived. There was no mass unemployment despite rapid demobilization of the armed forces. As George Mason University economist David Henderson explains is his 2010 paper, "The U.S. Postwar Miracle" (which this entire post draws upon): ...

Writing in the Washington Examiner, **Veronique de Rugy** says successful austerity programs come primarily from spending cuts.

... In a 2009 paper, Harvard University's Alberto Alesina and Silvia Ardagna looked at 107 attempts to reduce the ratio of debt to gross domestic product over 30 years in countries in the Organisation for Economic Co-operation and Development. They found fiscal adjustments consisting of both tax increases and spending cuts generally failed to stabilize the debt and were also more likely to cause economic contractions. On the other hand, successful austerity packages resulted from making spending cuts without tax increases. They also found this form of austerity is more likely associated with economic expansion rather than with recession.

The Baltic nations of Latvia, Lithuania and Estonia provide good examples of successful fiscal adjustments. In the last few years, and contrary to the rest of Europe, the Baltic countries have focused on significantly cutting government spending without equivalent increases in taxes. As a result, the Cato Institute's Dan Mitchell reports, between 2008 and 2011, Estonia and Lithuania reduced nominal spending by 5 percent, and Latvia by 11 percent. France and the United Kingdom increased spending more than 8 percent over the same period, and Spain and Italy increased spending by 3 percent. In contrast to these others, the Baltic states have experienced some of the largest economic gains in the world: Between 2009 and 2010, Estonia's economy rose from an annual GDP growth of minus-13 percent to 3.1 percent.

Sweden is another good example. ...

The above two items lead to a piece from **Browser** on the reasons for studying economic history. This takes the form of an interview with Simon Johnson, former IMF chief economist.

In choosing these books, you mentioned you were interested in whether economic history, or books about it, can influence policy and help convince people about the future. Can it?

The problem for economics is that to a lot people it's kind of boring. Particularly if you write about analytical economics, there's no narrative that draws you in like a novel or even other social science books can. If you're talking about big macro themes, it's hard to write an anecdotal history in a compelling way. I've chosen books that are intended to add those dimensions, to talk about historical experiences in such a way that you can say, "Oh yes, I get that, I understand the story." Then you can think about how to apply that story to the modern predicament and what policy could be in the future. ...

Let's talk about this more as we go through the books. Your first choice is A History of Interest Rates, in which Sidney Homer and Richard Sylla look at interest rate trends and lending practices over four millennia. Tell me why you chose it and what the lessons are for our time.

This is one of my favourite type of books, which are just about data. You can argue all kinds of things about the past, but then you have to go back and look at the actual numbers. The interesting thing about interest rates is that you have these decade-long swings. It's important to try to situate today in that historical context. We are in the fourth decade of a very long bull market in bonds – meaning rates have gone down and bond prices have gone up – and at some point that will switch. We need to be aware of that. It's a very simple observation. I don't know when rates are going to turn against us, but Homer and Sylla's history shows us that interest rates can go down – and they can go down for a very long time – and then they go the other way, they go up. This means that you can't build your public finances on the view that, "Oh yes, today's rates are going to be the rates in two decades." You can't bet on the US being able to borrow indefinitely, an infinite amount, at 2% interest. ...

Tell me about Why Nations Fail, which looks both at countries around the globe, and at examples from history, to figure out what political and economic institutions make for economic success.

Why Nations Fail is by two of my favourite economists, two very close friends and co-authors of mine, Daron Acemoglu and James Robinson. They're tackling a subject that I've worked on with them, and they do a great job of bringing it to life and making it vivid. Why Nations Fail is like Jared Diamond's Guns, Germs, and Steel – which I didn't mention because it's such an obviously famous book – one of those books that stretches your mind and gives you all these examples and connections between them, so that you come away from it saying, "Wow. I didn't know that." It's really, really interesting.

By the way, it turns out their blog is even better than the book, and they're even better on Twitter than they are on their blog. So there's no limits to the genres these guys can master.

So one of the questions they're asking in the book is whether, politically, America has moved from "a virtuous circle in which efforts by elites to aggrandise power are resisted" to "a vicious one that enriches and empowers a small minority".

Yes, I have not exactly a beef, but a constructive dialogue going, particularly with Daron, about whether or not the US is already in a period of having, in their language, more "extractive" institutions and less inclusive ones. I recognise there is a big gap between the US and, say, Sierra Leone or Haiti, or whichever troubled country you want to pick from the book. But – and this is going back to Teddy Roosevelt – I fear that we have let the concentration of economic, financial and political power go too far. This is really bad for democracy and for the opportunities of most people in this country, and it's exactly the kind of thing they mean by extractive institutions.

I don't know if you saw it, but Matthew Yglesias gave a wonderful and hilarious review of Why Nations Fail, in which he compared it to The Hunger Games. His point is that the dystopian view of the world, which is rather chillingly and vividly portrayed in The Hunger Games, is not that far from things we've seen in history and things we see around the world today. It's actually a very extreme form of extractive institutions in which a few people live very well and most people live in squalor. You could say, been there, done that – not for the US, but for many countries. So could the US go down that path? Is our democracy forever? Are our institutions so strong that we have republic-long immunity from those problems? I don't think so. Ben Franklin was accosted by a stranger upon leaving the constitutional convention in Philadelphia in 1787. She asked him, "Well, Doctor, what have we got – a republic or a monarchy?" And Franklin said, "A republic, if you can keep it."

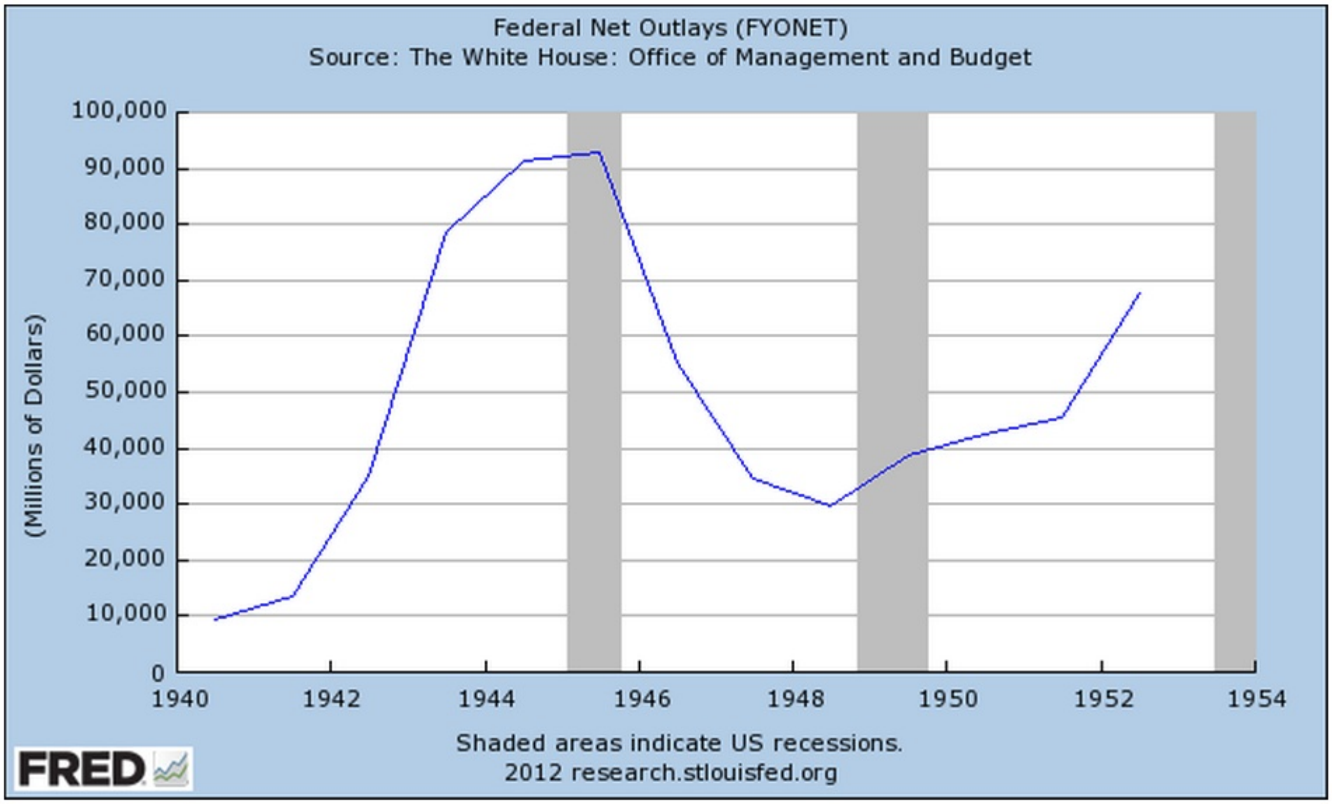
So you're more of a pessimist than the authors?

I would say I'm more of a realist, but yes, they would say I'm more pessimistic. ...

American.com

[When the U.S. really did try austerity, it worked!](#)

by James Pethokoukis



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Except the doomsayers were wrong, even though Washington obviously ignored Samuelson's call for gradual spending reductions. Despite cuts which dwarfed those seen in the EU today—not to mention those Republicans are calling for here at home—the U.S. economy thrived. There was no mass unemployment despite rapid demobilization of the armed forces. As George Mason University economist David Henderson explains is his 2010 paper, "The U.S. Postwar Miracle" (which this entire post draws upon):

As demobilization proceeded rapidly, employers in the private sector, full of the optimism … scooped up millions of the soldiers, sailors, and others who had been displaced from the armed forces and from military industries. … The number of unemployed people did increase, rising from 0.8 million to 2.3 million, but with a civilian labor force of 60.1 million, **the 2.3 million unemployed people implied an unemployment rate of only 3.8 percent. As President Truman said, "This is probably close to the minimum unavoidable in a free economy of great mobility such as ours.**

Of course, liberals are quick to point out the U.S. economy suffered its worst one-year downturn in history in 1946, a drop of 12%. To many Americans, it surely must have seemed like Samuelson was right, that the Great Depression had returned. But no one thought that back then, especially with jobs plentiful unlike during the 1930s. The drop in output was a statistical quirk caused by the removal of price controls. As Henderson explains:

For example, imagine that the free-market price of a pound of filet mignon during the war would have been $1.40 a pound. But imagine further that the government had set the price at $1.00 a pound. Then, when the price control was removed, the price would have shot to $1.40 a pound. Inflation statistics would have recorded some amount of inflation due to this large price increase. But those statistics would have overstated the real price increase because getting beef at $1.40 a pound is better for many of the people who couldn't, because of the shortage, get it at $1.00 a pound.

Second, those sky-high output figures during the war measured government spending on goods and services, lots of it military hardware, at their cost. But what was all that stuff really worth, in purely economic terms, vs. post-war consumer purchases of homes and cars and nylon stockings? While total output fell by 12% in 1946, private-sector GDP rose by nearly 30%.

Or look at it this this way: Real U.S. output in 1947 was 17% higher than in 1941 despite the decline in government spending. Why was the economy prospering in way it never did during the Great Depression? Taxes were cut a little, and government interference—including price and production controls and rationing—was reduced a lot. But perhaps just as important, Truman dumped many of FDR's most radical New Dealers. That change boosted business confidence, and companies started to invest again in America.

The typical Keynesian response mostly centers around dismissing the immediate post-war boom as a one-off event complicated by many unique factors. But it happened again, as Henderson notes! After the Cold War ended, overall federal spending fell to 18% of GDP in 2000 from 22% in 1991. But again the economy boomed. Real U.S. GDP grew by 40% with an average annual growth rate of 3.8%. Henderson speculates that perhaps the decline in defense spending freed up knowledge workers to help make technological miracles happen in the private economy.

The lesson here: Spending cuts might well produce prosperity instead of austerity, especially if accompanied by less government interference in the economy and less fear in the private sector of anti-market government policies.

Washington Examiner
Two kinds of austerity
by Veronique de Rugy

Austerity is destroying Europe, we are told. In fact, this "anti-austerity" slogan is supposedly an important reason for defeat of former French president Nicolas Sarkozy and for the victory of newly elected socialist Francois Hollande.

First, France has yet to cut spending. In fact, to the extent that the French are frustrated with "budget cuts," it's only because the increase in future spending won't be as large as they had planned. The same can be said about the United Kingdom. Spain, Italy and Greece have had no choice to cut some spending. However, in the case of these particular countries, the cuts were implemented alongside large tax increases. In fact, The Washington Examiner's Conn Carroll calculated that "Europe raised taxes by almost €9 for every €1 in actual spending cuts."

This approach to austerity, also known in the United States as the "balanced approach," has unfortunately proven a recipe for disaster. In a 2009 paper, Harvard University's Alberto Alesina and Silvia Ardagna looked at 107 attempts to reduce the ratio of debt to gross domestic product over 30 years in countries in the Organisation for Economic Co-operation and Development. They found fiscal adjustments consisting of both tax increases and spending cuts generally failed to stabilize the debt and were also more likely to cause economic contractions. On the other hand, successful austerity packages resulted from making spending cuts without tax increases. They also found this form of austerity is more likely associated with economic expansion rather than with recession.

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Sweden is another good example. The data show that after the recession, Sweden's finance minister, Anders Borg, not only successfully implemented reduction in welfare spending but also pursued economic stimulus through a permanent reduction in the country's taxes, including a 20-point reduction to the top marginal income tax rate. As a result, the country's economy is now the fastest-growing in Europe, with real GDP growth of 5.6 percent. Unsurprisingly, the Financial Times recently declared Borg the most effective finance minister in Europe.

While the debate over austerity continues, the evidence seems to point to the conclusion that austerity can be successful, if it isn't modeled after the "balanced approach." It's a lesson for the French and other European countries, as well as for American lawmakers who often seem tempted by the lure of closing budget gaps with higher taxes.

Veronique de Rugy is a senior research fellow of the Mercatus Center at George Mason University.

Browser

Simon Johnson on Why Economic History Matters

by Sophie Roell

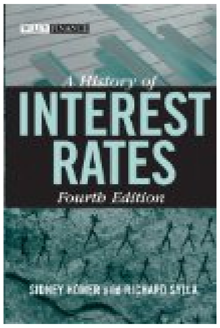
History contains useful warnings and lessons. And, says the former IMF chief economist, today's economic policymakers would do well to heed them

In choosing these books, you mentioned you were interested in whether economic history, or books about it, can influence policy and help convince people about the future. Can it?

The problem for economics is that to a lot people it's kind of boring. Particularly if you write about analytical economics, there's no narrative that draws you in like a novel or even other social science books can. If you're talking about big macro themes, it's hard to write an anecdotal history in a compelling way. I've chosen books that are intended to add those dimensions, to talk about historical experiences in such a way that you can say, "Oh yes, I get that, I understand the story." Then you can think about how to apply that story to the modern predicament and what policy could be in the future.

But what if awareness of economic history leads you in the wrong direction? For example, at the start of the recent crisis Ben Bernanke was a big expert on the Great Depression which meant that for him, letting some of these big banks go bankrupt was a complete no-no. I wondered if that put him in a weaker bargaining position. Perhaps he could have negotiated better deals with, say, JP Morgan, if he had been a bit less aware of the history.

I'm sure economic history can sometimes lead you in the wrong direction, but to be clear: The 1930s banking experience was very important and shapes everyone's thinking around these issues. The idea that you should let a lot of banks collapse is abhorrent because it led to such a bad outcome in the 1930s. You're right that we can then have an argument about whether we should protect all creditors under all circumstances, which I agree is a bad idea. I'm not sure that's the number one thing I would pick on Ben Bernanke for though. I'm much more worried about his reluctance to take on the big banks both before and after the crisis – his reluctance to regulate, his reluctance to insist on a lot more capital. I'm not in favour of abolishing central banks. We learned the really hard way in this country that if you try to get on without a central bank it can be very, very difficult, particularly as the finance system becomes bigger relative to the economy. But let's argue about the history. The history is still relevant and vivid and it should be a part of thinking about what happens with policy in the future.



A History of Interest Rates

By Sidney Homer, Richard Sylla

Buy

Let's talk about this more as we go through the books. Your first choice is *A History of Interest Rates*, in which Sidney Homer and Richard Sylla look at interest rate trends and lending practices over four millennia. Tell me why you chose it and what the lessons are for our time.

This is one of my favourite type of books, which are just about data. You can argue all kinds of things about the past, but then you have to go back and look at the actual numbers. The interesting thing about interest rates is that you have these decade-long swings. It's important to try to situate today in that historical context. We are in the fourth decade of a very long bull market in bonds – meaning rates have gone down and bond prices have gone up – and at some point that will switch. We need to be aware of that. It's a very simple observation. I don't know when rates are going to turn against us, but Homer and Sylla's history shows us that interest rates can go down – and they can go down for a very long time – and then they go the other way, they go up. This means that you can't build your public finances on the view that, "Oh yes, today's rates are going to be the rates in two decades." You can't bet on the US being able to borrow indefinitely, an infinite amount, at 2% interest.

And then be totally surprised and unprepared when rates do go up.

Exactly. The cool thing about Homer and Sylla is it's such a great book – it costs nearly $50 on Kindle. I take that as an indication of the market realising the intrinsic value of a ridiculous amount of data about interest rates.

Is it going to be readable to a non-economist? Or are their eyes going to glaze over?

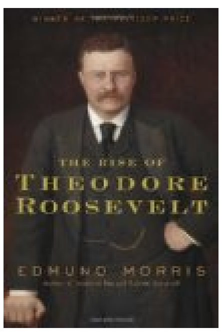
You have to go to it with a question. You have to say, "I want to know how much it costs to borrow, in this or that time period, for this or that government or the private sector." If you just read it, it's a bit overwhelming, I agree. But then facts have a tendency to overwhelm people. You should try and be aware of the facts as much as possible.

Is there another example in history of a government borrowing so much for so little for so long as the US now?

The US national debt right now is nowhere near what it was at the end of World War II. This is the sixth debt surge in American history. Five of them were all about war. This one was partly wars – it was also the Bush tax cuts, Medicare Part D [prescription drug coverage] and the financial crisis. What's different about this surge is that it coincides with a rather difficult demographic transition – the baby boomers are retiring. Also, we don't have healthcare costs under control. The demographics were much more favourable, and healthcare was not this kind of an issue, after any of the previous surges. So there is an unfortunate convergence – this combination of issues is not something we've dealt with before.

In terms of the actual interest rates – their low levels over this period – is that unusual historically?

Yes, in the modern era, that is since we moved away from the gold standard. There were certainly episodes under gold, first in the UK and then for the US, when interest rates were very low. But interest rates have come down and they've kept coming down. I've refinanced my mortgage five times since 1997. Each time I thought, "Wow, that's a great deal, I guess I'm done now." We'll see how long they stay low. If you read this history, you'll see you have to take a pretty agnostic view of the short term, at the same time as not taking a long-term bet, from a public finance point of view, that interest rates stay low.



The Rise of Theodore Roosevelt

By Edmund Morris

Buy

Tell me about your next book, the biography of Teddy Roosevelt by Edmund Morris. One of the reviews says that it "reads like a novel". Why is it on your list?

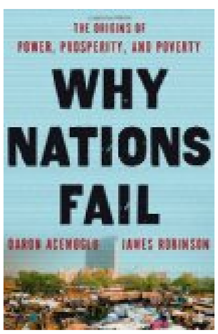
This is one of the great political biographies. Teddy Roosevelt was like a character out of a novel, so it's not surprising that his biography reads like one. This book is the exact opposite of Homer and Sylla. Homer and Sylla are all facts all the time, the long swing of history. This book is about admiration for an individual, a man who rises through a series of remarkable – if not incredible – coincidences. Within 10 years, he goes from being a somewhat unsuccessful chief of police in New York City to being president of the US. You have to read the details to understand how he did it. The key thing is that he channelled the times. He channelled a lot of the progressive objections of the day to the political and economic system into the heart of the Republican Party. He forged an alliance across the political spectrum that really confronted concentrated economic power and changed it absolutely and completely, most directly using the anti-trust laws. He was remarkably successful and very popular when he was done, though after he left office and tried to come back it didn't go so well. But in his day, Roosevelt's achievement was profound. When you look at this history, and see how he got there and how he held and exercised power, you realise that it's not easy to find such individuals, who really want to break with the system. We need another Teddy Roosevelt.

And you feel Obama is not up to the job? He's not another Teddy Roosevelt?

He's certainly not another Teddy Roosevelt. We'll see whether or not he gets a second term. Roosevelt did not wait for his second term to confront JP Morgan and Northern Securities. He took the opportunities when they presented themselves. He took a lot of risk to do that, but built a very strong coalition opposing concentrated economic and financial power. He was tapping into a broad American tradition – with support from the right and the left – but it was a distinctly Rooseveltian coalition. It didn't long survive the end of his political career.

Couldn't you argue that things have changed, and that it would be much tougher to be a Teddy Roosevelt today?

No. If you read this book, you'll see how tough it was for him. Nobody expected him to become president.



Why Nations Fail

By Daron Acemoglu and James Robinson

Buy

Tell me about *Why Nations Fail*, which looks both at countries around the globe, and at examples from history, to figure out what political and economic institutions make for economic success.

Why Nations Fail is by two of my favourite economists, two very close friends and co-authors of mine, Daron Acemoglu and James Robinson. They're tackling a subject that I've worked on with them, and they do a great job of bringing it to life and making it vivid. *Why Nations Fail* is like Jared Diamond's *Guns, Germs, and Steel* – which I didn't mention because it's such an obviously famous book – one of those books that stretches your mind and gives you all these examples and connections between them, so that you come away from it saying, “Wow. I didn’t know that.” It’s really, really interesting.

By the way, it turns out their blog is even better than the book, and they’re even better on Twitter than they are on their blog. So there’s no limits to the genres these guys can master.

So one of the questions they’re asking in the book is whether, politically, America has moved from “a virtuous circle in which efforts by elites to aggrandise power are resisted” to “a vicious one that enriches and empowers a small minority”.

Yes, I have not exactly a beef, but a constructive dialogue going, particularly with Daron, about whether or not the US is already in a period of having, in their language, more “extractive” institutions and less inclusive ones. I recognise there is a big gap between the US and, say, Sierra Leone or Haiti, or whichever troubled country you want to pick from the book. But – and this is going back to Teddy Roosevelt – I fear that we have let the concentration of economic, financial and political power go too far. This is really bad for democracy and for the opportunities of most people in this country, and it’s exactly the kind of thing they mean by extractive institutions.

I don’t know if you saw it, but Matthew Yglesias gave a wonderful and hilarious review of *Why Nations Fail*, in which he compared it to *The Hunger Games*. His point is that the dystopian view of the world, which is rather chillingly and vividly portrayed in *The Hunger Games*, is not that far from things we’ve seen in history and things we see around the world today. It’s actually a very extreme form of extractive institutions in which a few people live very well and most people live in squalor. You could say, been there, done that – not for the US, but for many countries. So could the US go down that path? Is our democracy forever? Are our institutions so strong that we have republic-long immunity from those problems? I don’t think so. Ben Franklin was accosted by a stranger upon leaving the constitutional convention in Philadelphia in 1787. She asked him, “Well, Doctor, what have we got – a republic or a monarchy?” And Franklin said, “A republic, if you can keep it.”

So you’re more of a pessimist than the authors?

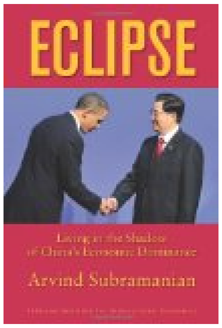
I would say I’m more of a realist, but yes, they would say I’m more pessimistic.

Is the central thesis of the book pretty controversial?

Their experience with this book has been like our experience with some of the papers we did together, which is that, at some level, people on the right and the left like the thesis. People on the right say, “Aha! You mean that you don’t have secure property rights!” which is exactly what part of the message is. People on the left say, “Aha! A few people have too much power in society” which again is part of the message. At that level it’s not controversial – in fact it’s an unusual book in that it appeals to people across a broad spectrum. However, when you start talking about a particular country, say the US, becoming more extractive in this or that specific way – and I would say the Paul Ryan budget will push us towards a more extractive society – then of course people find that amongst the most controversial things you can say in American politics today.

And leads to accusations of not being patriotic?

I haven't been accused of not being a patriot, but I have been accused of lots of other things that aren't fit for public consumption. Though when you write a book and start blogging you become a bit immune to that kind of thing.



Eclipse

By Arvind Subramanian

Buy

Tell me about *Eclipse*, which envisages a world where China is both economically and politically dominant.

This is by another good friend of mine, Arvind Subramanian. He's a senior fellow at the Peterson Institute where I work part-time in DC. I remember saying to him at one point, "Arvind, you should be careful about predicting that China is going to overtake the US, because lots of times when people predict that kind of thing it doesn't come true." He replied: "Don't worry, Simon. I'm actually saying they've already overtaken us."

Arvind is a very historically minded person. He has dug up a lot of relevant data, and has some wonderful stories that illustrate his points. The most vivid, and my favourite, is about the Suez Crisis in the 1950s. At that moment, the British thought they were still top dog in the world. They invaded the Suez Canal with the French and Israelis, and the Americans were not happy. The British were having problems with the pound and their balance of payments, and Eisenhower would not agree to the IMF lending to them until they withdrew from Suez. This was an extraordinary reversal, an extraordinary fall of the position of the British pound in the world economy. Arvind's point is that this could absolutely happen to the US. There's no law of economics or physics that says the US dollar is the world's reserve currency indefinitely, irrespective of what America does.

It's not one of these books making the argument that China is better placed to manage its economy because it's a one-party state, I hope?

No, he's fairly agnostic on that. He has an institutionalist view of history, so you have to take some points off China on that score. He's just arguing that it's a very large economy, it's going to be an increasingly important part of the world and it trades a lot. These things will naturally bring it the status of safe-haven asset or currency, and that will tend to displace the dollar. It's more about the long-term impetus of economic growth, though I'm sure he will tell you there will be ups and downs along the way. But there will be a rebalancing of the world, so the share of income is more like it was in 1700, when the West was nowhere near as important as it is today. China and India will be more important, and, of the two, China is a bigger, more open trading nation, so its currency is more likely to contest or replace the US as the predominant reserve currency.

How does this fit into your theme of economic history or ideas mattering? Just as a wake-up call for the US?

Yes. I actually disagree with Arvind in that I think China is going to have a lot of problems – it won't overtake us exactly in this fashion. But ideas matter, and it's a well-argued, nicely balanced wake-up call. It's also selling a ton of copies in China. Anyone in Washington who is paying attention and trying to think strategically must read this book. They have to think about what happened to the British and why. My argument would be that if we don't put our fiscal house in order, the US dollar will lose its role in the world. US treasuries will no longer be the ultimate safe haven, our interest rates will go up, and we'll absolutely have a decline of the kind Arvind talks about. Arvind's thesis is more that China will take over, there's not much we can do about it, while I think the future of America is much more in American hands.

OK, so let's talk about America getting its fiscal house in order, which is what the last book on your list is about. I also just read your own and James Kwak's book on this, *White House Burning*. You actually seem quite optimistic that getting budget deficits and the national debt under control is completely doable.

That's the message: Don't panic, we can fix it. The good news is that when I talk to audiences around the US, people on the right and the left get really intelligently engaged with the issues and the numbers. We have a fantastic discussion, admittedly up to the point where I say that their taxes will likely have to increase. Then they get upset and I have to sneak out the back. But this is progress.

Why did you choose the title *White House Burning*?

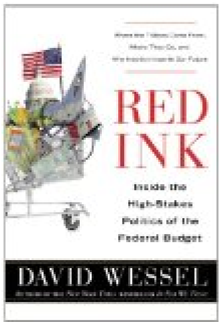
The war of 1812 is a good example for me. It relates to the theme we're discussing, of using history to try to say something about policy today. In the war of 1812 the Americans were trying to get their government to deliver in terms of defence, but they weren't willing to pay for it. You get what you pay for and you pay for what you get: Washington was burned. The US did not default on its debt, but there was still a fiscal disaster of the first order. That's something we should seek to avoid at all costs.

In your book you cite the Dick Cheney quote: "Reagan proved that deficits don't matter." Isn't that more recent history part of the problem in getting people focused on the debt now? In the 1980s we kept hearing what a disaster the national debt was, how our grandchildren would be paying for it. Then, seemingly in the blink of an eye, in the late 1990s, the challenge was what we should do with our budget surpluses. To the general public it really can seem as if deficits don't matter all that much.

I don't think that discredits the people who raised the alarm. On the contrary, those warnings were pretty timely.

Are you saying the warning worked?

Exactly. Politicians swung back to being more careful. Unfortunately that was just on the surface. Beneath the surface the right wing of the Republican Party was moving further away from caring about debt as a fiscal responsibility and much more towards cutting taxes and reducing the scale of government. That political shift – which has been going on since the late 1970s – was masked by the fact that the 1990s had relatively good fiscal outcomes. It's that movement of the Republican right that gave you the Bush tax cuts, the idea that deficits didn't matter in the 2000s, and a lot of the political deadlock today.



Red Ink

By David Wessel

Buy

Your last book, David Wessel's *Red Ink*, hasn't come out yet. But like your own, it deals specifically with the national debt. One of the blurbs about it said: "It will scare your pants off. It will motivate you to call your congressman and scream, 'For God's sake, enough partisanship – save America, cut spending, raise revenue, whatever, but do it now!'"

This is my competition. I chose it because I think we need more of these intelligent, thoughtful, well-documented books that scare the pants off you and convince you that action is needed. Not panicky overreaction – that's not what David is arguing for – but more, "Let's change the policies now, figure out a way to bring the debt under control, and let's do that in a reasonable and responsible manner." His message should appeal to people across the political spectrum. I wish him luck and will do everything I can to promote his book as a way to help educate everybody who should care about these issues.

How does his book differ from yours?

We agree on a lot of things, but our book is much more about raising revenues than almost anybody else's. I claim that we are consistent with the views the Eisenhower Republicans had, which are that we have to protect social insurance, including social security, Medicare and Medicaid, and we want to bolster revenues to do that. Other reasonable people are not so focused on revenue, and that's a good discussion to have. I'm happy to have that discussion in an analytical way, in a historical way, in a non-emotional way, and I think it's terrific that people like David are advancing alternative visions. What we really need is an educated, well-informed debate.

So does he want to do away with social security?

No, no, he's not that extreme. But he's less in favour of increasing revenue than we are. So is almost everyone.

But surely revenue does need to be raised?

Why don't you come down to Washington and talk to people about that? We need to get your voice in the mix! Yes. That's my view too. But I know you have a European background, and continental Europeans in particular have a different view towards government and towards revenue. I'm actually more on the side of limited government than a lot of my European friends, but I think we should defend and stick up for the basic social insurance programmes we have in the US. I don't want to see them gutted.

I'm not unsympathetic to the American attitudes to taxes, because government doesn't seem to work very well over here – as a consumer you don't seem to get much bang for your buck. Look at bank regulation. We keep hearing how the financial crisis was caused by lack of regulation. And I'm sure it was. But the fact is that American banks are hugely regulated. I covered Wall Street as a journalist in the wake of Eliot Spitzer's global settlement in 2001. Regulations were being slapped on the banks left, right and centre in the early 2000s. But they must have been the wrong sort of regulations, or not very effective, because they didn't prevent the crisis from happening.

I think healthy scepticism is the right attitude towards government, and what you said about financial regulation and its ineffectiveness or failures is exactly right. I'm not expecting government to fix all the problems. I think a better solution to the banks would be to break them up and let the markets sort out who is going to succeed and who is going to fail. That's a view some people on the left like, and I have plenty of libertarian friends who agree with that also. The government services that are problematic in the US are often provided by state and local governments and I have plenty of issues that I'm not happy about with my local government. But the federal government doesn't do that much. As we discuss in the book, the things it does do are pretty high value and, while you can squeeze it a little bit, that's not the big money. The big money is social insurance and healthcare. Healthcare is the toughest problem of all to deal with, and it's one where Americans are very divided. To a lot of Europeans this is strange, but it goes back to the issue of a deep distrust of government. I think the interesting question over the next 100 years will be whether this deep distrust of government is going to serve Americans well, as it did previously, or whether it will increasingly become a handicap. I voted with my feet and I became an American, and I'm happy to be an American, but we'll see where this tradition takes us.

Why has America been unable to control healthcare costs? I know the divergence between the cost of healthcare in the US compared to Europe started in the 1980s, but why is it so much more expensive over here?

The healthcare experience in Europe varies. Costs have been controlled better in some places than others. The only countries that have really been able to hold those costs down – and which look likely to be able to hold them down going forward – are those with single-payer systems with more or less universal coverage. But the Americans don't want to hear this. It's not a popular message.

That's Britain, and who else?

Scandinavia. You can look in the back of the IMF Fiscal Monitor, the latest to come out. They have a table, I think it's table 9a, which gives you projected healthcare costs and the impact on the budget over a 20-30 year period.

Legal Insurrection

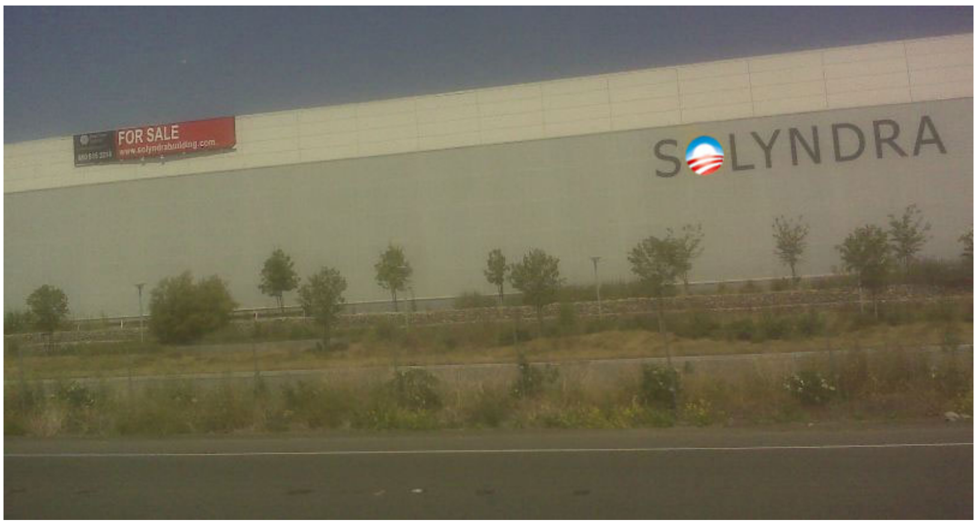
Please do not photograph Obama's wreck at the side of the road

by William A. Jacobson

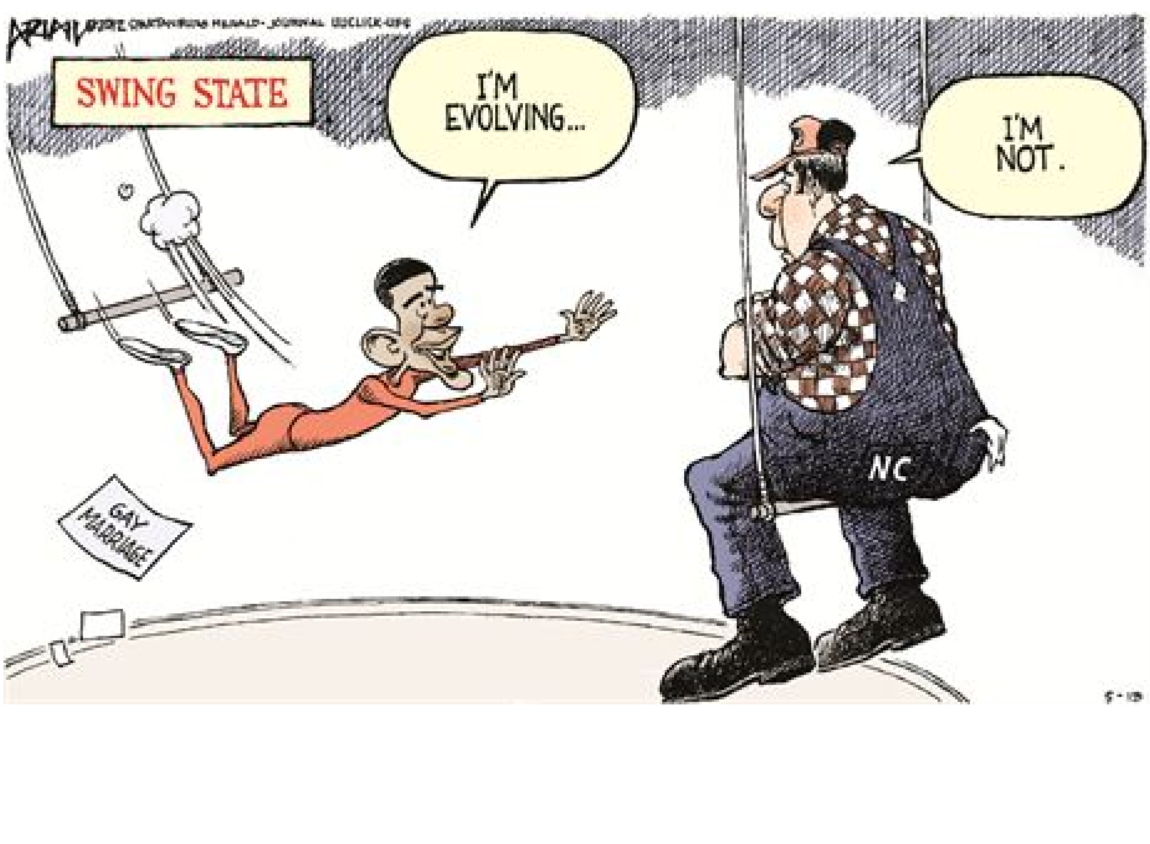
Solyndra's LEED certified 400,000+ sq ft. facility in Freemont, California, has been for sale since mid-April.

Reader Ann was driving by the building today, and just couldn't help but snap a photo:

Update: Thanks to commenter Liberty Jane for clarifying the image:




MS. VAN PELT, ISN'T IT TRUE THAT 50 YEARS AGO YOU CONTINUOUSLY BULLIED CHARLIE BROWN BY PULLING AWAY THE FOOTBALL CAUSING HIM PHYSICAL AND MENTAL TORMENT, AND SCARRING HIM FOR LIFE ?
GOOD GRIEF!


SWING STATE
I'M EVOLVING...
I'M NOT.
GAY MARRIAGE
NC