IWAN MORGAN

Reply to Brian Domitrovic

I suggest in *The Age of Deficits* that the budget is an important field for historical study but has suffered relative neglect from historians because of the "esoteric, elitist and endless" nature of this policy domain (x). Brian Domitrovic's fair and well-reasoned review is in agreement about the historical significance of budget policy. While I have reservations about some of his criticisms, they demand constructive engagement that hopefully follows below.

Domitrovic ends with the interesting observation that the Age of Deficits "is best understood" as the era following the abandonment of the Bretton Woods system of international monetary arrangements that underpinned the postwar growth of the world economy. In his view, the termination of the fixed rate of dollar convertibility into gold in 1971 and the final abandonment of fixed-currency exchange rates in 1973 opened the way to the operation of fiscal imbalances of previously unthinkable regularity and size. It is certainly true, as I acknowledge (37), that concerns about foreign holders of dollars exchanging these for gold and the consequent threat to American reserves impelled deficit control in the postwar era, especially in 1959–60 and 1968.

However, I would place greater emphasis on two other developments for the emergence of the Age of Deficits. One was the shift from aggregative fiscal policy to program-oriented budgeting in the wake of Keynesianism's eclipse in the stagflation-hit 1970s. This marked the end of rule-driven budgets. In the first 150 years of fiscal operations under the Constitution, the balanced-budget rule—namely, the belief that the federal government had an obligation to balance its annual outlays and income except in the exceptional circumstances of war and recession—dominated policymaking. Despite Domitrovic's disparagement of it, the Keynesian doctrine that shaped fiscal policy from the late 1930s to the 1970s could also be characterized as rule-driven. Far from being predicated on the belief that the sky was the limit for the deficit, it prescribed anti-inflation restraint during prosperity (manifest in the stabilizing budget policy of the Truman-Eisenhower era) and generally emphasized the importance of assessing the level of deficit (or surplus) that would best serve economic growth (even in the 1960s era of the "new economics").

THE JOURNAL OF POLICY HISTORY, Vol. 23, No. 3, 2011.
© Donald Critchlow and Cambridge University Press 2011
doi:10.1017/S0898030611000200

https://doi.org/10.1017/S0898030611000200 Published online by Cambridge University Press

Program-oriented budgeting, by contrast, placed more emphasis on budget composition rather than the aggregates that produced deficits and surpluses. Economist Herbert Stein, a moderate conservative, characterized this development as "the disintegration of fiscal policy."

Related to this change, the budget increasingly lost suppleness as a result of the post-1960s rise of the entitlement state. From 1945 to the Vietnam era, defense regularly consumed the lion's share of the budget because of Cold War imperatives. Moreover, discretionary programs, including domestic ones, accounted for the bulk of spending. Automatic outlays fixed in law (mandatory payments to individuals and interest payment on the public debt) made up only 33.7 percent of the budget in FY1960. The expansion of Social Security, the creation of new entitlements in the 1960s—notably Medicare and Medicaid—and the index-linking of some programs to inflation in the 1970s had a significant effect on budget composition. By FY2000, automatic payments to individuals constituted some 59 percent of total federal spending and interest payments accounted for 12.5 percent, leaving less than a 30 percent share for the discretionary defense and domestic appropriations that were subject to annual control by budget policymakers.

Domitrovic also suggests that my book "gets across the sense that presidents have been relatively helpless" against the burgeoning deficit. Whether this is an apt conclusion to draw from its reading is a matter for debate. Presidents may lack the constitutional power of the purse, but it is my contention that their powers of agenda-setting and persuasion make them the principal actor in the making of budget policy. The presidencies of Ronald Reagan, Bill Clinton, and George W. Bush arguably support this view. The point is that only Clinton made deficit reduction his priority; Reagan and Bush were more focused on their program objectives of small taxes and big defense. Even presidents perceived as failed budget leaders were significant in shaping the course of budgetary policy. Jimmy Carter began the Democrats' transformation into an antideficit party from the Reagan era until the current economic crisis. George H. W. Bush's 1990 budget deal with the congressional Democrats and its corollary Budget Enforcement Act constituted the first steps toward restoration of fiscal responsibility at the end of the decade.

Domitrovic suggests that I slight George W. Bush in not acknowledging the fulfillment of his 2004 pledge to halve the budget deficit in his second term. It is true that the FY2007 budget met this goal, but this success could not be sustained in the face of the financial crisis of his final year in office. Arguably we should consider a president's record in its totality rather than at a point advantageous to his reputation. I still hold by my assessment that

https://doi.org/10.1017/S0898030611000200 Published online by Cambridge University Press

Bush's fiscal agenda of huge tax cuts, massive national security outlays, and the domestic program growth associated with his big-government conservatism marked him out as "the least deficit-conscious president since the Budget and Accounting Act endowed the office with budgetary responsibility" (220).

Domitrovic makes a powerful case for the Reagan administration's economic record, also criticizing me for undue reliance on David Stockman's rubbishing in his memoirs of the 1981 "rosy scenario." While crediting Reagan as a skillful and successful political leader on the budget, I am less convinced of the economic benefits of his fiscal policy. One might deploy the standard argument that the greatest economic achievement of the 1980s, the conquest of inflation, was predominantly the work of the Federal Reserve under Paul Volcker. Related to this, annual unemployment remained stubbornly high after the 1981–82 recession, averaging 6.5 percent in 1984–88—hardly a stellar record. Most significant, the Reagan-era deficits were instrumental in transforming the United States from being the world's largest creditor nation in 1981 into its largest debtor in 1985 because of their depressing effect on national saving. This laid the foundations for the imbalanced global economy, which is such a troubling feature of the early twenty-first century. Since the Reagan era, America has consumed more than it produced and become reliant on foreign credit, while Asian nations—led initially by Japan and latterly by China—have pursued the saving and export route to economic growth.

Domitrovic broadly lauds the benefits of tax reduction for economic growth that is ultimately essential for healthy national finances. My review of fiscal policy from Carter to Bush 43 makes me skeptical of this claim. Without doubt the Reagan personal tax cuts boosted the economy in the wake of the 1981–82 recession, but this has to be measured against their contribution to the deficit/debt problem. There is precious little evidence that the Bush tax cuts of 2001 and 2003, skewed as they were in distribution toward the affluent, strengthened the foundations of American prosperity. Monetary relaxation arguably contributed far more to the post-2001 recovery cycle. In contrast to presidential claims, the U.S. Treasury calculated in 2007 that the extension of the Bush tax cuts beyond their 2010 expiration date would only increase annual economic output by 0.7 percent over ten years. I also doubt Domitrovic's assertion that the economy would have avoided recession had George H. W. Bush achieved a capital gains tax cut rather than agreeing a tax-increasing budget deal with the congressional Democrats in 1990. Arguably, the Federal Reserve's interest rate hikes, a reflection of its concern about the inflationary consequences of the deficit, were mainly responsible for triggering the downturn.

https://doi.org/10.1017/S0898030611000200 Published online by Cambridge University Press

One also wonders about the claim that the 2001 recession would have been avoided if Clinton had invested the surplus in tax reduction. This surely underplays the significance of the burst bubble of overvalued dot-com shares that sent the stock market into tailspin.

While we disagree on the issues outlined above, Domitrovic and I are at one in our view that the budget deficit constitutes a huge threat to America's power and prosperity in the twenty-first century. As he notes, my allusion to this as "the other red peril" underplays its current and future significance as the real red peril. Perhaps historians should stick to studying the past, but it is difficult not to look ahead when writing modern budget history. Unless America changes fiscal course, the Congressional Budget Office recently warned, the public debt-GDP level of 64.5 percent in 2010 may conceivably exceed its historical World War II–era peak of 109 percent in 2025 and reach 185 percent in 2035 as a result of rising entitlement outlays, inadequate tax revenues, and mushrooming interest costs. If it becomes a reality, this trajectory will at some stage become fiscally unsustainable. It is to be hoped that America's political leaders in the executive and legislative branches will put matters right before then. Unfortunately, *The Age of Deficits* does not inspire confidence in their capacity to prioritize long-term fiscal interests over immediate programmatic and political concerns.

University of London

https://doi.org/10.1017/S0898030611000200 Published online by Cambridge University Press