LETTER FROM AMERICA

Of Bush and Economic Nightmare

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When people look back someday at the catastrophe that was the Bush administration, they will think of many things: the tragedy of the Iraq war, the shame of Guantánamo and Abu Ghraib, the erosion of civil liberties. The damage done to the American economy does not make front-page headlines every day, but the repercussions will be felt beyond the lifetime of anyone reading this page.

The president has not driven the United States into a recession during his almost seven years in office. Unemployment stands at a respectable 4.6 percent. Well, fine. But the other side of the ledger groans with distress: a tax code that has become hideously biased in favor of the rich; a national debt that will probably have grown 70 percent by the time this president leaves Washington; a swelling cascade of mortgage defaults; a record near-$850 billion trade deficit; oil prices that are higher than they have ever been; and a dollar so weak that for an American to buy a cup of coffee in London or Paris—or even the Yukon—becomes a venture in high finance.

And it gets worse. After almost seven years of this president, the United States is less prepared than ever to face the future. Americans have not been educating enough engineers and scientists, people with the skills America will need to compete with China and India. Americans have not been investing in the kinds of basic research that made them the technological house of the late 20th century. And although the president now understands—or so he says—that Americans must begin to wean themselves from oil and coal, they have on his watch become more deeply dependent on both.

Up to now, the conventional wisdom has been that Herbert Hoover, whose policies aggravated the Great Depression, is the odds-on claimant for the mantle "worst president" when it comes to stewardship of the American economy. Once Franklin Roosevelt assumed office and reversed Hoover's policies, the country began to recover. The economic effects of Bush's presidency are more insidious than those of Hoover, harder to reverse, and likely to be longer-lasting. There is no threat of America's being displaced from its position as the world's richest economy. But the young generation will still be living with, and struggling with, the economic consequences of Mr Bush.

The world was a very different place, economically speaking, when George W Bush took office, in January 2001. During the Roaring 1990s, many had believed that the *Internet* would transform everything. Productivity gains, which had averaged about 1.5 percent a year from the early 1970s through the early 90s, now approached 3 percent. During Bill Clinton's second term, gains in manufacturing productivity sometimes even surpassed 6 percent. The Federal Reserve chairman, Alan Greenspan, spoke of a New Economy marked by continued productivity gains as the *Internet* buried the old ways of doing business. Others went so far as to predict an end to the business cycle. Greenspan worried aloud about how he'd ever be able to manage monetary policy once the nation's debt was fully paid off.

This tremendous confidence took the Dow Jones index higher and higher. The rich did well, but so did the not-so-rich and even the downright poor. The Clinton years were not an economic *Nirvana*. The global-trade agreements America pushed through were often unfair to developing countries. America should have invested more in infrastructure, tightened regulation of the securities markets, and taken additional steps to promote energy conservation. But America fell short because of politics and lack of money—and also, frankly, because special interests sometimes shaped the agenda more than they should have. And these boom years were the first time since Jimmy Carter that the deficit was under control. And they were the first time since the 1970s that incomes at the bottom grew faster than those at the top—a benchmark worth celebrating.

By the time George W Bush was sworn in, parts of this bright picture had begun to dim. The tech boom was over. The nasdaq fell 15 percent in the single month of April 2000, and no one knew for sure what effect the collapse of the *Internet* bubble would have on the real economy. It was a moment ripe for Keynesian economics, a time to prime the pump by spending more money on education, technology, and infrastructure—all of which America desperately needed, and still does, but which the Clinton administration had postponed in its relentless drive to eliminate the deficit. Bill Clinton had left President Bush in an ideal position to pursue such policies. Remember the presidential debates in 2000 between Al Gore and George Bush, and how the two men argued over how to spend America's anticipated $2.2 trillion budget surplus? The country could well have afforded to ramp up domestic investment in key areas. In fact, doing so would have staved off recession in the short run while spurring growth in the long run.

But the Bush administration had its own ideas. The first major economic initiative pursued by the president was a massive tax cut for the rich, enacted in June of 2001. Those with incomes over a million got a tax cut of $18,000—more than 30 times larger than the cut received by the average American. The inequities were compounded by a second tax cut, in 2003, this one skewed even more heavily toward the rich. Together these tax cuts, when fully implemented and if made permanent, mean that in 2012 the average reduction for an American in the bottom 20 percent will be a scant $45, while those with incomes of more than $1 million will see their tax bills reduced by an average of $162,000.

The administration crows that the economy grew—by some 16 percent—during its first six years, but the growth helped mainly people who had no need of any help, and failed to help those who need plenty. A rising tide lifted all yachts. Inequality is now widening in America, and at a rate not seen in three-quarters of a century. A young male in his 30s today has an income, adjusted for inflation, that is 12 percent less than what his father was making 30 years ago. Some 5.3 million more Americans are living in poverty now than were living in poverty when Bush became president. America's class structure may not have arrived there yet, but it's heading in the direction of Brazil's and Mexico's.

THE BANKRUPTCY

In breathtaking disregard for the most basic rules of fiscal propriety, the administration continued to cut taxes even as it undertook expensive new spending programs and embarked on a financially ruinous "war of choice" in

Iraq. A budget surplus of 2.4 percent of gross domestic product (GDP), which greeted Bush as he took office, turned into a deficit of 3.6 percent in the space of four years. The United States had not experienced a turnaround of this magnitude since the global crisis of World War II.

Agricultural subsidies were doubled between 2002 and 2005. Tax expenditures—the vast system of subsidies and preferences hidden in the tax code—increased more than a quarter. Tax breaks for the president's friends in the oil-and-gas industry increased by billions and billions of dollars. Yes, in the five years after 9/11, defense expenditures did increase (by some 70 percent), though much of the growth wasn't helping to fight the 'War on Terror' at all, but was being lost or outsourced in failed missions in Iraq. Meanwhile, other funds continued to be spent on the usual high-tech gimcrackery—weapons that don't work, for enemies America doesn't have. In a nutshell, money was being spent everyplace except where it was needed. During these past seven years the percentage of GDP spent on research and development outside defense and health has fallen. Little has been done about America's decaying infrastructure—be it levees in New Orleans or bridges in Minnea-polis. Coping with most of the damage will fall to the next occupant of the White House.

Although it railed against entitlement programs for the needy, the US administration enacted the largest increase in entitlements in four decades—the poorly designed Medicare prescription-drug benefit, intended as both an election-season bribe and a sop to the pharmaceutical industry. As internal documents later revealed, the true cost of the measure was hidden from Congress. Meanwhile, the pharmaceutical companies received special favors. To access the new benefits, elderly patients couldn't opt to buy cheaper medications from Canada or other countries. The law also prohibited the US government, the largest single buyer of prescription drugs, from negotiating with drug manufacturers to keep costs down. As a result, American consumers pay far more for medications than people elsewhere in the developed world.

The bang for the buck—the amount of stimulus per dollar of deficit—was astonishingly low. Therefore, the job of economic stimulation fell to the Federal Reserve Board, which stepped on the accelerator in a historically unprecedented way, driving interest rates down to 1 percent. In real terms, taking inflation into account, interest rates actually dropped to negative 2 percent. The predictable result was a consumer spending spree. Looked at another way, Bush's own fiscal irresponsibility fostered irresponsibility in everyone else. Credit was shoveled out the door, and subprime mortgages were made available to anyone this side of life support. Credit-card debt mounted to a whopping $900 billion by the summer of 2007. "Qualified at birth" became the drunken slogan of the Bush era. American households took advantage of the low interest rates, signed up for new mortgages with "teaser" initial rates, and went to town on the proceeds.

All of this spending made the economy look better for a while; the president could (and did) boast about the economic statistics. But the consequences for many families would become apparent within a few years, when interest rates rose and mortgages proved impossible to repay. The president undoubtedly hoped the reckoning would come sometime after 2008. It arrived 18 months early. As many as 1.7 million Americans are expected to lose their homes in the months ahead. For many, this will mean the beginning of a downward spiral into poverty.

Between March 2006 and March 2007 personal-bankruptcy rates soared more than 60 percent. As families went into bankruptcy, more and more of them came to understand who had won and who had lost as a result of the president's 2005 bankruptcy bill, which made it harder for individuals to discharge their debts in a reasonable way. The lenders that had pressed for "reform" had been the clear winners, gaining added leverage and protections for themselves; people facing financial distress got the shaft.

AND FINALLY IRAQ

The war in Iraq (along with, to a lesser extent, the war in Afghanistan) has cost America dearly in blood and treasure. The loss in lives can never be quantified. As for the treasure, it's worth calling to mind that the administration, in the run-up to the invasion of Iraq, was reluctant to venture an estimate of what the war would cost (and publicly humiliated a White House aide who suggested that it might run as much as $200 billion). When pressed to give a number, the administration suggested $50 billion—what the United States is actually spending every few months. Today, government figures officially acknowledge that more than half a trillion dollars total has been spent by the US "in theater." But in fact the overall cost of the conflict could be quadruple that amount—as a study this writer did with Linda Bilmes of Harvard has pointed out—even as the Congressional Budget Office now concedes that total expenditures are likely to be more than double the spending on operations. The official numbers do not include, for instance, other relevant expenditures hidden in the defense budget, such as the soaring costs of recruitment, with re-enlistment bonuses of as much as $100,000. They do not include the lifetime of disability and health-care benefits that will be required by tens of thousands of wounded veterans, as many as 20 percent of whom have suffered devastating brain and spinal injuries. Astonishingly, they do not include much of the cost of the equipment that has been used in the war, and that will have to be replaced. If one also takes into account the costs to the economy from higher oil prices and the knock-on effects of the war—for instance, the depressing domino effect that war-fueled uncertainty has on investment, and the difficulties US firms face overseas because America is the most disliked country in the world—the total costs of the Iraq war mount, even by a conservative estimate, to at least $2 trillion.

The soaring price of oil is clearly related to the Iraq war. The issue is not whether to blame the war for this but simply how much to blame it. It seems unbelievable now to recall that Bush-administration officials before the invasion suggested not only that Iraq's oil revenues would pay for the war in its entirety—hadn't America actually turned a tidy profit from the 1991 Gulf War?—but also that war was the best way to ensure low oil prices. In retrospect, the only big winners from the war have been the oil companies, the defense contractors, and al-Qaeda. Before the war, the oil markets anticipated that the then price range of $20 to $25 a barrel would continue for the next three years or so. Market players expected to see more demand from China and India, sure, but they also anticipated that this greater demand would be met mostly by increased production in the Middle East. The war upset that calculation, not so much by curtailing oil production in Iraq, which it did, but rather by heightening the sense of insecurity everywhere in the region, suppressing future investment.

The continuing reliance on oil, regardless of price, points to one more administration legacy: the failure to diversify America's energy resources.

CONTEMPT FOR THE WORLD

America's budget and trade deficits have grown to record highs under President Bush. To be sure, deficits don't have to be crippling in and of themselves. If a business borrows to buy a machine, it's a good thing, not a bad thing. During the past six years, America—its government, its families, the country as a whole—has been borrowing to sustain its consumption. Meanwhile, investment in fixed assets—the plants and equipment that help increase America's wealth—has been declining.

What's the impact of all this down the road? The growth rate in America's standard of living will almost certainly slow, and there could even be a decline. The American economy can take a lot of abuse, but no economy is invincible, and America's vulnerabilities are plain for all to see. As confidence in the American economy has plummeted, so has the value of the dollar—by 40 percent against the euro since 2001.

The disarray in economic policies at home has parallels in economic policies abroad. President Bush blamed the Chinese for huge trade deficit, but an increase in the value of the yuan, which he has pushed, would simply make Americans buy more textiles and apparel from Bangladesh and Cambodia instead of China; American deficit would remain unchanged. The president claimed to believe in free trade but instituted measures aimed at protecting the American steel industry. The United States pushed hard for a series of bilateral trade agreements and bullied smaller countries into accepting all sorts of bitter conditions, such as extending patent protection on drugs that were desperately needed to fight aids.

Not surprisingly, protests over US trade practices erupted in places such as Thailand and Morocco. But America has refused to compromise—refused, for instance, to take any decisive action to do away with huge agricultural subsidies, which distort international markets and hurt poor farmers in developing countries. This intransigence led to the collapse of talks designed to open up international markets. As in so many other areas, President Bush worked to undermine multilateralism—the notion that countries around the world need to cooperate—and to replace it with an America-dominated system. In the end, he failed to impose American dominance—but did succeed in weakening cooperation.

The administration's basic contempt for global institutions was underscored in 2005 when it named Paul Wolfowitz, the former deputy secretary of defense and a chief architect of the Iraq war, as president of the World Bank. Widely distrusted from the outset, and soon caught up in personal controversy, Wolfowitz became an international embarrassment and was forced to resign his position after less than two years on the job.

Globalization means that America's economy and the rest of the world have become increasingly interwoven. As families default, the owners of the mortgages find themselves holding worthless pieces of paper. The originators of these problem mortgages had already sold them to others, who packaged them, in a non-transparent way, with other assets, and passed them on once again to unidentified others. When the problems became apparent, global financial markets faced real tremors: it was discovered that billions in bad mortgages were hidden in portfolios in Europe, China, and Australia, and even in star American investment banks such as Goldman Sachs and Bear Stearns. Indonesia and other developing countries—innocent bystanders, really—suffered as global risk premiums soared, and investors pulled money out of these emerging markets, looking for safer havens. It will take years to sort out this mess.

Today, China alone holds more than $1 trillion in public and private American IOU's. Cumulative borrowing from abroad during the six years of the Bush administration amounts to some $5 trillion. Most likely these creditors will not call in their loans—if they ever did, there would be a global financial crisis. But there is something bizarre and troubling about the richest country in the world not being able to live even remotely within its means. Just as Guantánamo and Abu Ghraib have eroded America's moral authority, so the Bush administration's fiscal housekeeping has eroded America's economic authority.

THE WAY FORWARD

Whoever moves into the White House in January 2009 will face an unenviable set of economic circumstances. Extricating the country from Iraq will be the bloodier task, but putting America's economic house in order will be wrenching and take years.

In short, there's a momentum here that will require a generation to reverse. Decades hence Americans should take stock, and revisit the conventional wisdom. Will Herbert Hoover still deserve his dubious mantle? □□□