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Fiscal Austerity Policies and their Implications - USA

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Abstract: ***Deficits have been raising at both federal and state government levels which led to austerity-focused class war in the USA. In this paper, we analyze the situations that led to this huge fiscal deficit and the policies behind them. Then we show how the New Deal Under President Franklin led the circumstances that currently persist.***

Keywords: Policies, tax-cuts, Right-Wing coalition, New Deal

1. Fiscal Austerity

The word Fiscal refers to the Government Finance, whereas the word Austerity refers to economically difficult situation due to which people living standard are lessened. In macroEconomics aspect, Fiscal austerity together refers to policies of the government in which the government reduces the amount of its borrowing and spending (cut debt-taxes etc.), this is done in order to avoid economic overheating and for long run debt sustainability. Under Fiscal Austerity Policies implementation also, government can spend far more than it receives in the forms of taxes.

2. The great Austerity War in USA

Instead of solving common people problems by solving the cause of deficit, Right- Wing Coalition, a coalition of most economically powerful and richest segment of the society, demanded the elimination of government spendings on public investment and cuts on government spending that will support poor and the middle class. Also, They demanded severe tax-cuts for the richer section of the society. This was termed as "Starve the Beast Strategy" that reduces government spending by regressive tax cuts other than on defence and programmes that enrich Right-Wing coalition.

This paper makes three main points-

The cause of this austerity war dates way back in time. The Great Depression led to consequences which resulted in powerful political movements demanding an end to the uncontrolled capitalism that cost such terrible economic instability.

Second, the current govt debt crisis is a direct consequence of policies brought forward by the right-wing coalition implemented after the President Reagan took charge. This resulted in not only poor economic performance, but also created large budget deficits.

And Third, Instead of attacking the root causes of the problem, both the sides have been insisting on substantial cuts on non-defence spendings.

While the democrats suggested large cuts in social spending as the way ahead, the Republicans brought strong opposition to the New Deal and want to destroy the entire project.

3. Understanding the history

Mid 1920s was marked with a boom in income. This period between 1920 and 1929 is often referred to as "**Roaring Twenties**" mainly because it associated with Economic Prosperity. But the concern with this era was that about seventy percent of the profit went to only the richest one percent which further widened the rich-poor gap. Such wealth concentration in the hands of a few limited growth of economy.

The rich and the wealthy poured money into the political system which gave them command over the political system. This was what the ring-wing had always dreamed about.

This capitalism beyond the control of common man, led to a financial crisis in 1929 and a chain of events that plunged USA into its deepest and longest economic crisis and ultimately to a depression.

The American economic system had been fundamentally flawed. Banks operated with no guarantee to their customers. With almost no regulations on the banks, they lent money to those who speculated recklessly in stocks.

This phase continued until the Democratic party took charge in 1933. Under President **Franklin D Roosevelt**, the democratic party brought forward a series of programs and projects aimed at restoring prosperity to Americans. FDR took damage control steps and stabilized the economy by providing jobs and relief. The series of programs are what are now referred to as **New Deal**.

The Role of federal govt was restructured with the onset of new deal. For most Americans, it led to a realignment of the constituents in the democratic party, so-called new deal coalition.

The new deal is described as three R's
1) **Relief programme** - Provide help, usually money, to the poor people in need.
2) **Recovery program**- Intended to fix economy in short run & put people back to work.
3) **Reform programs-** Designed to regulate the economy to prevent future depression.

"*Unions were the most important constraint on the power of corporations and the rich both in the political arena and in* *the economy, and the most important force pushing for government economic policies in the interest of the emerging middle class and the poor.*"

Although most of the credit for the success (or otherwise) of New Deal is given to Roosevelt, there was a constant opposition to both the policies he was implementing to curtain unemployment and the beliefs that he held. To finance this project, Roosevelt needed huge funds. He sort to do this by increasing the taxes for the rich. FDR's response to the anger of the industrialists was typically blunt claiming that these policies would benefit the masses but would tread on the toes of a few.

Although Most the criticism against the New Deal was for Self- interest, there was deeper moral and ideological reasoning as well. While on one end, the New Deal was seen as a threat to profit, on the other end, it was a threat to deeply held values and a way of life.

"*They believed that the free-market was equivalent to freedom itself, that regulating the market meant surrendering political liberty as well as economic strength. For them, the turning back of the New Deal was a question not only of the bottom line but of the deepest social principles.*"

However, FDR brushed aside this saying- "*Everybody is against me except the voter.*"

The period between 1950s to 1960s was seen as a "Golden Era" as the business prospered, unemployment was low and family incomes rose rapidly. Thus, most of the business sector distanced itself from a coalition to overthrow the New Deal.

Although many of the capitalists had problems with this new deal, there were no major revolts against this until the mid to late 1970s. There was economic turbulence during this period. Oil prices rose resulting a steep increase in the rate of infiltration.

Since the United States followed Keynesian model, the government chose to restrict spending to stop inflation at the cost of rising unemployment and slower growth.

Increasing unemployment, high rate of infiltration, unstable stocks led to ring-wing to form a coalition with the cultural conservatives.

This gave enormous funds to the Republican party to mobilise workers and hold economic and political events for the public in a conservative prism.

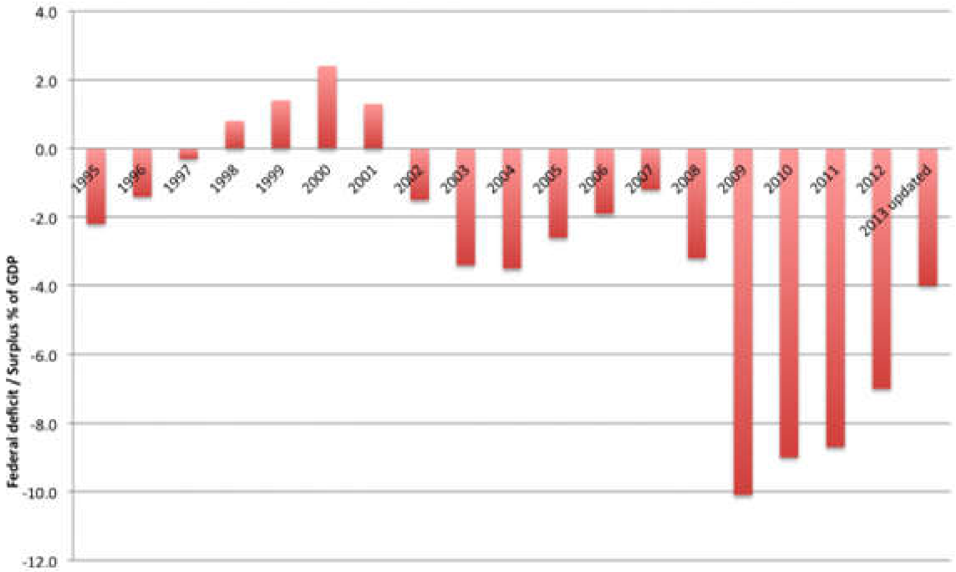

Figure 1: Us Federal Deficit % of GDP
Source: whitehouse.gov

History Continued 1970s – 2010

When Reagan took office in the 1980's, the US was in a tremendous amount of debt. The debt had reached a phenomenal amount of 1 trillion dollars. To counter the staggering amount of debt, Reagan redefined the US economic policy system and he with the help of Congressional democrats created a new economic model known as Neo-liberal Capitalism. The key highlights of this policy were-

1) Government spending on the poor and middle class was reduced so as to reduce spending.
2) Tax rates were cut hoping that corporations would flourish.

This new policy backfired and instead of decreasing the debt, it tripled by the end of his second term, reaching a total amount of 3 trillion dollars.

After Reagan, George Bush took the office and continued on the ideas of Reagan hoping that neoliberal policies would reduce the burden of the the debt on the US, but by the end of his term another trillion added to the debt reaching an amount of 4 trillion.

Bill Clinton took the office in the 1990's, and was successful in reducing the debt to some extent. He was in the office during a time of economic expansion, combined with this, he increased the upper income tax rates. But the relief was short lived as the expansion depended on various unsustainable forces like the Internet bubble, which when bursted left the economy stagnant. Bill Clinton messed up the Public Welfare System leading to further problems in layman's life.

George Bush was elected the president after Bill Clinton, and he reimplemented the Reagan policies with a belief that it would reduce the debt in the economy, and was determinant on the policy during his tenure. But once again the policy backfired and the national debt doubled during his tenure. The amount of debt added during his tenure was greater than the combined debt under all the other presidents.

Obama came to power in the 2010's and had promised to redo the policy changes done by Bush, but contrary to his promise,Obama and the Congress continued upper income tax cuts for two years which resulted in further increase of debt.

There was an economic slowdown which started from the 1970's in the US and lead to the debt in US economy, there were several reasons for that some of which are explained below.

1) Loss of post war advantage - The second world war had affected a lot of countries in the world which created an economic slowdown in the affected countries, but since the US was not affected much by the war, it gained an upper hand over others. But the effect neutralised over time.
2) Shifting of Industries - Due to availability of cheap labour in Eastern Asia, the companies present in the US shifted their factories to Asia.
3) US policies did not focus on job creation thus leading to higher levels of unemployment.

4. Pro-cyclical Fiscal Policies (Destabilizing Fiscal Policies)

Cycle 1:
When Reagan took the charge, US economy was already in recession. At that time, Reagan implemented austerity measures, which further increased the debt. Rather, at that moment , expansion policies could have helped US economy to decrease the debt.

In 1988, when George H.W. Bush took the office, the economy had already neared the peak of the business cycle but was in great debt. It was time to increase the tax rates and recover the deficit. But Bush implemented expansion policies and added to the deficit in US Economy.

Cycle 2:
The second cycle came in the period from 1900-2000, during the reign of GW Bush. The first President Bush implemented his will and applied taxes but apparently at the wrong moment because till then , the US economy had again entered recession. During 1993-2000, the US economy underwent a strong growth and there was a robust recovery in the fiscal deficits. In 2003, GW Bush went for a second round of tax cuts even when all the inherited surpluses were converted into deficits in the first time. Again, during boom, there were expansion policies in the US economy, which added to the debts and deficits.

Cycle 3:
As the new recession hit, the Republican Congressman opposed Obama and discontinued the expansion policies after two years even after there were high unemployment rates. This was the third time when wrong fiscal policy was implemented in the US economy, which subsequently resulted in extremely high debts and fiscal deficits. During the three cycles, there were efforts for austerity measures when the economy was in recession , followed by fiscal expansions when the economy was already expanding.

5. Effect of Cutting Spending on FIscal Deficits

The total federal spending in 2013 was 3.5 trillion dollars, and the net deficit was ¾ trillion dollars, down from 1.1 trillion dollars in 2012 and 1.4 trillion dollars in 2009.

This was achieved by a major cutting in the spending in non-defense sector. Senior Citizen related spending was also exempted from the cuts.

But the deficit was so high that even if they had cut spending of all other sectors than defense and senior spendings, it would not have been possible to balance the deficits.

Political constraints also played a major role in the downfall of US economy and in the piling of deficits. The republican Congressman strongly opposed the fiscal expansion in the economy and were also very adamant to introduction of new taxes and hence did not allowed the economy to expand. Also the change in government and hence the fiscal policies were a major cause for the deficits incurred.

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