I hope the Democratic candidates for President are in touch with Joseph E. Stiglitz, the 2001 Nobel prize co-winner in economics, who served as chairman of President Clinton's Council of Economic Advisers from 1995 until 1997. In Stiglitz' new book, The Roaring Nineties, and at a recent conference at Columbia University honoring his work on market failures, Stiglitz challenged a premise that has become like holy writ: the idea that deficit reductions caused the boom of the 1990s.

Under this scenario, Clinton agreed to cut the deficit, the Federal Reserve obliged with lower short-term rates, markets were reassured, and the great boom was on. Message: A balanced budget equals prosperity. Stiglitz has a more persuasive view: Other forces, most notably higher productivity growth, allowed the Fed to run a hotter economy. "Deficit reduction," he writes, "accelerated the decline in interest rates, which helped recapitalize the banks. But interest rates would have fallen anyway. The forces taming inflation -- weaker unions and increased international competition in addition to rising productivity -- were already at play. It was the lower inflation as well as the deficit reduction that lowered long-term interest rates."

STIGLITZ DID SUPPORT REDUCTION of the structural deficits inherited from the Reagan and Bush I administrations, resulting from excessive tax cuts. These had to be reduced because they had put the budget on a path to ever-rising national debt. But in Stiglitz' view, Clinton overdid a good thing. He writes that if the Clinton Administration had put less money into deficit reduction and more into research and development, technology, infrastructure, and education, "given the high returns for these investments, [gross domestic product] in 2000 would have been even higher, and the economy's growth potential would have been stronger."

Stiglitz told Clinton all this. But he lost that argument with Treasury Secretary Robert E. Rubin, on whom Clinton relied to understand the markets' pulse. Recently, Rubin reiterated that high deficits cause high interest rates because government competes with other users of credit for a limited supply of savings. However, this premise is true only at full employment.

Stiglitz' point on the deficit is especially important now, as George W. Bush repeats Reagan's squeeze play: cut taxes, generate huge deficits, make Democrats play the role of fiscal Scrooges, and force permanent program cuts. As Rubinomics has more sway over most Democrats than Stiglitz-omics, Democrats are about to repeat Clinton's mistake.

It's hardly surprising that the immense deficits have stimulated sizzling short-term growth. The third-quarter growth is impressive, but entirely Keynesian. And while
temporary deficits can generate short-term stimulus, permanent structural deficits can sap productivity.

As Stiglitz made clear at the recent conference, the Bush tax cuts should certainly be repealed, save those for middle- and lower-income taxpayers. But the revenue gained should not go entirely for deficit reduction. Rather, it would be better in the short term if the money went to help states and localities avoid cutting jobs. In the long term, it would be better for more money to go into productivity-enhancing public investments in education and technology. And the proposed new corporate tax cuts? They won't spur much investment, given the capacity overhang.

Bush's earlier tax cuts were so huge that even if those for the rich are repealed, there appears to be little room for increased public outlay. Here, I commend The New York Times reporter David Cay Johnston's Perfectly Legal, the definitive investigation of legal (and illegal) tax cheating. Johnston shows how tax avoidance among corporations and upper-income individuals is far outrunning the audit capacity of the Internal Revenue Service. There's a $113 billion gap between what corporations should be paying and what they pay. And 78% of the cases of known underpayment by partnerships were not even pursued by the IRS.

Combine a repeal of much of the tax cut with a serious effort to collect revenue, and the deficit can be brought down to, say, 2% of GDP, with money to spare for new public outlays. This would be sensible economics and better politics, since it would let Democrats offer something tangible to voters. But it's more likely the Dems will wrap themselves in the reassuring -- and suffocating -- blanket of Rubinomics.

Biography:

Robert Kuttner is co-editor of The American Prospect and author of Everything for Sale

Credit: Robert Kuttner