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JIMMY CARTER, BILL CLINTON, AND THE NEW DEMOCRATIC ECONOMICS

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ABSTRACT. *Jimmy Carter's response to stagflation, the unprecedented combination of stagnation and double-digit inflation that afflicted the American economy during his presidency, made him the subject of virulent attack from liberal Democrats for betraying New Deal traditions of activist government to sustain high employment and strong economic growth. Carter found himself accused of being a do-nothing president whose name had become 'a synonym for economic mismanagement' like Herbert Hoover's in the 1930s.¹ Liberal disenchantment fuelled Edward Kennedy's quixotic crusade to wrest the 1980 Democratic presidential nomination from Carter. '[H]e has left behind the best traditions of the Democratic Party', the Massachusetts senator charged, 'We are instructed that the New Deal is old hat and that our best hope is no deal at all.'² A quarter-century later a more dispassionate analysis would suggest that Carter was neither a do-nothing president nor a throwback to the past in terms of economic policy. Far from being the 'Jimmy Hoover' of liberal obloquy, Carter was really 'Jimmy Clinton' because in seeking solutions for stagflation his administration laid the foundations of a new political economy that the next Democratic president would build upon.*

Assessments of presidential economic management conventionally rate Bill Clinton a success and Jimmy Carter a failure because the economy performed so much better in the 1990s than in the late 1970s.³ Indeed, so durable were negative images of Carter's economic failure that when Clinton ran for president, he was on guard against being typecast as another southern governor who would

¹ Sidney Weintraub, 'Carter's Hoover syndrome', *New Leader*, 24 Mar. 1980, p. 18. See too, Seymour Melman, 'Jimmy Hoover?', *New York Times*, 7 Feb. 1979, and Arthur M. Schlesinger Jr, 'The great Carter mystery', *New Republic*, 12 Apr. 1980, pp. 18–21.

² Quoted in William E. Leuchtenburg, *In the shadow of FDR: from Harry Truman to Ronald Reagan* (rev. edn, Ithaca, NY, 1985), p. 203.

³ On a simple misery index (the combination of annual inflation and unemployment rates), Carter has the worst record of any post-war president (1945–2000), while Clinton ranks fifth of ten – the highest of any post-1968 president. On the more complex misery index conceived by economist Robert Barro, which measures inflation, unemployment, interest rates, and GDP growth, Carter continues to occupy last place, but Clinton holds first place just ahead of Ronald Reagan. See Raymond Tatalovich and John Fren dreis, 'Clinton, class and economic policy', in Steven E. Schier, ed., *The post-modern presidency: Bill Clinton's legacy in U.S. politics* (Pittsburgh, 2000), pp. 43–4, and Robert Barro, 'Reagan vs. Clinton: who's the economic champ?', *Business Week*, 22 Feb. 1999, p. 22. For a staunch but not wholly convincing econometric defence of Carter's record, see Ann Mari May, 'Fiscal policy, monetary policy and the Carter presidency', *Presidential Studies Quarterly*, 23 (1993), pp. 699–711.

mismmanage the nation's prosperity.⁴ However, the different rankings of these two Democratic presidents in what one scholar has criticized as 'narrow scorecard history' should not obscure what is arguably their real historical significance in terms of economic governance.⁵ Both pursued a common goal to renegotiate the New Deal compact between their party and the American people. With regard to political economy, this entailed a more limited role for government than was the case from the 1940s through the 1960s. Whatever their differences in detail, the Carter and Clinton economic programmes, as finally constituted, shared common principles: greater reliance on the market economy to achieve prosperity; prioritization of the inflation problem over unemployment; restoration of balanced budgets; the elevation of monetary policy over fiscal policy as the principal instrument of economic management; and emphasis on supply-side measures to enhance investment and long-term economic strength.

The economic course steered by both Carter and Clinton departed from the liberal tenets of the fiscal revolution of the mid-twentieth century. Post-war Democratic administrations drew upon Keynesian doctrines that Franklin D. Roosevelt's administration had adopted hesitantly in the late 1930s and then applied more robustly to underwrite full economic recovery from the Great Depression during the Second World War.⁶ Public policy therefore facilitated the transition from the producer-oriented capitalism of the American past to the consumer-oriented capitalism of modern times. In the Keynesian ethos, it was not the level of saving that determined the level of investment, as classical economics decreed, but the level of consumption because demand for goods was the determinant of business confidence. Manipulation of aggregate demand through federal spending and taxation constituted the organizing principle of Democratic economic policy for thirty years after the war. The Employment Act of 1946 legitimized, albeit vaguely, government responsibility for maximum employment, production, and purchasing power and signalled the president's status as chief manager of prosperity by creating the Council of Economic Advisers (CEA) to assist him. Over the next two decades Democratic economic activism grew increasingly ambitious. At the minimum, exemplified by Harry Truman's response to the 1949 recession, it entailed running countercyclical budget deficits to compensate for decline in the private economy. More significantly, as optimism grew about the seemingly limitless capacity of the post-war economy, the Democrats sought to accelerate economic expansion in the recovery stage of the business cycle.

⁴ Bob Woodward, *The agenda: inside the Clinton White House* (New York, 1994), pp. 23, 62; Martin Walker, *Clinton: the president they deserve* (rev. edn, London, 1997), pp. 155, 166.

⁵ See Bruce J. Schulman, 'Slouching towards the supply-side: Jimmy Carter and the new American political economy', in Gary M. Fink and Hugh Davis Graham, eds., *The Carter presidency: policy choices in the post-New Deal era* (Lawrence, KS, 1998), esp. pp. 51–2.

⁶ The best economic study remains Herbert Stein, *The fiscal revolution* (Chicago, 1969). For the political impact of Keynesianism, see Alan Brinkley, *The end of reform: New Deal liberalism in recession and war* (New York, 1995).

What one historian has labelled 'growth liberalism' was promoted initially by the Truman CEA, was developed further in the late 1950s as a Democratic antidote for the slack economy of Eisenhower's second term, and found ultimate expression in the new economics of the Kennedy–Johnson administrations that utilized consumption-boosting tax reduction to close the production gap between actual and potential economic growth.⁷ The expansion of productive capacity generated not only full employment but also bumper tax revenues to fund social activism at home and containment of communism abroad. It was also seen as the means to keep inflation at bay. The Keynesian economists who directed 1960s Democratic economics from their CEA bailiwick were confident of achieving a benign 'Phillips curve trade-off', whereby policy-makers could choose combinations of inflation and unemployment rates that were appropriate in light of their relative costs.⁸ Their optimism on this score barely faltered even as the additional demand pressures of Vietnam war spending on an economy effectively operating at full capacity drove up the annual inflation rate from under 2 per cent in 1964 to 4.7 per cent in 1968. The inclusion in the Johnson CEA's final *economic report* of a Phillips curve diagram based on annual inflation and unemployment data from 1954 to 1968 expressed the conventional Keynesian belief that movement up and down the curve was still possible. CEA chair Arthur Okun acknowledged that the 'task of combining prosperity with price stability now stands as the major unsolved problem of aggregative economic performance', but insisted that a 'satisfactory compromise' between these two ends could be formulated.⁹

In their efforts to find this satisfactory compromise, the next two Democratic presidents moved away from Keynesianism but did not embrace a new theory in its place. Their mode of economic governance was empirical and pragmatic rather than doctrinaire. As such it was in harmony with the political beliefs of both Carter and Clinton. Neither of these former southern governors was a devotee of the socioeconomic liberalism instilled in the northern wing of their party by the New Deal. Carter traced his political values to early twentieth-century southern progressivism with its concern for economy and efficiency in government and compassion for the poor. He described himself as a fiscal conservative, but liberal on matters like civil rights, the environment, and 'helping people to overcome handicaps to lead fruitful lives', an ideological

⁷ Robert M. Collins, *More: the politics of economic growth in postwar America* (New York, 2000), pp. 17–97. See too: Iwan Morgan, *Eisenhower versus 'the spenders': the Eisenhower administration, the Democrats and the budget, 1953–1960* (London, 1990), pp. 40–8, 171–3; Allen J. Matusow, *The unraveling of America: a history of liberalism in the 1960s* (New York, 1984), pp. 30–59, 153–79.

⁸ *Economic report of the president 1962*, pp. 44–8. See too the memoir of CEA member James Tobin, *The new economics a decade older* (Princeton, 1974), pp. 15–17. For the Phillips curve, which tracked the relationship between rising wages and inflation and declining unemployment, see A. W. Phillips, 'The relationship between unemployment and the rate of change of money wage rates in the United Kingdom, 1861–1957', *Economica*, 25 (1958), pp. 283–99.

⁹ *Economic report of the president 1969*, p. 42; Arthur Okun, *The political economy of prosperity* (Washington, DC, 1970), p. 130.

construct that appeared to make him the legatee of Dwight Eisenhower rather than Franklin D. Roosevelt.¹⁰ Clinton defined himself as a centrist New Democrat rather than a New Deal Democrat and played a leading role in the project of the southern-dominated Democratic Leadership Council to move the party away from its liberal traditions. Announcing his presidential candidacy in 1991, he articulated a vision for expanded economic opportunity that was resolutely ambiguous in its ideological character. ‘The change we must make isn’t liberal or conservative’, Clinton avowed, ‘It’s both and it’s neither.’ Such androgynous values saddled him with a reputation for expediency and inconsistency but later enabled him to deal with a Republican congress through a triangulation strategy. In 1995–6 Clinton did much to constrain the ‘contract with America’ agenda of conservative Republicans by reaffirming his centrist image through identification with the most popular symbols of both parties – middle-class entitlements in the case of the Democrats and balanced budgets, welfare reform, and tough-on-crime initiatives in the case of the Republicans.¹¹

Economic circumstances reinforced the non-doctrinaire nature of post-Keynesian Democratic economic management. In Carter’s case, the battle against stagflation entailed initial dithering about whether to prioritize inflation or unemployment and repeated policy failure before adoption of a robust anti-inflation strategy from an increasingly limited range of policy choices. The fog of uncertainty inhibited confident assertion that his administration was on the right economic course. In April 1978 a White House aide warned, ‘It is important, if we do not know the consequences of our actions, or know them to be small in effect and limited in duration, not to promise too much ... Whatever steps are announced, we should try to have viewed as a pragmatic response to the immediate situation with the promise of further actions to follow.’¹² Even when the administration finally decided to prioritize inflation, its rhetoric remained hesitant and qualified. Just before Carter addressed the nation about a new anti-inflation strategy in October 1978, his media advisers urged him to warn that Americans ‘should not expect too much from these or any other measures ... Bringing inflation under control is a slow, tedious, *on-going* process – there is no quick fix.’ The president duly told his audience, ‘[T]here is no single solution for inflation. What we have, instead, is a number of partial measures. Some of them may help,

¹⁰ Jimmy Carter, *Keeping faith: memoirs of a president* (New York, 1982), pp. 73–4. See too John Dumbrell, *The Carter presidency: a re-evaluation* (Manchester, 1993); and Kenneth E. Morris, *Jimmy Carter: American moralist* (Athens, GA, 1996).

¹¹ ‘Announcement of candidacy for president by Bill Clinton’, 3 Oct. 1991, speech reproduced in Robert E. Levin, *Bill Clinton: the inside story* (New York, 1992), pp. 277–87 (quote p. 281); Bert A. Rockman, ‘Cutting with the grain: is there a Clinton leadership legacy?’, in Colin Campbell and Bert A. Rockman, eds., *The Clinton legacy* (New York, 2000), pp. 274–94; Bruce Miroff, ‘Courting the public: Bill Clinton’s postmodern education’, in Schier, ed., *Post-modern presidency*, pp. 106–23.

¹² Al Stern to Stuart Eizenstat, ‘Inflation’, 4 Apr. 1978, domestic policy staff [dps] – Eizenstat, box 144, Jimmy Carter Library (JCL).

others will not ... [we have] to maintain a constant search for additional steps which may be effective.¹³

Thereafter Carter's speeches grew progressively pessimistic in the face of seemingly intractable economic problems and held out little hope of immediate improvement. To the ears of the then obscure young governor of Arkansas these jeremiads made the president sound more 'like a 17th century New England Puritan than a 20th century Southern Baptist'.¹⁴ As president himself, Clinton restored optimism to Democratic rhetoric but continued in practice to pursue a cautious, empirical approach to economic policy. He campaigned in 1992 on a promise of massive public investment to achieve the 'most dramatic economic growth program since the Second World War'.¹⁵ This appealed to voters worried about job insecurity amidst a recession that had pushed the unemployment rate up to 7.5 per cent in the pre-election period, but in office Clinton quickly shifted emphasis to keeping inflation in check. One of the defining characteristics of his economic policy was the determination to learn from the mistakes of the past. It pursued growth only insofar as anti-inflation imperatives allowed and sought to eradicate what was deemed the principal threat to long-term economic strength – the mammoth budget deficit inherited from the Reagan era. This meant treating economic policy as a technical matter of competent management rather than as the grand crusade it had been for both post-war liberalism and 1980s conservatism. It was only after the economy improved that the Clinton administration offered a coherent vision of how this had been achieved. The CEA's 1997 *economic report* outlined a middle-way strategy between tax and spend liberalism and the trickle down ethos of Reaganomics. 'Arriving at an economic philosophy that lies between these two', avowed CEA chair Joseph Stiglitz, 'represents an achievement in the sense that it lays a new course, a direction for our time.'¹⁶ Though critical of the report, liberal economist James Galbraith acknowledged, 'After three years of tacking one way and another, the Clinton council here has made its most serious attempt to define how it thinks and what it stands for.'¹⁷

¹³ Jerry Rafshoon, Greg Schneider, and Jim Fallows, memorandum for the president, 'Anti-inflation "fireside"', 4 Oct. 1978, staff secretary's file (ssf) – presidential handwriting file (phf), box 105, JCL; 'Anti-inflation program', *Public papers of the presidents of the United States* (hereafter *Public papers*): *Jimmy Carter 1978 II*, p. 1840.

¹⁴ Quoted in William E. Leuchtenburg, 'Jimmy Carter and the post-New Deal presidency', in Fink and Graham, eds., *The Carter presidency*, p. 21. Historian Leo Ribuffo has suggested that Carter's 'visceral puritanism' predisposed him to accommodate rather than seek to overcome the limits of the 1970s economy. See Ribuffo, 'Jimmy Carter and the selling of the president, 1976–1980', in Herbert D. Rosenbaum and Alexej Ugrinsky, eds., *The presidency and domestic policies of Jimmy Carter* (Westport, CT, 1994), p. 616.

¹⁵ Bill Clinton and Al Gore, *Putting people first: how we can all change America* (New York, 1992), p. 7.

¹⁶ *Economic report of the president 1997*; Joseph Stiglitz, 'Defending the Clinton administration', *Challenge*, 40 (May–June 1997), p. 22.

¹⁷ James Galbraith, 'The Clinton administration's vision', *Challenge*, 40 (July–Aug. 1997), p. 45. Previous CEA statements of a new economic philosophy had been made in the relevant administration's first economic report – 1954 for Eisenhower economics, 1962 for the new economics, and 1982 for Reaganomics.

Shortly after his narrow election victory in 1992, Clinton acknowledged, 'The economy is why we started down this road ... [and] the economy is why the American people gave me the chance ... to turn this country around.'¹⁸ Accordingly economic issues were at the core of his presidential agenda from the outset. By contrast, Carter did not give them the same prominence until he had been in office for over eighteen months.¹⁹ In late 1977 Vice President Walter Mondale in vain urged him to use the forthcoming state of the union address to make the economy the administration's cardinal issue.²⁰ As domestic policy aide Bob Ginsberg commented, 'I do not think the President sees himself as, or will want to run for reelection as, a "man of the economy".'²¹

Carter's reluctance to be a 'man of the economy' was unsurprising given CEA projections that his first term economic record would be only average, but it also testified to the initial fuzziness of his economic agenda. When he took office nearly 8 million Americans, 7.5 per cent of the labour force, were unemployed, while inflation was a relatively low 4.8 per cent. The economy was in an abnormally slow recovery from the 1974–5 recession, the worst since the 1930s, which had been triggered by fiscal and monetary restraint to curb the surge of inflation above 12 per cent in the wake of the oil price increases levied by the Organization of Petroleum Exporting Countries (OPEC). Carter owed his narrow election as president in 1976 to the solid support of the traditional Democratic constituency of blue-collar and low-income voters who were worried about unemployment. Accordingly, he recognized that 'joblessness was our most pressing economic problem', yet he also worried that the record \$73.7 billion deficit inherited from the Ford administration and the constant escalation of federal spending were 'root causes' of inflation.²² Carter's early attempts to balance these unemployment and inflation concerns made his economic policy appear confused and vacillating.

In the planning sessions to develop the new administration's economic policy, Carter showed himself more optimistic about the prospects of employment growth without large-scale federal stimulus than the economists called in from the Democratic party's Keynesian cadre to advise his transition team. One of these, Lawrence Klein, later commented, 'We were surprised at how closely the unemployment rate fitted in with his view and the way things worked out.' At the time, however, CEA chairman-designate Charles Schultze stated

¹⁸ Quoted in *President Clinton's new beginning: the complete text ... of the historic Clinton-Gore economic conference, Little Rock, Arkansas, December 14–15, 1992* (New York, 1992), p. 3.

¹⁹ See W. Carl Biven, *Jimmy Carter's economy: policy in an age of limits* (Chapel Hill, NC, 2002); Schulman, 'Slouching towards the supply-side', pp. 51–71; and John T. Woolley, 'Exorcising inflation-mindedness: the transformation of economic management in the 1970s', *Journal of Policy History*, 10 (1998), pp. 130–52.

²⁰ Mondale to Stuart Eizenstat, 7 Dec. 1977, dps – Eizenstat, box 194. Carter's closest confidante, budget director Bert Lance, had also warned that his presidency would stand or fall on the economy. See Bert Lance with Bill Gilbert, *The truth of the matter: my life in and out of politics* (New York, 1991), p. 127.

²¹ Ginsberg to Eizenstat, 7 Dec. 1977, Eizenstat to Mondale, 7 Dec. 1977, dps – Eizenstat, box 194.

²² Carter, *Keeping faith*, pp. 75–6.

unequivocally that at current growth rates there would still be slack in the economy two years hence and a stimulus programme could be undertaken without fuelling inflation.²³ Carter bowed to this expert advice, though without enthusiasm and within the limits of his instincts. On 31 January 1977, he announced a stimulus programme whose \$15.5 billion cost for fiscal 1977 ran counter to his own prudence but drew criticism from Keynesian *doyen* Walter Heller as ‘unduly modest’ at less than 1 per cent of gross national product.²⁴ In mid-April, signs that unemployment was falling faster than expected led Carter to withdraw a key element of the stimulus, the \$50 *per capita* tax rebate, on grounds that its effects were now likely to be inflationary. At the next day’s press conference, however, he avowed: ‘I think that if you deliberately accept unemployment as a means to control inflation, that’s wrong.’²⁵ The administration consequently eschewed bold action against either element of the stagflation problem for fear of the unacceptable consequences for the other. It was not a position that could be held indefinitely. In late 1977 the CEA warned Carter that failure to reduce the underlying inflation rate – now above 6 per cent – would result in ‘significant acceleration’ of price instability in late 1979 or early 1980, which would ‘pose a serious threat to the continuation of healthy expansion’.²⁶

Acknowledging the growing severity of the inflation problem proved easier than resolving it. Lacking a clear doctrinal impulse, Carter’s economic programme evolved incrementally in response to the shifting balance of power between the groups within the administration competing for the president’s ear. The disorganization of economic policymaking structures, which lacked a clear chain of command, increased the difficulties of achieving consensus in support of strong measures. Officials from the Office of Management and Budget (OMB) and the treasury and the conservative Georgians on the presidential staff wanted all-out war on inflation even at the cost of economic slowdown. In their view a short recession early in Carter’s presidency would not harm his reelection if price stability was restored.²⁷ Aligned against them were the heads of cabinet departments like health, education and welfare, housing and urban development, and labour, who were anxious to protect

²³ Klein quoted in Biven, *Carter’s economy*, p. 79; Charles Schultze to Walter Mondale, ‘Anti-inflation aspects of the administration’s economic program’, 19 Jan. 1977, dps – Eizenstat, box 144, JCL.

²⁴ ‘Economic recovery program’, *Public papers: Carter 1977 I*, pp. 47–55; Committee on Ways and Means, Hearings on the Tax Aspects of President Carter’s Economic Stimulus Program, 94th Congress, 1st session, p. 199.

²⁵ Carter interview, JCL (Miller Center Oral History); ‘The president’s news conference of April 15, 1977’, *Public papers: Carter 1977 I*, p. 633.

²⁶ Schultze, memorandum for the president, ‘Friday morning meeting with your economic advisers’, 7 Dec. 1977, ssf – phf, box 63, JCL.

²⁷ OMB director James McIntyre interview, JCL; treasury secretary Michael Blumenthal to the president, ‘Possible further cut in FY ’79 budget’, undated (but mid-May 1978 – Carter wrote on it ‘I agree with thrust’), phf – ssf, box 87, JCL; Gerald Rafshoon to Carter, 1 Sept. 1978, *ibid.*, box 101.

their constituencies against spending cuts and recession.²⁸ A third group comprising the CEA, domestic policy chief Stuart Eizenstat and his staff, inflation adviser Alfred Kahn and Vice President Mondale effectively held the balance. It initially sought a way of restraining inflation without economic contraction but eventually came to accept the need for progressively stronger measures to attain price stability. Eizenstat later acknowledged that the administration had been too temperate in addressing inflation early on. 'I was very much part of that temperance', he reflected, 'because there was a mortal fear among Keynesians of throwing the economy into recession and of hurting poor people, hurting our constituents.'²⁹

The most significant indication of the eclipse of Keynesian thinking was the CEA's eventual advocacy of anti-inflation imperatives. A fellow of the liberal think tank, the Brookings Foundation, Charles Schultze was the voice of the old orthodoxy in the administration. In July 1977 he urged Carter to adopt a 1960s style fine-tuning approach that would safeguard economic growth through 'a balanced high-employment budget strategy ... [by which] the fiscal dials are set to produce a balanced budget in 1981 only if the economy returns to high employment'.³⁰ Like other Keynesians, Schultze attributed inflation to demand shocks, namely the Vietnam war and President Nixon's excessive stimulation of the economy to achieve reelection, and the OPEC oil price shock that he mistakenly assumed would not recur. Only belatedly did the CEA perceive the existence of a new and more dangerous source of inflation in the 1970s, the slowdown in productivity growth. As a result its early economic forecasts of modest employment growth and relative price stability proved inaccurate. A frustrated Carter reportedly exploded at one cabinet meeting, 'There's a mystic down in Smithville who's got as good a batting average as my economic advisers.' When the CEA eventually produced more realistic estimates of inflation, the president ruefully commented, 'I hope your present forecasts are also wrong!'³¹

Average annual productivity growth, which had been a healthy 2.8 per cent between 1945 and 1973, dropped below 1 per cent in the mid-1970s and actually turned negative in 1979. The reasons for this were unclear at the time and remain a matter of largely ill-informed speculation.³² The productivity slowdown, which was difficult to perceive until it had been going on for some time, led to crucial

²⁸ Health, education, and welfare secretary Joseph Califano to the president, 'Inflation and budget strategy for fiscal 1980', 18 Sept. 1978, dps – Eizenstat, box 145, JCL; labour secretary Ray Marshall to the president, 'Responsibility for inflation', 17 Oct., 1977, ssf – phf, box 56, JCL.

²⁹ Quoted in Hobart Rowen, *Self-inflicted wounds: from LBJ's guns and butter to Reagan's voodoo economics* (New York, 1994), p. 176.

³⁰ Schultze to the president, 'Economic and budgetary outlook for fiscal years 1979–1981', 7 July 1977, dps – Eizenstat, box 191, JCL.

³¹ Carter quoted in Hobart Rowen, 'The tax-cut dilemma', *Washington Post*, 11 May 1978, p. 1; Schultze to the president, 'Our past forecasts', 14 Dec. 1979, ssf – phf, box 160, JCL.

³² For analysis of the causes of the slowdown, see Paul Krugman, *Peddling prosperity: economic sense and nonsense in the age of diminished expectations* (New York, 1994), pp. 55–65.

errors in policy because the CEA overestimated the economy's potential output and consequently its level of slack, which determined how much it could be stimulated before inflation grew. What finally alerted the Carter economists to the decline was that unemployment was actually falling faster than economic growth warranted because it now took more workers to increase gross domestic product (GDP). In May 1978 Shultze advised the president that the productivity slowdown necessitated 'considering strategies to reduce the FY 1979 and 1980 budget deficits'. Carter underlined these words on his copy of the memorandum and penned in the margin 'a new convert?'.³³ Nevertheless, the CEA continued to underestimate the problem, which it hoped would be temporary, so its assessment of how much restraint was needed to curb inflation remained faulty. Not until late 1979, by when the core inflation rate was running at 9 per cent even without allowance for the effects of the new round of oil price increases imposed by OPEC in the wake of the Iranian revolution, did Schultze recognize the true severity of the productivity decline.³⁴

Carter announced his determination to make the conquest of inflation his chief economic priority in an address to the nation on 24 October 1978. The new programme he unveiled contained deregulation initiatives, budgetary restraint, a cap on federal hiring, new wage-price guidelines, federal procurement restrictions in favour of firms that upheld the guidelines, and a proposal for real-wage insurance giving workers who met the pay standards a tax rebate if annual inflation exceeded 7 per cent.³⁵ The most successful component was deregulation, but this was a policy that acquired an anti-inflation rationale rather than being specifically conceived to this end. Reaction against economic regulation grew in the early 1970s because of broad concern that it served the entrenched interests of producers and workers in an industry rather than the public, inhibited innovation, and distorted prices. Hearings held in 1975 by the senate's subcommittee on administrative practice and procedure, chaired by Edward Kennedy, had put deregulation on the political agenda. Carter himself had promised in his 1976 campaign to promote deregulation in the name of equity and efficiency and made the airlines his first target. The battle against inflation gave added momentum to this agenda, which was extended to include trucking, railways, and financial institutions. This swathe of deregulation was enacted in the face of considerable opposition from special interests and arguably constituted Carter's greatest economic achievement.³⁶ In contrast, the rest of his 1978 anti-inflation programme proved a damp squib.

³³ Schultze to the president, 'Some disturbing thoughts about the economic outlook', 6 May 1978, ssf - phf, box 84, JCL.

³⁴ Schultze to the president, 'Briefing notes for tomorrow's meeting with Giaino and Muskie', 10 May 1978, ssf - phf, box 85, JCL, and 'An outline of short and long-run anti-inflation strategy', 17 Oct. 1979, *ibid.*, box 152.

³⁵ *Public papers: Carter 1978 II*, pp. 1839-48.

³⁶ Biven, *Carter's economy*, pp. 217-22; Martha Derthick and Paul Quirk, *The politics of deregulation* (Washington, DC, 1985); Dorothy Robyn, *Breaking the special interests: trucking deregulation and the politics of policy reform* (Chicago, 1987).

The administration held high hopes for the wage–price guidelines but the surge of inflation generated by the oil price increases of 1979 torpedoed them at launch. As a result they antagonized the unions, bred public cynicism that violations would be penalized, and proved virtually impossible to administer.³⁷ In March 1979 the president’s new inflation adviser, Alfred Kahn, warned, ‘The price standards are close to futile in an overheated economy. They are being ignored by many businesses Without price restraint, there is no chance that labor will continue to accept wage increases well below the expected rise in the cost of living.’³⁸ Though the CEA later claimed that the guidelines had moderated wage increases in 1979 by 1 to 1.5 percentage points, this did little to mitigate the actual inflation rate of 13.3 per cent. A more pessimistic assessment by the General Accounting Office found ‘no convincing evidence’ that they had ‘any effect’ on inflation in 1979–80.³⁹ Meanwhile the rapid rise in inflation persuaded congress to reject the real-wage insurance proposal for fear that this would saddle the government with huge costs at a time of budgetary retrenchment.

Carter’s efforts to impose fiscal restraint also had limited economic success in the war on inflation but had immense consequences for Democratic unity. In the eyes of the president and his advisers, budget deficits had become harbingers of inflation that drove up interest rates, aggravated demand pressures at a time of productivity decline, and served as a bad example of public excess when business and labour were being asked to practise price and wage restraint.⁴⁰ Their fiscal 1980 budget plan, which presidential aides described as ‘the most constrained budget in years’, aimed to reduce the deficit to \$29 billion, half the fiscal 1978 level, as a prelude to balancing the budget in fiscal 1981.⁴¹ On this occasion an internal administration debate about whether to specify such an ambitious target resulted in victory for treasury and OMB hawks over the domestic policy staff, who warned that it would alienate the Democratic constituencies and might produce economic slowdown, and the CEA, which estimated that a deficit of \$32 to \$35 billion was more realistic.⁴² Experience soon showed, however, that fiscal policy was an ineffective instrument against inflation.

Achieving deficit reduction of the scale planned required cutbacks in real spending, but the administration signally failed to persuade congress to support

³⁷ Ray Marshall to Charles Schultze, 16 Mar. 1979, White House central files – subject files (whcf – sf), series BE-4, box BE-19, JCL.

³⁸ Alfred Kahn to the president, ‘Anti-inflation policy’, 16 Mar. 1979, ssf – phf, box 123, JCL.

³⁹ *Economic report of the president 1981*, p. 59; General Accounting Office, *The voluntary pay and price standards* (Washington, DC, 1980), pp. 1–2.

⁴⁰ See, for example, Charles Schultze to the president, ‘Califano’s memorandum on budget strategy for fiscal 1980’, 2 Oct. 1978, ssf – phf, box 105, JCL.

⁴¹ James McIntyre and Frank Moore to the president, ‘White House budget task force’, 6 Dec. 1978, ssf – phf, box 111, JCL.

⁴² Michael Blumenthal to the president, 27 Sept. 1978, Eizenstat and Bob Ginsburg to the president, ‘Schultze decision memo on the anti-inflation program’, 29 Sept. 1978, Charles Schultze to the president, ‘Ani-inflation program: decision memo’, 26 Sept. 1978, dps – Eizenstat, box 145, JCL.

retrenchment. Inherited legislative commitments for expenditure expansion and the magnitude of uncontrollable entitlement programmes, notably those benefiting the elderly, limited the margin for discretionary budget reductions. To make matters worse, the decline of détente and renewal of Cold War tensions prompted Carter to propose a 3 per cent real increase in military spending in the otherwise austere fiscal 1980 budget plan.⁴³ This attempt to finance defence expansion through domestic spending retrenchment ran counter to the New Deal tradition. It outraged core Democratic constituencies like labour, African Americans, and urban groups. The congressional black caucus, for example, castigated the budget as 'unjust and immoral' in its treatment of the poor and disadvantaged. The president's frosty reception at the Democratic mid-term convention in Memphis in December 1978 prefaced the difficulties he would encounter with liberal Democrats in congress and in the party at large over the next two years.⁴⁴ Congress eventually voted even more money than Carter requested to build up America's military but also increased appropriations for the domestic programmes he wanted to cut. As a result, total federal spending grew from 20.7 per cent to 22.2 per cent of GDP between fiscal 1977 and fiscal 1981 and discretionary expenditure on domestic programmes was 2.4 per cent higher in real terms in the 'austerity' budget of fiscal 1980 than in fiscal 1979.

Carter's hopes of balancing the budget were blown even further off course by economic slowdown and recession. Having whittled down the record imbalance inherited from Ford to \$40.2 billion in fiscal 1979, the president saw his final two budgets accumulate enlarged deficits of \$73.8 billion and \$79 billion. The only comfort to the administration was that the rate of expenditure growth had slowed. Human resource spending, the largest element of the federal budget, had increased from 7.0 per cent to 11.2 per cent of GDP between fiscal 1969 and 1977, but stood at only 11.8 per cent of GDP in fiscal 1981.⁴⁵ Even so, an air of desperation permeated the White House in the face of the growing deficit. OMB forecasts that the fiscal 1980 deficit would be at least 50 per cent higher than expected made nonsense of the nearly balanced budget projection in the fiscal 1981 budget plan that went to congress in January 1980. This caused panic on Wall Street, which led in late February to the collapse in the bond market, the major source of capital investment, because of concern that a rising deficit would aggravate inflationary pressures which would in turn undermine the value of assets. In reality bond prices had been in decline since October 1979 and portfolio losses over the next four months ran to an estimated \$400 billion. Nevertheless,

⁴³ Dennis Ippolito, *Why budgets matter: budget policy and American politics* (University Park, PA, 2003), pp. 208–21.

⁴⁴ 'Congressional black caucus statement on economic policy', 19 Jan. 1979, copy in staff office files – Louis Martin, box 15, JCL; Burton I. Kaufman, *The presidency of James Earl Carter Jr* (Lawrence, KS, 1993), pp. 133–5.

⁴⁵ *Historical tables, budget of the United States government, fiscal year 2005* (Washington, DC, 2004), pp. 48–9.

Carter's budget was widely held to have tipped the bond market into freefall.⁴⁶ In an effort to restore investor confidence, the president took the unprecedented step of recalling his budget from congress and instructed his economic policy team to produce a new balanced budget plan with additional spending cuts for presentation in March. Yet there was no prospect of congress enacting all the new cuts, while the depressing effect of economic slowdown on revenue was certain to produce a budget imbalance even if the proposed retrenchment were achieved. As Stuart Eizenstat presciently warned '[W]e are proposing a budget program which is unachievable and undesirable in the present recessionary climate.'⁴⁷

The abject failure of wage-price guidelines and budgetary restraint left monetary policy as the only viable option in the battle against inflation. Paradoxically, Carter had in early 1978 denied a second term as federal reserve chairman to Arthur Burns, a Nixon appointee who was unsympathetic to the administration's initial preference for a trade-off between inflation and unemployment. Even treasury secretary Blumenthal joined Schultze in counselling the president that Burns 'will not hesitate to frustrate the employment goal if he thinks there is the slightest risk for the inflation goal'. They also warned him, 'A Fed chairman forceful enough to dominate the Board has the power to enforce his own priorities on the nation.'⁴⁸ This was precisely what happened when Carter eventually came to rely on monetary policy to fight inflation. The key institutional change between the old and new Democratic political economy would be the president's *de facto* replacement as chief economic manager by the federal reserve chair.

Burns's replacement, William Miller, proved too soft on inflation when administration priorities changed. In early 1979 Schultze warned that the federal reserve was 'exerting very modest restraint', the first ever expression of concern by any Democratic CEA chair that monetary policy was not tight enough.⁴⁹ Eventually in August 1979 Miller was persuaded to become treasury secretary and was replaced by Paul Volcker, an inflation hawk who had won the confidence both of Wall Street and the international currency markets as president of the New York federal reserve bank. Before accepting the post, Volcker made plain to Carter his convictions about 'the importance of an independent central bank and the need for tighter money'. In his first appearance before congress as fed chair,

⁴⁶ 'America's bond market crash', *Economist*, 8 Mar. 1980, pp. 12-13; 'A lever against inflation', editorial, *Washington Post*, 24 Feb. 1980, p. B6; 'The case for a new, and balanced, budget', editorial, *New York Times*, 28 Feb. 1980, p. 22. See too, Joseph White and Aaron Wildavsky, *The deficit and the public interest: the search for responsible budgeting in the 1980s* (Berkeley, 1989), pp. 28-33.

⁴⁷ Stuart Eizenstat to the president, 'Economic decisions', 1 Mar. 1980, ssf - phf, box 173, JCL.

⁴⁸ Blumenthal and Schultze to the president, 10 Dec. 1977, Lipschutz file - federal reserve board, box 10, JCL. See, too, Wyatt Wells, *Economist in an uncertain world: Arthur Burns and the federal reserve, 1970-1978* (New York, 1994).

⁴⁹ Schultze to the president, 'Policy response to recent economic developments', 16 Mar. 1979, ssf - phf, box 123, JCL. Blumenthal and Schultze orchestrated a campaign of press leaks to pressurize Miller into action until rebuked by Carter for 'unnecessary and improper' conduct, a handwritten comment on Schultze to the president, 11 Apr. 1979, whcf - sf, FI-27, box FI-7, JCL.

he reaffirmed his belief in the absolute priority of price stability and the impossibility of an inflation–unemployment trade-off. ‘That is the lesson of the 1970s’, Volcker declared, ‘not just in the United States but elsewhere.’⁵⁰

On 6 October 1979 a secret meeting of the federal reserve board agreed to adopt monetary targeting, which entailed controlling the aggregate quantity of money and reserves, rather than the conventional anti-inflation policy of incremental interest rate rises. This gave the fed greater control over the money supply and put the onus on banks and financial markets to raise interest rates.⁵¹ The combined effect of skyrocketing interest rates and the federal reserve’s imposition at the president’s behest of consumer credit controls in March 1980 pushed the economy into a brief but sharp recession, marked by the steepest ever quarterly decline of GDP between April and June. Paradoxically credit control was an administration effort to ease the cost of consumer borrowing by slowing down credit expansion, but the psychological effect on consumer confidence was much greater than expected. As one analyst has noted, the controls may well have blurred the effects of monetary restraint and prolonged ‘the transition to a non-inflationary environment’.⁵² Their unexpected impact persuaded Congress in July to revoke the 1969 legislation that gave the president authority to recommend such restraint. This marked the end of the US peacetime experimentation with formalized economic controls that had begun in the Nixon era. After the controls were removed, however, the sharp rundown in debt, money supply, and interest rates went into steep reversal with consequent ill effects for inflation. In response, Volcker trod on the monetary brakes again to drive interest rates up to record levels in the pre-election period. After a brief respite at the start of Ronald Reagan’s presidency, the fed lowered monetary targets once again in mid-1981 and finally succeeded in choking off the great inflation that had been building up since the late 1960s – though at the cost of the worst recession since the 1930s.⁵³

Carter’s oft-stated determination to conquer inflation meant that he had no option but to be publicly supportive of Volcker despite the consequences of restraint for his reelection. The president’s sole deviation from this line was an impromptu comment during the election campaign that the federal reserve

⁵⁰ Paul Volcker and Toyoa Gyohten, *Changing fortunes: the world’s money and the threat to America’s leadership* (New York, 1992), p. 64; house committee on the budget, *Hearings on the economic outlook at mid-summer*, 95: 1, pp. 293–4.

⁵¹ Volcker and Gyohten, *Changing fortunes*, pp. 166–8; Erwin Hargrove and Samuel Morley, eds., *The president and the Council of Economic Advisors: interviews with CEA chairmen* (Boulder, CO, 1984), pp. 486–7. See too Paul Volcker, ‘The role of monetary targets in an age of inflation’, *Journal of monetary economics*, 4 (1978), pp. 329–39.

⁵² Biven, *Carter’s economy*, p. 249. For advocacy of credit controls, see Kahn to the president, ‘Anti-inflation policy’, 16 Mar. 1979, ssf – phf, box 123, and Eizenstat to the president, ‘Economic decisions’, 1 Mar. 1980, *ibid.*, box 173, JCL.

⁵³ Kenneth Bacon, ‘Ready reserve: fed vowing to retain “tight money” policies’, *Wall Street Journal*, 4 Aug. 1980, pp. 1, 11; William Greider, *Secrets of the temple: how the federal reserve runs the country* (New York, 1987), pp. 214–18; John W. Sloan, *The Reagan effect: economics and presidential leadership* (Lawrence, KS, 1999), pp. 225–9.

had 'put too much of their eggs in the money supply basket'. Otherwise the administration always defended Volcker to Democratic sceptics and the party's various constituencies.⁵⁴ In private, however, there was considerable doubt within the White House as to whether, in Schultze's words, 'we went through more than we had to'. The CEA preferred a traditional interest rate strategy against inflation because the money supply strategy involved a huge risk. It was an untried policy that could have been very destabilizing and might have produced a full depression. At a conference on the Carter presidency a decade later, however, Schultze reflected more positively on the federal reserve's achievement. 'For Carter to stop the inflation', he declared, 'unemployment would have had to go from 6 per cent to 10 per cent. No democratically elected president can or would do it ... You have to have an independent central bank. If I had said this thirty years ago, I would have thrown rocks at myself.'⁵⁵

Of course, the transfer of anti-inflation responsibility to the federal reserve did not solve the problem of how to restore productivity growth. In pursuit of this end, the Carter administration moved hesitantly towards industrial policy, which entailed a microeconomic and predominantly supply-side approach to specific sectors of the economy in contrast to the demand-related macroeconomic approach of fiscal and monetary policy. Its initiatives foreshadowed the strategy that Bill Clinton advocated with more enthusiasm in 1992. Already well established in Western Europe and Japan, industrial policy generally sought to revitalize older industries and encourage the development of new ones. The Carter administration engaged in a variety of piecemeal interventions to boost problem industries, such as the 1977 Solomon plan for the steel industry (which put a price floor under foreign steel and established a committee to advise on modernization), the 1980 loan guarantee to the ailing Chrysler automobile corporation (made conditional on government oversight of the company's performance), and the various deregulation initiatives.⁵⁶ Encouraged by these ventures, some of Carter's advisers eventually came to see industrial policy as a strategic alternative to Reagan's free market economics.

In a speech in April 1980, Stuart Eizenstat declared that Keynesianism had been 'ill equipped' to deal with productivity problems, so there needed to be '*greater emphasis on the supply side of the economy*'. A second Carter administration, he predicted, would continue to emphasize restrained budgets to combat inflation but would also

⁵⁴ *Public papers: Carter 1980-1981 III*, pp. 2040-1; Hargrove and Morley, *The president and the CEA*, p. 499; Schultze to Congressman Jim Wright, 28 Nov. 1979, whcf-sf, FG 143, box FG-188, JCL. In October 1979, commenting on union leader George Meany's call that he get rid of Volcker, Carter avowed, 'The best way to get interest rates down is to lower inflation.' See 'Interview with the president', *Public papers: Carter 1979 II*, p. 2051.

⁵⁵ Hargrove and Morley, *The president and the CEA*, p. 486; conference remarks in Biven, *Carter's economy*, p. 244.

⁵⁶ Otis Graham, *Losing time: the industrial policy debate* (Cambridge, MA, 1992), esp. pp. 38-45; Richard Vietor, *Contrived competition: regulation and deregulation in America* (Cambridge, MA, 1994), pp. 14-15. For a sharp critique of Carter's limited industrial policy, see Judith Stein, 'The locomotive loses power: the trade and industrial policies of Jimmy Carter', in Fink and Graham, eds., *The Carter presidency*, pp. 72-94.

develop supply-side tax incentives to boost investment, promote further deregulation, and the redevelopment of ailing industries. 'We must improve the productivity of capital – through incentives for innovation, investment and savings – and of labor – by employment and training programs funded by the federal government, particularly for youths and minorities.' Eizenstat avowed, 'We simply cannot rely on the blunt tools of the past – universal tax cuts and broad spending programs.'⁵⁷

The administration's interdepartmental economic policy group worked on developing an industrial policy plan in the summer of 1980. Carter accepted most of its recommendations but balked at proposals for immediate business tax cuts because he insisted on holding to the mid-year budget estimates recently sent to congress. Unveiling the programme on 28 August, the president declared, 'Increasing productivity is the foremost economic challenge of the 1980s.' His proposals included establishment of an economic revitalization board, a national development bank, tripartite committees representing business, labour, and government for major industries, assistance for regions undergoing industrial decline, enhanced depreciation allowance to promote industrial modernization, and investment tax credit revision to assist new businesses and ailing industries that the current tax did not help because they had no earnings.⁵⁸

This programme elicited little enthusiasm from business and labour and was largely ignored by the media. Reagan's election victory ensured that it would never make the transition from blueprint to policy. Over the next decade, however, industrial policy was repackaged as strategic trade policy to emerge as the formative influence on Bill Clinton's grandiose plan for a public investment revolution. The continued stagnation of productivity and the widening trade deficit in the 1980s strengthened the case of those who argued that Reaganite tax cuts for the rich were the wrong supply-side prescription to enhance America's competitiveness in the new environment of economic globalization. Strategic traders argued fundamentally that for America to prosper within the increasingly competitive international economy it had to establish a leading role in what economist Lester Thurow dubbed 'sunrise industries', in which the application of new technologies could boost productivity.⁵⁹ Such thinking came under devastating

⁵⁷ Transcript, 'A non-economist's look at economic policy for the 1980's', speech at University of North Carolina, 10 May 1980, James McIntyre records, box 5, JCL. For similar views, see (all in JCL): Kahn to the president, 'Taking stock on anti-inflationary policy', 5 Nov. 1979, ssf – phf, box 155; Eizenstat to the president, 'Major economic and energy decisions', 11 Dec. 1979, *ibid.*, box 159; Al Stern to Eizenstat, 17 Dec. 1979, dps – Eizenstat, box 192; 'OMB director's report on growth and inflation', June 1980, James McIntyre records, box 7.

⁵⁸ William Miller to the president, 'Background for meeting with economic advisers', 30 July 1980, ssf – phf, box 197, JCL; 'Remarks announcing the economic renewal program', *Public papers: Carter 1980–1981 II*, pp. 1585–91 (quotation p. 1587).

⁵⁹ Lester Thurow, *The zero-sum society* (New York, 1980). Other strategic trade tracts include: *Business Week*, special issue, 'The reindustrialization of America', 30 June 1980; Robert B. Reich and Ira Magaziner, *Minding America's business* (New York, 1982); and Robert B. Reich, *The next American frontier* (New York, 1983). See too Conrad P. Waligorski, *Liberal economics and democracy: Keynes, Galbraith, Thurow and Reich* (Lawrence, KS, 1997).

attack from the Democratic party's economic policy intelligentsia at the August 1983 annual conference of the federal reserve bank of Kansas City at Jackson Hole, Wyoming, on grounds that it overestimated the interdependence of the US economy with the world economy, confused productivity with competitiveness, exaggerated US industrial decline, and ignored empirical evidence in designating some industries as 'sunrise' and others not.⁶⁰ Accordingly, strategic trade did not figure in the Democratic presidential campaign agendas of 1984 and 1988. It found its way back into the fold thanks largely to Harvard professor and Clinton confidante Robert Reich, who conceived of public investment as a politically more attractive means to the same ends.⁶¹

Clinton's 1992 *Putting people first* manifesto utilized Reich's ideas in advocating massive public investment in human capital, mainly education and training, and infrastructure programmes like transportation, communication, and technology to enhance America's global competitiveness. Expenditure that could be labelled 'investment' and whose purpose was to help the 'working middle class' fitted the new Democrat emphasis on personal opportunity and responsibility in preference to tax and spend palliatives. Clinton signalled his intentions by inviting Robert Reich to head his economics transition team. In his diary, the latter recorded the president-elect telling him: 'Macroeconomics is important, but micro is critical – productivity, education, job training, management–labor relations. So the whole thrust will be new and different.'⁶²

Despite this initial optimism federal outlays for non-defence public investment actually declined from 1.8 per cent to 1.6 per cent of GDP between fiscal 1992 and fiscal 2000. Clinton's ambitions fell victim to the restoration of deficit reduction priorities at the outset of his presidency. The fiscal 1992 deficit of \$290.4 billion (4.9 per cent of GDP) inherited from the Bush administration was far higher than expected because of the depressing impact of the recession on tax revenues. This marked a serious reversal of the downward movement of the deficit in the late 1980s after the level of public borrowing had mushroomed in Ronald Reagan's first term. In February 1993, Clinton warned congress that on current trends the deficit would grow to \$635 billion, raising the national debt to nearly 80 per cent of GDP, by the end of the decade.⁶³

The renewed deficit problem gave rise to a struggle over economic priorities between two groups within the Clinton White House. The so-called 'gang of four' – treasury secretary Lloyd Bentsen, budget director Leon Panetta, deputy

⁶⁰ Krugman, *Peddling prosperity*, pp. 254–66. The author wrote one of the background papers for the conference.

⁶¹ See Robert B. Reich, *The resurgent liberal (and other unfashionable prophecies)* (New York, 1989), and idem, *The work of nations: preparing ourselves for 21st-century capitalism* (New York, 1993).

⁶² Robert B. Reich, *Locked in the cabinet* (New York, 1997), p. 8.

⁶³ 'Address to the joint session of congress', *Public papers: Clinton 1993 I*, pp. 195–203. The deficit had declined from its high point of \$207.8 billion (6.0 per cent GDP) in fiscal 1983 to \$152.5 billion (2.8 per cent GDP) in fiscal 1989. See *Historical tables, budget of the United States government, fiscal year 2005*, p. 25 (and p. 157 for public investment statistics).

budget director Alice Rivlin, and national economic council (NEC) director Robert Rubin – insisted that deficit reduction was essential to bring down long-term interest rates and generate strong economic recovery. Aligned against them were labour secretary Robert Reich, CEA chair Laura Tyson, NEC deputy director Gene Sperling, and the 1992 campaign consultants James Carville and Paul Begala, who regarded the public investment programme as essential to create jobs for and increase the wealth of Americans in the lower half of the income distribution.⁶⁴ The deficit hawks won the argument because Clinton heeded their claims that the Wall Street bond market and foreign investment in dollar-denominated bonds would react positively to deficit reduction. The voice of former Goldman Sachs investment bank co-chair Robert Rubin was especially influential in tutoring the president that a sound fiscal policy was essential to the well being of America's economy in view of the increasing globalization and integration of financial markets. As Laura Tyson later acknowledged, 'At that point, it was very important that he could say that based on his own [Wall Street] experience.' For his part, Rubin later commented that historians would come to regard Clinton as 'the first American President with a deep understanding of how these issues were reshaping our economy, our country, and the world'.⁶⁵

The five-year budget plan that became the core of the administration's economic recovery programme projected a net deficit reduction of \$473 billion. It also proposed an aggregate increase in investment spending of \$153 billion, but the portion of this devoted to new commitments was far lower than Reich and his allies wanted and was mainly back-loaded at the end of the cycle. However, the White House had failed to take into account the five-year caps on discretionary spending mandated by the Omnibus Budget Reconciliation Act of 1990. Largely devised by the Democratic congressional leadership and reluctantly signed by President George Bush, this measure had originally been intended to compel defence retrenchment, but congressional budgeters now automatically applied its caps to the investment expenditures. Having emphasized the absolute priority of deficit reduction, Clinton was consequently in no position to call for the spending caps to be raised from his investment programme for fear that this would legitimize Republican attacks on the tax increases in his fiscal plan. A disconsolate Robert Reich complained that the deficit reduction plan as finally enacted offered only 'a tiny morsel', barely \$7 billion in total for fiscal 1994 and 1995, for new public investment. In his view, the administration had created a 'conceptual prison' for itself through its insistence that the essential elixir for economic revitalization was reduced government borrowing, 'regardless of what the borrowing is for'.⁶⁶

⁶⁴ The dispute is chronicled in Woodward, *The agenda*, pp. 80–133.

⁶⁵ Tyson quoted in John Judis, 'Old master: Robert Rubin's artful role', *New Republic*, 13 Dec. 1993, p. 21; Robert E. Rubin and Jacob Weisberg, *In an uncertain world: tough choices from Wall Street to Washington* (New York, 2003), p. 121.

⁶⁶ Ippolito, *Why budgets matter*, pp. 258–65; Reich, *Locked in the cabinet*, p. 119. For an interesting comparison of 'new Democrat' and 'new Labour' deficit reduction, see Ravi K. Roy and Arthur T. Denzau, *Fiscal policy convergence from Reagan to Blair: the left veers right* (London, 2004), pp. 71–101.

The outcome of the debate within the Clinton administration over economic priorities signified that the evolution of the new Democratic economics was nearly complete. First, it reaffirmed the orthodoxy of the supply-side approach that had emerged in the Carter era. This was not a dispute between Keynesians and conservatives about economic stimulus but between competing supply-side ideas to boost productivity. The public investors wanted to make labour more productive through increased spending on education and infrastructure, while the priority of the deficit hawks was to make capital cheaper and more productive through shifting it from government to private hands by means of reduced public borrowing. Secondly, it marked the resolution of the implicit contradiction in the final manifestation of Carter economics in 1980 between budget-balancing and monetary restraint to reassure the bond market about Democratic determination to control inflation and the emergent industrial policy strategy that allocated a more positive social purpose for the state in defining the nation's economic course. A Democratic administration had now tied its economic prospects unambiguously to the confidence of Wall Street in its capacity to cut the deficit. Clinton accepted this as economically necessary but was far from enthusiastic about its political implications. 'I hope you're all aware we're all Eisenhower Republicans', he railed sarcastically in one White House economic policy meeting, 'We're Eisenhower Republicans here, and we are fighting the Reagan Republicans. We stand for lower deficits and free trade and the bond market. Isn't that great?'⁶⁷

The prioritization of deficit reduction also confirmed the primacy of the federal reserve in the new Democratic economics. In contrast to the Carter–Volcker relationship, Clinton found himself dealing with a Republican appointee, Alan Greenspan, who had previously served as chair of the Ford administration CEA and economic adviser in the 1980 Reagan campaign. At their first meeting, in Little Rock on 2 December 1992, the fed chair helped to persuade the president-elect that deficit reduction was necessary for three reasons: the inflation excesses of the 1970s still conditioned the inflationary expectations of the 1990s; the greatest contribution to economic growth would be a drop in long-term interest rates; but the gap between the now relatively low short-term rate and the correspondingly high long-term rate represented an inflation premium levied by the financial markets because they assumed that an exploding deficit would bring renewed inflation and devalue their investments. Clinton's openness to this message convinced Greenspan that he was serious about his new Democrat credentials. In turn, Clinton appreciated that Greenspan had not ruled out tax increases as a means to cut the deficit. 'We can do business', he told Al Gore after the meeting.⁶⁸

Recognizing Greenspan's immense influence with the financial community, Clinton hitched his administration's economic policy to the federal reserve chair even more firmly than Jimmy Carter had done to Volcker. Indeed Greenspan

⁶⁷ Quoted in Woodward, *The agenda*, p. 165.

⁶⁸ *Ibid.*, pp. 68–71.

enjoyed more influence with Clinton than with the two Republican presidents – Reagan and George Bush Sr – who had respectively appointed and re-appointed him. Clinton's re-appointment of Greenspan to two further terms in office in 1996 and 2000 underlined their co-operative relationship. As Laura Tyson told one reporter, the Clinton economic team by 1996 thought of Greenspan as one of them because he 'wasn't running the Fed as a Republican'.⁶⁹

In early 1993 Clinton's advisers consulted Greenspan over the scale of deficit reduction and accepted his argument that an ambitious target would produce interest rate changes whose benefits would more than offset the contractional economic effects of budgetary retrenchment.⁷⁰ In turn the president used Greenspan to legitimize his deficit reduction plan against Republican criticism that it was to be achieved in almost equal measure through tax increases and spending cuts, instead of just the latter. As one analyst has noted, 'The central budget battle of the 1990s – whether to balance the budget at high- or low-revenue levels – was won by Clinton and congressional Democrats, and their victory carried over to spending policy.'⁷¹ When Clinton announced his proposals to congress on 17 February, Greenspan found himself seated in the front row of the gallery between Hillary Clinton and Tipper Gore. As well as being seen on television applauding the speech, he testified two days later before the senate banking committee that the Clinton plan was 'serious' and 'credible', support that made newspaper headlines.⁷²

By contrast, there was tension between the White House and the fed over economic fine-tuning. Clinton's hope that deficit reduction was sufficient insurance against inflation ran counter to Greenspan's determination to reinforce this with monetary restraint. In a twelve-month period beginning in February 1994, the federal reserve raised its short-term funds rate in seven consecutive hikes from 3 per cent to 6 per cent to ensure that recovery did not destabilize prices. 'Monetary policy which fails to focus on the long-term requirement of achieving price stability', Greenspan declared, 'is inevitably going to find itself in a position where inflation emerges.'⁷³ Though not as draconian as Volcker's approach, his rate increases were undertaken at a time when inflation was below 3 per cent and unemployment exceeded 6 per cent of the labour force, a level not substantially lower than at the peak of the 1992 recession. Significantly, 54 per cent of respondents told the *New York Times*/CBS tracking poll in 1994 that the economy was the nation's most important problem, the highest level since 1980. The slow pace of economic recovery played its part in the Republican capture of both

⁶⁹ Bob Woodward, *Maestro: Greenspan's fed and the American boom* (New York, 2000), p. 159. Robert Reich, whose importance waned after the public investment defeat, records his dissenting view in *Locked in the cabinet*, esp. pp. 78–82, 333–4.

⁷⁰ Woodward, *Maestro*, pp. 98–101; Rubin and Weisberg, *In an uncertain world*, p. 120.

⁷¹ Ippolito, *Why budgets matter*, p. 288.

⁷² 'Clinton's program gets endorsement of fed's chairman', *New York Times*, 20 Feb. 1993.

⁷³ David Wessel, 'Blinder denies there's a rift with fed chair', *Wall Street Journal*, 9 Sept. 1994, p. 2.

houses of congress in 1994 and made the president anxious about his reelection prospects.⁷⁴

Although Clinton wanted greater emphasis on employment growth, he could not afford a public confrontation with Greenspan. As Laura Tyson put it, 'We decided early on that the financial markets could misinterpret criticism of the Fed. And the Fed itself might react in unpredictable ways.'⁷⁵ When new White House chief of staff Leon Panetta unilaterally broke ranks by calling for lower interest rates during an appearance on NBC's *Meet the press* in June 1995, he earned a public rebuke from new treasury secretary Robert Rubin and private criticism from Clinton.⁷⁶ The president instead sought to influence monetary policy by nominating economists who were Democratic sympathizers in place of Republican appointees on the federal reserve's seven-person board of governors. This strategy was first tested through the appointment of Yale's Alan Blinder as vice chair and Berkeley's Janet Yellen as governor in June 1994. However, the outcome served only to confirm Greenspan's ascendancy in the domain of macroeconomic management.

Though Blinder had a reputation as a hard-headed Keynesian, who had supported deficit reduction as a member of Clinton's CEA, he had in earlier writings warned against hysteria over inflation, an economic problem he adjudged was more akin to a head cold than a serious disease. When appraised by an aide that Blinder was no communist but was by fed standards soft on inflation, Greenspan reportedly quipped, 'I would have preferred he were a Communist.'⁷⁷ But their incipient power struggle over monetary policy was quickly settled by the hostile reaction to an address given by Blinder at the Kansas City federal reserve's Jackson Hole conference in August 1994. The vice chair proposed that monetary policy should have a short-term employment objective as well as an inflation objective; in other words it should promote employment up to the point at which inflation started to accelerate. The responding firestorm of criticism from both American and foreign central bankers, Wall Street, and financial journalists isolated Blinder and fortified Greenspan's dominance over monetary decisionmaking.⁷⁸

Blinder quit the Federal Reserve in early 1996, occasioning media speculation that he did not wish to serve in what had effectively become a ceremonial post.⁷⁹ In reality, Greenspan had by then moved of his own volition to adopt the position

⁷⁴ Tatalovich and Frendreis, 'Clinton, class and economic policy', p. 43.

⁷⁵ Quoted in David Rosenbaum and Steve Lohr, 'With a stable economy, Clinton hopes for credit', *New York Times*, 3 Aug. 1996, p. 8.

⁷⁶ Dean Foust, 'In a fix at the fed', *Business Week*, 26 June 1995, p. 34. For Rubin's public statement, see Clay Chandler, 'Panetta urges fed to cut short-term interest rates', *Washington Post*, 12 June 1995, p. 6.

⁷⁷ Alan S. Blinder, *Hard heads, soft hearts: tough-minded economics for a just society* (Reading, MA, 1987), esp. ch. 2; Woodward, *Maestro*, p. 127.

⁷⁸ David Wessel, 'Central bankers say: look elsewhere on jobs', *Wall Street Journal*, 29 Aug. 1994, p. 1; Keith Bradsher, 'A split over fed's role', *New York Times*, 29 Aug. 1994, p. D1; Robert J. Samuelson, 'Economic amnesia: Alan Blinder forgets the dangers of inflation', *Newsweek*, 13 Sept. 1994, p. 52. ⁷⁹ John Cassidy, 'Fleeing the fed', *New Yorker*, 19 Feb. 1996, pp. 76-7.

advocated by his vice chair. As Blinder and Janet Yellen later observed, while Greenspan never endorsed the concept of a non-accelerating inflation rate of unemployment, his strategy from mid-1995 to mid-1999 indicated that '[monetary] *fine tuning is at least possible*'.⁸⁰ According to one biographer, Greenspan had 'never been rule driven or theory driven' and responded above all to the economic data. To some critics, this judgement glossed over Greenspan's small-government bias, evidenced by his insistence on deficit reduction in 1993 and his support of George W. Bush's tax cut in 2001 to soak up the projected budget surplus lest this set off a new round of federal spending.⁸¹ Nevertheless his empiricism was more evident in the second half of the 1990s.

Greenspan's monitoring of economic data revealed a significant slowdown in recovery in the first half of 1995, so in July he led the federal reserve into the first of a series of rate reductions that produced a 'soft landing' for the economy instead of recession. Meanwhile long-term interest rates were also coming down, so fulfilling the expectation underlying the 1993 deficit reduction plan. Greenspan kept the federal funds interest rate low for the next four years. A 0.25 per cent hike in early 1997, a direct response to a brief spurt of inflation above 3 per cent in the last quarter of 1996, was the sole exception to this trend. This was more than counterbalanced by a series of rate reductions in late 1998 and early 1999 to sustain investor and consumer confidence against the spread of international financial crisis from East Asia and Russia. However the steady climb of inflation from under 2 per cent in 1998 to above 3 per cent by mid-1999 induced Greenspan to levy a new series of rate increases which pushed the federal funds interest to the highest level in ten years over the next twelve months, a tightening that critics dubbed as excessive.

Aided by a benign monetary regime, the United States entered one of the most remarkable periods of economic expansion in its history from 1996 to 2000. The unemployment rate fell from 5.6 per cent to 4 per cent, while inflation kept on the lowest track since the 1950s. Most encouragingly, after a prolonged period of sluggish growth averaging only 1.4 per cent annually between 1973 and 1995, labour productivity increased at an annual rate of 2.7 per cent. While the causes of this remain a matter of dispute among economists, Greenspan was one of many analysts who placed great store on the influence of new technology. Though too cautious to join the throng of corporate executives and media commentators who proclaimed the existence of a 'new economy' driven by computers, the internet, well-functioning venture capital markets, and globalization, he was seemingly willing to accept the paradigm that employment could rise without fuelling inflation in an environment of growing labour productivity.⁸²

⁸⁰ Alan S. Blinder and Janet L. Yellen, *The fabulous decade: macroeconomic lessons from the 1990s* (New York, 2002), p. 85.

⁸¹ Woodward, *Maestro*, p. 227; Joseph Stiglitz, *The roaring nineties: seeds of destruction* (London, 2003), pp. 79–80.

⁸² Woodward, *Maestro*, pp. 166–78. Michael Mandel and others, 'How long can this last?' *Business Week*, 19 May 1997, pp. 29–34, exemplifies media explanation of the late 1990s boom as the product of

This economic success helped to reelect Clinton in 1996 and to save him from impeachment over the Monica Lewinsky scandal.⁸³ However, this did not necessarily signify that his administration had discovered a new formula to underwrite long-term Democratic economic and political success akin to Keynesianism. The belief that private investment would respond positively to interest rates was an article of faith for the Clinton administration but it was not an iron rule for the markets. In contrast to the experience of the second half of the 1990s, lower interest rates did not boost investment in the 1991 recession nor when the economy experienced another downturn in 2001. Another danger of over reliance on Wall Street became apparent as the stock market boom turned into a bubble that would eventually burst and plunge the nation into recession shortly after Clinton left office. As Joseph Stiglitz, Clinton's second CEA chair, later commented, 'We had put ourselves at the mercy of the mercurial bond markets, those same people who at times exhibited irrational exuberance, and at others irrational pessimism.'⁸⁴

The reduction in long-term interest rates helped make the stock market more attractive than the bond market to investors. Since the White House considered a bull market to be a badge of honour for a Democratic administration, it was in no position to speak out as the Dow Jones industrial index rose from 5,000 to over 6,500 in 1996. Indeed, Robert Rubin had to dissuade Clinton from agreeing to ring the bell at the New York stock exchange because of the damage to his reputation if the market went down.⁸⁵ Greenspan was better placed to prick the bubble early on, but confined himself to rhetorical warnings – notably his famous comment in December 1996 about 'irrational exuberance' unduly inflating asset values – that proved ineffective. Over the next three years the Dow Jones index surged beyond 10,000 points. Probably the strongest instrument of restraint at the fed's disposal was its power to raise margin requirements, which governed how much stock could be bought with borrowed money. Greenspan told the federal reserve board meeting of 24 September 1996 that this action would certainly douse the stock market, but he worried that the entire economy would be dragged down in consequence. 'My concern', he admitted, 'is that I am not sure what else it will do.'⁸⁶

a 'new economy'. For differing academic perspectives, see Stephen D. Oliner and Daniel Sichel, 'The resurgence of growth in the late 1990s: is information technology the story?', *Journal of Economic Perspectives*, 14 (2000), pp. 3–22; and Robert J. Gordon, 'Does the new economy measure up to the great inventions of the past?', *ibid.*, pp. 49–74.

⁸³ Robert Busby, *Defending the American presidency: Clinton and the Lewinsky scandal* (London, 2001), pp. 203, 223.

⁸⁴ Stiglitz, *The roaring nineties*, p. 42.

⁸⁵ Woodward, *Maestro*, p. 179. For the stock market boom, see Robert Shiller, *Irrational exuberance* (Princeton, 2000), and Robert Brenner, *The boom and the bubble: the US in the world economy* (New York, 2002).

⁸⁶ Minutes of the federal reserve open market committee meeting, 24 Sept. 1996, p. 31, www.federalreserve.gov//transcripts/1996/19960924meeting.pdf.

In the late 1990s Greenspan became the subject of hyperbolic media adulation as the author of the boom.⁸⁷ Of course, economic success was a complex process that could not be credited to a single individual or institution. The Clinton administration also assisted in a number of ways that built upon the new supply-side emphasis of Democratic political economy. These included the earned income tax credit (which cut the effective tax rate paid by families in the bottom quintile of the income distribution to the lowest level since the 1970s), raising the minimum wage, the partial overhaul of the New Deal farm support system to enhance the competitiveness of American farming (in co-operation with the Republican congress), beefing up the national labour relations board with pro-union appointees, and education initiatives like tuition tax cuts and credits. The administration itself postulated deficit reduction as its main contribution to the economy's well being, but the political and economic benefits of this may not have been as great as once thought.

A case can be made that the Clinton administration pushed deficit reduction too far. Cyclical fluctuations have been historically characteristic of America's market economy – every boom has petered out and every recession was followed by recovery. The economy would have recovered from the 1991 recession even if the 1993 deficit reduction plan had been smaller in scope. Arguably it was the *real* changes in the economy – weaker unions, greater international competition, higher productivity – that constituted the principal agency of growth. In that case the economy would have performed even better had Clinton carried through his public investment plans. The notion that deficit reduction was essential for economic growth also contradicted his administration's efforts to persuade the governments of Japan and western Europe to stimulate their stagnant economies by means of expansionary fiscal and monetary policies. As Joseph Stiglitz contended, '[U]nless we understand how to think about deficits, economic policies in the future will be distorted – and economic prosperity will be at risk.'⁸⁸

The transformation in the attitude of both political parties to balanced budgets since the 1970s was also significant. Under Ronald Reagan and George W. Bush Jr the Republicans reaped the political benefits of identifying themselves as the party of low taxes, even at the cost of sacrificing fiscal integrity. By contrast the Democrats have gained little political advantage from adopting the former Republican symbol of balanced budgets, which has made it more difficult for them to fulfil their historic mission. 'If the Democratic party stands for anything', Robert Reich avowed, 'it's the simple proposition that prosperity should be shared.'⁸⁹

⁸⁷ See, for example, the editorial 'Who needs gold when we have Greenspan?', *New York Times*, 4 Mar. 1999, p. 30. An editorial in the same paper on Greenspan's reappointment was only marginally less effusive in declaring he was 'more responsible for the economy's spectacular performance than ... any other identifiable factor'. See 'Another term for Mr Greenspan', *ibid.*, 5 Jan. 2000, p. 24.

⁸⁸ Stiglitz, *The roaring nineties*, pp. 41–55 (quotation p. 49). For a defence of deficit reduction by other former members of the administration, see Blinder and Yellen, *The fabulous decade*, pp. 15–24, 83–5, and Rubin and Weisberg, *In an uncertain world*, pp. 353–71.

⁸⁹ Reich, *Locked in the cabinet*, p. 318.

With the mitigating role of the state in retreat because of domestic spending retrenchment, the trend of growing income inequality that had emerged in the 1970s continued in the 1990s. Real median family income, which did not exceed its 1989 level until 1998, stagnated for most of the Clinton era. Workers with only a high school education or less benefited least from the boom. Women experienced a decline in the rate of improvement in their earnings ratio to men – the annual income of full-time female workers was 73 per cent that of men in 1998 compared with just over 71 per cent in 1992. The African-American male to white male median income ratio improved from 61 per cent in 1992 to 70 per cent in 1998 but more than half this gain took place in 1992–3, well before the boom. Moreover, despite the boom, the unemployment rate of 8.2 per cent among black men was more than double that of 3.6 per cent among white males in 1999. Meanwhile African-American female full-time workers experienced a decline in their earnings relative to white females from 91 per cent in 1992 to 87 per cent in 1998. According to the liberal think tank, the centre on budget and policy priorities, the lowest quintile's share of aggregate household income dropped 12 per cent while the highest income quintile increased its share by 38.2 per cent between 1977 and 1999. It was true that the poverty rate declined steadily from 15.1 per cent of the population in 1993 to 11.8 per cent in 1999, the lowest level since 1979, but this was not significantly better than the poverty rate of 12.8 per cent at the end of the Reagan era in 1989.⁹⁰ Even Greenspan acknowledged that the fruits of prosperity had fallen unevenly. 'Expansion of income and wealth has been truly impressive', he declared in his Harvard commencement address of 1999, 'though regrettably the gains have not been as widely spread across households as I would like.' For a member of the Democratic party's old liberal intelligentsia, James MacGregor Burns, the 'grotesque income gap' between rich and poor was testimony to the inadequacy of Clinton–Gore centrism.⁹¹

Building on the foundations laid by Jimmy Carter, Bill Clinton appeared to have concocted an eclectic political economy that was a viable substitute for the old Democratic economics. Everything that Carter had aspired to achieve, he had seemingly been able to deliver. Inflation had been conquered, high employment was once more the norm, and productivity growth hit levels not seen since the 1960s. Even the fiscal crisis that had been brewing in the 1970s and had boiled over in the 1980s had apparently been resolved. In 1998 Clinton became the sole Democratic president excepting Harry Truman to sign off a balanced

⁹⁰ *Economic report of the president 1999*, p. 166; *Economic report of the president 2000*, pp. 342, 352, 354; David Johnston, 'Gap between rich and poor found substantially wider', *New York Times*, 5 Sept. 1999, p. 14; Francine D. Blau and Lawrence M. Kahn, 'Gender differences in pay', *Journal of Economic Perspectives*, 14 (2000), pp. 75–99; Lawrence Mishel, Jared Bernstein, and John Schmitt, *The state of working America, 2000–2001* (Ithaca, NY, 2001).

⁹¹ Pamela Ferdinand and Michael Grunwald, 'At two commencements, perspective is the reality', *Washington Post*, 11 June 1999, p. 3; James MacGregor Burns and Georgia Sorenson, *Dead center: Clinton–Gore leadership and the perils of moderation* (New York, 1999), p. 338.

budget since modern fiscal procedures were established by the Budget and Accounting Act of 1921. With healthy surpluses projected into the first decade of the new century, he was optimistic that the Democrats could invest this fiscal dividend to address the inequalities that the 1990s boom had failed to redress. 'F.D.R.'s mission was to save capitalism from its own excesses', Clinton reportedly told his chief speechwriter, Jacob Weisberg, 'Our mission has been to save government from its own excesses so it can again be a progressive force.'⁹²

Such optimism that the American economy could be managed over the long haul to eliminate serious cyclical fluctuation and deliver bountiful revenue surpluses for government has proved to be misplaced. The recession of 2001 demonstrated that the so-called 'new economy' remained vulnerable to old-fashioned business cycles. Moreover, the downturn's depressing effects on federal revenues in combination with the massive expansion of national and homeland security expenditure in the wake of the 9/11 terrorist attacks and the Bush tax cut have generated a new era of huge deficits. If the Carter political economy was unable to overcome the limits of the 1970s, the Clinton political economy failed to transcend the bubble economy of the late 1990s and to spread the benefits of economic growth throughout American society. Bill Clinton may have completed the transformation of Democratic economic governance started by Jimmy Carter, but it is doubtful that their project can survive intact. If the Democrats do regain the White House in the first decade of the twenty-first century, the ingenuity and creativity of the new administration will need to be applied to learn from the economic shortcomings as well as the successes of its two predecessors.

⁹² Quoted by Jacob Weisberg, 'The governor-president', *New York Times Magazine*, 17 Jan. 1999, p. 33. Robert Rubin records a similar comment by Clinton during deliberations over the fiscal 1996 budget plan, the first after the loss of control of congress to the Republicans: 'If I'm going to get heard on anything else, I first have to show a balanced budget. Once I do that I can talk about progressive programs. But if I don't show a balanced budget, they'll never listen to me about progressive programs.' See *In an uncertain world*, p. 164.