How Obama Reconciles Dueling Views on Economy

By DAVID LEONHARDT

I. A Broken Economy

As Barack Obama prepares to accept the Democratic nomination this week, it is clear that the economic policies of the next president are going to be hugely important. Ever since Wall Street bankers were called back from their vacations last summer to deal with the convulsions in the mortgage market, the economy has been lurching from one crisis to the next. The International Monetary Fund has described the situation as “the largest financial shock since the Great Depression.” The details are too technical for most of us to understand. (They’re too technical for many bankers to understand, which is part of the problem.) But the root cause is simple enough. In some fundamental ways, the American economy has stopped working.

The fact that the economy grows — that it produces more goods and services one year than it did in the previous one — no longer ensures that most families will benefit from its growth. For the first time on record, an economic expansion seems to have ended without family income having risen substantially. Most families are still making less, after accounting for inflation, than they were in 2000. For these workers, roughly the bottom 60 percent of the income ladder, economic growth has become a theoretical concept rather than the wellspring of better medical care, a new car, a nicer house — a better life than their parents had.

Americans have still been buying such things, but they have been doing so with debt. A big chunk of that debt will never be repaid, which is the most basic explanation for the financial crisis. Even after the crisis has passed, the larger problem of income stagnation will remain. It’s hardly the economy’s only serious problem either. There is also the slow unraveling of the employer-based health-insurance system and the fact that, come 2011, the baby boomers will start to turn 65, setting off an enormous rise in the government’s Medicare and Social Security obligations.

Most of these problems aren’t immediate, which helps explain why they have gone unaddressed for so long. And the United States remains a fabulously prosperous country, relative to almost any other country, at any point in history. Yet Americans seem to realize that something has gone wrong. In recent polls, about 80 percent of respondents say the economy is in bad shape, and almost 70 percent say it’s going to get worse. Together, these answers make for the most downbeat assessment since at least the early 1980s, and underscore that the next president will be inheriting a set of domestic problems as serious as any the country has faced in a long time.

John McCain’s economic vision, as he has laid it out during the campaign, amounts to a slightly altered version of Republican orthodoxy, with tax cuts at the core. Obama, on the other hand, has more-detailed proposals but a less obvious ideology.
Well before this point on the presidential calendar, it's usually clear where a candidate fits within the political spectrum of his party. With Obama, there is vast disagreement about just how liberal he is, especially on the economy. My favorite example came in mid-June, shortly after Obama named Jason Furman, a protégé of Robert Rubin, the centrist former Treasury secretary, as his lead economic adviser. Labor leaders recoiled, and John Sweeney, the head of the A.F.L.-C.I.O., worried aloud about “corporate influence on the Democratic Party.” Then, the following week, Kimberley Strassel, a member of The Wall Street Journal editorial board, wrote a column titled, “Farewell, New Democrats,” concluding that Obama’s economic policies amounted to the end of Clintonian centrism and a reversion to old liberal ways.

Some of the confusion stems from Obama’s own strategy of presenting himself as a postpartisan figure. A few weeks ago, I joined him on a flight from Orlando to Chicago and began our conversation by asking about his economic approach. He started to answer, but then interrupted himself. “My core economic theory is pragmatism,” he said, “figuring out what works.”

This, of course, is not the whole story. Invoking pragmatism doesn’t help the average voter much; ideology, though it often gets a bad name, matters, because it offers insight into how a candidate might actually behave as president. I have spent much of this year trying to get a handle on what is sometimes called Obamanomics and have come away thinking that Obama does have an economic ideology. It’s just not a completely familiar one. Depending on how you look at it, he is both more left-wing and more right-wing than many people realize.

II. A New Democratic Consensus, of Sorts

To understand where Obama stands, you first have to know that, for 15 years, Democratic Party economics have been defined by a struggle that took place during the start of the Clinton administration. It was the battle of the Bobs. On one side was Clinton’s labor secretary and longtime friend, Bob Reich, who argued that the government should invest in roads, bridges, worker training and the like to stimulate the economy and help the middle class. On the other side was Bob Rubin, a former Goldman Sachs executive turned White House aide, who favored reducing the deficit to soothe the bond market, bring down interest rates and get the economy moving again. Clinton cast his lot with Rubin, and to this day the first question about any Democrat’s economic outlook is often where his heart lies, with Reich or Rubin, the left or the center, the government or the market.

Obama has obviously studied this debate, and early on during the flight to Chicago, he told me a story about Reich and Rubin. The previous week, Obama convened a discussion with a high-powered group of economists and chief executives. He was sitting at a conference table, with Rubin two seats to his left and Reich across from him. “One of the points I raised,” Obama told me, “is if you just use you, Bob, and you, Bob, as caricatures, the truth is, both of you acknowledge the world is more complicated.” By this, Obama didn’t simply mean that their views were more nuanced than many outsiders understood. He meant that both have come to acknowledge that the other man is, in part, correct. The two now occupy more similar ideological places than they did in 1993. The battle of the Bobs may not be completely over, but it has certainly been suspended.

Among the policy experts and economists who make up the Democratic government-in-waiting, there is now something of a consensus. They agree that deficit reduction did an enormous amount of good. It helped
ushi in the 1990s boom and the only period of strong, broad-based income growth in a generation. But that boom also depended on a technology bubble and historically low oil prices. In the current decade, the economy has continued to grow at a decent pace, yet most families have seen little benefit. Instead, the benefits have flowed mostly to a small slice of workers at the very top of the income distribution. As Rubin told me, comparing the current moment with 1993, “The distributional issues are obviously more serious now.” From today’s vantage point, inequality looks like a bigger problem than economic growth; fiscal discipline seems necessary but not sufficient.

In practical terms, the new consensus means that the policies of an Obama administration would differ from those of the Clinton administration, but not primarily because of differences between the two men. “The economy has changed in the last 15 years, and our understanding of economic policy has changed as well,” Furman says. “And that means that what was appropriate in 1993 is no longer appropriate.” Obama’s agenda starts not with raising taxes to reduce the deficit, as Clinton’s ended up doing, but with changing the tax code so that families making more than $250,000 a year pay more taxes and nearly everyone else pays less. That would begin to address inequality. Then there would be Reich-like investments in alternative energy, physical infrastructure and such, meant both to create middle-class jobs and to address long-term problems like global warming.

All of this raises the question of what will happen to the deficit. Obama’s aides optimistically insist he will reduce it, thanks to his tax increases on the affluent and his plan to wind down the Iraq war. Relative to McCain, whose promised spending cuts are extremely vague, Obama does indeed look like a fiscal conservative. But the larger point is that the immediate deficit isn’t as big as it was in 1992. Then, it was equal to 4.7 percent of gross domestic product. Right now it’s about 2.5 percent.

During our conversation, Obama made it clear that he considered the deficit to be only one of the long-term problems requiring immediate attention, and he sounded more worried about the others, like global warming, health care and the economic hangover that could follow the housing bust. Tellingly, he said that while he admired what Clinton did, he might have been more open to Reich’s argument — even in 1993. “I still would have probably made a slightly different choice than Clinton did,” Obama said. “I probably wouldn’t have been as obsessed with deficit reduction.”

The new Democratic consensus isn’t complete, obviously. Labor unions, in particular, would prefer more trade barriers than many other Democrats. During the primaries Obama nodded, and at times pandered, in this direction. Since then, he has disavowed that rhetoric, to almost no one’s surprise. Yet his zig-zagging on the issue did highlight the biggest weak spot in his, and his party’s, economic agenda. He still hasn’t quite figured out how to sell it. For all his skills as a storyteller and a speaker, he has not settled on a compelling message about how to put the economy on the right path.

The lack of such a message has contributed to several of his worst moments over the last year. Most recently, the campaign has come out with a series of small-bore, populist energy plans — a windfall-profits tax on oil companies, a crackdown on speculators, a partial opening of the strategic oil reserve — that seem more political than economic. The most glaring misstep on this score was his comment this spring about bitter rural voters clinging to guns and religion. It was, in effect, an admission that his own message about the economy hadn’t yet broken through.
III. A ‘University of Chicago’ Democrat

Starting in the early 1990s, Obama spent 12 years at the University of Chicago, mostly as a senior lecturer on constitutional law. It was a part-time job that helped him make money while he began to build his political career. But it also happened to place him inside what is arguably the intellectual center of modern American economic conservatism, the home of Milton Friedman and the laissez-faire philosophy known as the Chicago School of economics. By all accounts, Obama didn’t spend much time with Friedman’s disciples at the law school. Instead, he became friendly with another crowd: liberals who had come to think that Friedman was right about a lot, just not everything.

The Chicago School believes that markets — that is, millions of individuals making separate decisions — almost always function better than economies that are managed by governments. In a market system, prices adjust whenever there is a shortage or a glut, and the problem soon resolves itself. Just as important, companies constantly compete with each other, which helps bring down prices, improves the quality of goods and ultimately lifts living standards.

In its more extreme forms, the Chicago School’s ideas have some obvious flaws. History has shown that free markets aren’t so good at, say, preventing pollution or the issuance of fantastically unrealistic mortgages. But over the last few decades, as Europe’s regulated economies have struggled and Asia’s move toward capitalism has spurred its fabulous boom, many liberals have also come to appreciate the virtues of markets.

One of these liberals is Cass Sunstein, a prolific law professor who sometimes ate with Obama in the open, sunlit cafeteria off the lobby of the main building at Chicago’s law school. Over sandwiches in that cafeteria this spring, Sunstein told me that he didn’t think that Obama arrived at the law school as an old-style liberal or departed as anything like a Friedmanite. Yet Sunstein and other former Chicago colleagues I spoke with said they believed that Chicago had helped give Obama an intellectual framework for his instincts, at the least, and probably made him come to appreciate the virtues of markets more.

Obama, when I asked him, agreed that his years surrounded by Chicago School thinking affected him. He tends to assign his motives to more intimate narratives, though, and he said that his grandmother, a high-school graduate who rose to become the vice president of a bank and was the family’s main breadwinner, had the biggest impact. “She had to think very practically about, How do you make money?” he told me. “How does the system work? That led me to have an orientation to ask hardheaded questions. During my formative years, there was still ideological competition between a social-democratic or even socialist agenda and a free-market, Milton Friedman agenda. I think it was natural for me to ask questions of both sides and maybe try to synthesize approaches.”

There is plenty of evidence that this synthesis isn’t merely a part of a candidate’s inevitable tack to the center for a general election. In Obama’s memoir, “Dreams From My Father,” he sympathetically recounts a conversation he had with a Kenyan farmer, in which the man complains both about rich people who won’t pay their fair share of taxes and about burdensome government regulations on coffee growing. In Obama’s second book, “The Audacity of Hope,” he goes further: “Reagan’s central insight — that the liberal welfare state had grown complacent and overly bureaucratic, with Democratic policy makers more obsessed with slicing the economic pie than with growing that pie — contained a good deal of truth.”

The partial embrace of Reaganomics is a typical bit of Obama’s postpartisan veneer. In a single artful
sentence, he dismissed the old liberals, aligned himself with the Bill Clinton centrists and did so by reaching back to a conservative icon who remains widely popular. But the words have significance at face value too. Compared with many other Democrats, Obama simply is more comfortable with the apparent successes of laissez-faire economics.

Sunstein, now on the faculty at Harvard, has a name for this approach: “I like to think of him as a ‘University of Chicago’ Democrat.”

It’s a useful label. Today’s Democratic consensus has moved the party to the left, and on issues like inequality and climate change, Obama appears willing to be even more aggressive than many fellow Democrats. From this standpoint, he’s a true liberal. Yet he also says he believes that there are significant parts of Reaganism worth preserving. So his policies often involve setting up a government program to address a market failure but then trying to harness the power of the market within that program. This, at times, makes him look like a conservative Democrat.

From the beginning, Obama has sought out academic economists, rather than lawyers or former White House aides. His first economic adviser, Austan Goolsbee, is a young University of Chicago professor who shares Obama’s market-oriented Democratic views. This summer, Obama added Furman, who has a more traditional background, having worked for both the Clinton administration and the Kerry campaign. But he, too, has a Ph.D. in economics, from Harvard.

As anyone who has spent time with Obama knows, he likes experts, and his choice of advisers stems in part from his interest in empirical research. (James Heckman, a Nobel laureate who critiqued the campaign’s education plan at Goolsbee’s request, said, “I’ve never worked with a campaign that was more interested in what the research shows.”) By surrounding himself with economists, however, Obama was also making a decision with ideological consequences. Far more than many other policy advisers, economists believe in the power of markets. What tends to distinguish Democratic economists is that they set out to uncover imperfections of the market and then come up with incremental, market-based solutions to these imperfections. This helps explain the Obama campaign’s interest in behavioral economics, a relatively new field that has pointed out many ways in which people make irrational, short-term decisions. To deal with one example of such myopia, Obama would require companies to automatically set aside a portion of their workers’ salary in a 401(k) plan. Any worker could override the decision — and save nothing at all or save even more — but the default would be to save.

A more controversial version of Obama’s market friendliness came from his health-care proposal, which, unlike Hillary Clinton’s, would not mandate that people have health insurance. Like other Democrats, he was pushing for a big government program to deal with what he saw as market failures in health care and to bring down the price of insurance. Once the program was in place, though, he trusted a market of individuals to make its own decisions; once the government had subsidized health insurance, he thought the vast majority of the uninsured would sign up.

There are similar strains in Obama’s proposals on housing and education, and it’s worth remembering that these all came out before he was the presumptive nominee. The best example of his approach, however, may be his climate policy. By last year, Democrats in Congress essentially agreed that to reduce greenhouse-gas emissions, the government should place a nationwide cap on these emissions and then issue tradable
permits giving companies the right to produce them (thus the term “cap and trade”). Most Congressional bills envisioned giving away many of the permits to power companies. Economists, by and large, considered this giveaway to be the worst part of the plan. It would require Congress to decide how many free permits each company should get and would set off a frenzy of corporate lobbying.

The alternative was to auction off the permits — to let the market set their value. “If you don’t auction 100 percent of the permits,” Goolsbee told me, “this could be one of the biggest pieces of corporate welfare ever.” With Congress making the decisions, the power companies with the best political connections might get the permits. With a full auction, the permits would end up with companies willing to make the highest bids. Presumably, these would be the most efficient companies, the ones able to produce the most energy (and profits) for a given amount of greenhouse-gas pollution.

The auctions would have another big advantage too. They would raise billions of dollars for the government, money that could then be returned to taxpayers to offset the higher energy prices created by the emissions cap.

It seems likely that a President Obama would sign a cap-and-trade bill even if it did give away some permits. But candidate Obama has at least moved the debate toward a more pro-market solution.

**IV. The End of the Age of Reagan?**

“The market is the best mechanism ever invented for efficiently allocating resources to maximize production,” Obama told me. “And I also think that there is a connection between the freedom of the marketplace and freedom more generally.” But, he continued, “there are certain things the market doesn’t automatically do.” In other words, free-market policy isn’t likely to dominate his agenda; his project would be fixing the market.

And it does seem to need fixing. For three decades now, the American economy has been in what the historian Sean Wilentz calls the Age of Reagan. The government has deregulated industries, opened the economy more to market forces and, above all, cut income taxes. Much good has come of this — the end of 1970s stagflation, infrequent and relatively mild recessions, faster growth than that of the more regulated economies of Europe. Yet laissez-faire capitalism hasn’t delivered nearly what its proponents promised. It has created big budget deficits, the most pronounced income inequality since the 1920s and the current financial crisis. As Lawrence Summers, the former Treasury secretary and Rubin ally from the Clinton administration, says: “We’ve probably done a better job of the last 20 years on the problems the market can solve than the problems the market can’t solve. We’re doing pretty well on the size of people’s houses and televisions and the like. We’re not looking so good on infrastructure and education.”

The closest thing to an Obama doctrine on market regulation was a speech he gave in March at Cooper Union in New York, called “Renewing the American Economy.” It included his usual praise of market forces, and his prescriptions for regulating the financial system were mostly mainstream Democratic fare, like tougher penalties for loan fraud, tighter rules and closer oversight for Wall Street. These steps might or might not prevent the next crisis, but they would certainly place a bigger emphasis on trying to do so. And the speech, if anything, probably placed Obama on the more aggressively liberal side of the Democratic platform. Afterward, Robert Kuttner, an unabashedly left-leaning Democrat, praised Obama for going “well beyond the current Democratic Party consensus.”
Shortly before Obama’s speech, the Federal Reserve made emergency loans to investment banks that hadn’t officially been under its supervision. Obama argued that, going forward, the Fed had to be given permanent oversight of any such institutions, because their executives would henceforth assume that the government would come to their rescue. If taxpayers were going to be on the hook for those banks when they failed, he suggested, the government should have the chance to minimize the risk of failure. (Since March, Fed officials themselves have inched toward a similar position.)

There is, plainly, a big potential conflict between the University of Chicago side of Obama and the regulator side. A regulation that sounds sensible today can end up having nasty unintended consequences. But in Obama’s view, the risks to market-based capitalism now have more to do with too little regulation than too much. He can sound almost righteous on this point. He talked to me about the need for a moral element to capitalism and said that the crony capitalism of recent years should be the nightmare of any market-loving economist. At times, this part of his message can seem to overwhelm his respect for the market. Obama’s aides have justified his proposed windfall-profits tax on oil companies, for example, by saying that it makes up for the unjustifiable tax breaks the energy industry has received in the past. But that doesn’t change the fact that it’s a tax targeted at a specific industry, which, as some economists have pointed out, is just the sort of tinkering that the Chicago School detests.

V. Spreading the Wealth

The most tangible way that today’s economy feels unfair is the lack of real income growth for most families. Earlier this year, when I interviewed Obama during the primaries, he was careful to say that he didn’t think President Bush deserved all that much blame for the stagnant incomes of the current decade. Income growth for most families began to slow in the 1970s, and the causes of the great pay slowdown were complex. Obama didn’t name them all, but a decent list would look something like this: new technologies that have made some blue-collar work obsolete; a slowing in the nation’s educational attainment; the shriveling of labor unions; the increase in one-parent families, which are far less economically secure; and the rise of other countries that have huge low-wage work forces.

What Obama blamed the current administration for, he said, was aggravating these trends with the tax code. To a large extent, Obama’s own economic agenda revolves around reversing Bush’s tax policies and then going a bit further in the other direction. Here, more than in his regulatory approach, Obama stands on the left side of the Democratic Party, but not exactly in the traditional tax-and-spend ways.

It’s helpful to start with a little history. When Reagan was elected, in 1980, tax rates on top incomes were so high that even liberal economists now say the economy was suffering. There simply wasn’t enough of an incentive for rich people to start new companies or expand existing ones, because so much of their profits would have gone to the federal government. Someone making the equivalent of $5 million in 1980 — in inflation-adjusted terms — would have paid a combined federal tax rate of almost 60 percent, according to research by Emmanuel Saez and Thomas Piketty, two academic economists. (These calculations cover not only income taxes but also payroll taxes, capital-gains taxes and others.) Reagan, by the end of his second term, had cut this rate to about 35 percent. Clinton raised it above 40 percent, but the current President Bush has reduced it to 34 percent. So over the same period that the rich have been getting much richer before taxes, their tax rates have also been falling far faster than the rates of any other income group.
Dating back to Reagan, Republicans have packaged tax cuts on high earners with more modest middle-class tax cuts and then maneuvered the Democrats into an unwinnable choice: are you for tax cuts or against them? Obama, however, argues that this is the moment when the politics of taxes can be changed.

To do this, he is proposing tax cuts for most families that are significantly larger than those McCain is offering, along with major tax increases for families making more than $250,000 a year. “That’s essentially a major part of our economic plan,” Obama said. “But it’s also a political message.” Economically, he is trying to use the tax code to spread the bounty from the market-based American economy to a far wider group of families. Politically, he is trying to drive a wedge through the great Reagan tax gambit.

The Tax Policy Center, a research group run by the Brookings Institution and the Urban Institute, has done the most detailed analysis of the Obama and McCain tax plans, and it has published a series of fascinating tables. For the bottom 80 percent of the population — those households making $118,000 or less — McCain’s various tax cuts would mean a net savings of about $200 a year on average. Obama’s proposals would bring $900 a year in savings. So for most people, Obama is the tax cutter in this campaign.

If there is a theme to the Obama tax philosophy, it’s that the tax code is not quite as progressive as you think it is. Most of the public discussion about taxes tends to focus on the income tax, which taxes the affluent at a considerably higher rate than anyone else. But the income tax doesn’t take the biggest bite out of most families’ annual tax bill. The payroll tax does. And even as the federal government has been reducing income taxes over the last few decades, it has allowed the payroll tax, which finances Social Security and Medicare, to creep up. That’s a big reason that overall tax rates for the bottom 80 percent of earners have not fallen as much as rates for the affluent.

Obama’s second-most-expensive proposal, after his health-care plan, is the equivalent of a $500 cut in the payroll tax for most workers. (It is actually a credit that is applied toward income taxes based on payroll taxes paid.) In a speech this month in Florida, he proposed that the cut take effect immediately, in the form of a rebate, to stimulate the economy. For most workers, it would be the first significant cut in the payroll tax in decades, if not ever.

The other way that he would cut taxes involves a series of technicalities. But since the campaign began, Goolsbee has been arguing that those technicalities offer one of the best glimpses of how Obama thinks about the tax code. Right now, several big tax breaks that sound broad-based — like those for child care and mortgage interest — don’t always benefit middle-income and lower-income families. Another example is the Hope Credit for college tuition, a creation of the Clinton administration. Obama wants to more than double the credit, to $4,000. More to the point, he would make it “fully refundable.” As a result, a family with an income-tax bill of $3,000 wouldn’t merely have that bill eliminated; it would also receive a $1,000 check. Increasingly, the income-tax system becomes a way to transfer money to poor families.

All told, Obama would not only cut taxes for most people more than McCain would. He would cut them more than Bill Clinton did and more than Hillary Clinton proposed doing. These tax cuts are really the essence of his market-oriented redistributionist philosophy (though he made it clear that he doesn’t like the word “redistributionist”). They are an attempt to address the middle-class squeeze by giving people a chunk of money to spend as they see fit.

He would then pay for the cuts, at least in part, by raising taxes on the affluent to a point where they would
eventually be slightly higher than they were under Clinton. For these upper-income families, the Tax Policy Center’s comparisons with McCain are even starker. McCain, by continuing the basic thrust of Bush’s tax policies and adding a few new wrinkles, would cut taxes for the top 0.1 percent of earners — those making an average of $9.1 million — by another $190,000 a year, on top of the Bush reductions. Obama would raise taxes on this top 0.1 percent by an average of $800,000 a year.

It’s hard not to look at that figure and be a little stunned. It would represent a huge tax increase on the wealthy families. But it’s also worth putting the number in some context. The bulk of Obama’s tax increases on the wealthy — about $500,000 of that $800,000 — would simply take away Bush’s tax cuts. The remaining $300,000 wouldn’t nearly reverse their pretax income gains in recent years. Since the mid-1990s, their inflation-adjusted pretax income has roughly doubled.

To put it another way, the wealthy have done so well over the past few decades, with their incomes soaring and tax rates plummeting, that Obama’s plan would not come close to erasing their gains. The same would be true of households making a few hundred thousand dollars a year (who have gotten smaller raises than the very rich but would also face smaller tax increases). As ambitious as Obama’s proposals might be, they would still leave the gap between the rich and everyone else far wider than it was 15 or 30 years ago. It just wouldn’t be quite as wide as it is now.

VI. Is He a European-Model Neoliberal?

Even some Republicans have started to wonder whether the Reagan strategy on taxes has run its course. Earlier this year, two young conservative writers, Ross Douthat and Reihan Salam, came out with a book called “Grand New Party.” Their basic thesis is that the Republican Party, for all its successes over the past generation, has failed to cement its majority because of economics. If the party’s agenda continues to revolve around tax cuts that mostly benefit the well off, the book argues, Republicans risk allowing a generation-long Democratic majority, like the kind that ruled the country from F.D.R. to L.B.J. To avoid this outcome, the authors offer an agenda of what they call Sam’s Club Republicanism, focused on the working class.

For now, the people running the party, be they in the Bush administration or the McCain campaign, evidently do not share this concern. They have responded to Obama’s tax proposals with the same kind of attacks that the party has been using since the 1980s. First, they have argued that Obama’s tax increases would end up hitting every income group. Strictly speaking, this is true. Obama’s increase on the corporate income tax would ultimately fall on all stockholders, even poor ones. In practical terms, though, most families own little enough stock that the other features of the tax plan would matter far, far more. That’s why the Tax Policy Center numbers, which include the corporate tax increase, come out as they do.

The second criticism is that Obama’s tax increases would send an already-weak economy into a tailspin. The problem with this argument is that it’s been made before, fairly recently, and it proved to be spectacularly wrong. When Bill Clinton raised taxes on upper-income families in 1993, his supply-side critics insisted that he would ruin the economy. As we now know, Clinton presided over the longest economic expansion on record, the fastest income growth most workers had experienced in a generation and the disappearance of the federal-budget deficit. His successor, Bush, then did exactly what the supply-siders wanted, cutting upper-income tax rates, and the results were much worse. Economic growth wasn’t quite as strong or nearly
as widespread, and the deficit returned. At the very least, Clinton’s increases did no discernible economic damage. Rubin, citing academic work on tax rates, made the case to me that rates under an Obama administration would not be nearly high enough to stifle innovation.

There is, however, a more philosophical critique of Obama’s tax policies. It’s one that Douthat and Salam make in “Grand New Party.” The book doesn’t mention Obama by name, but it contains one of the best summaries of his economic policy that I have read. The authors describe a new-model liberal consensus that weds “the free-market centrism of the Clinton years to a revived push for European-style social democracy.” This neoliberalism, as they call it, wouldn’t involve the big-government programs of the postwar years, but the government would come to play a larger role in the economy and would redistribute much more income from the rich to everyone else. “This is, in many respects, a deeply un-American solution to the problems facing our country,” the authors write, “one that would emphasize dependence over self-sufficiency and bureaucratic condescension over self-help.”

Douglas Holtz-Eakin, a former head of the Congressional Budget Office who has been advising McCain since the primaries, made a more specific version of this same point to me. Since Social Security was founded, its benefits have been based on the amount of payroll taxes that an individual worker paid over his or her lifetime. The system is progressive, in that the rich contribute more than the poor and do not get out everything they put in. But Obama would make it vastly more progressive. Currently, only income up to $102,000 is subject to the tax. After a decade, he would leave income between $102,000 and $250,000 untaxed, but would begin taxing income above that. The people paying this new tax probably would not get any additional retirement benefits in return. “As a political matter,” Holtz-Eakin argued, “it reveals a lack of judgment.” A program with almost unrivaled political support, he added, could turn into yet another government transfer program.

During my recent conversation with Obama, he mentioned Sam’s Club Republicanism in a different context, and I asked him if he had read “Grand New Party.” He hadn’t, he said, so I read him the line about dependence and condescension and asked for his reaction.

He said it made him think of Warren Buffett, an Obama supporter, who, if anything, might argue that he wasn’t going far enough to change the tax code. “If you talk to Warren, he’ll tell you his preference is not to meddle in the economy at all — let the market work, however way it’s going to work, and then just tax the heck out of people at the end and just redistribute it,” Obama said. “That way you’re not impeding efficiency, and you’re achieving equity on the back end.” He continued by saying that he thought there was some merit in Buffett’s argument. But, he said: “I do think that what the argument may miss is the sense of control that we want individuals to have in determining their own career paths, making their own life choices and so forth. And I also think you want to install that sense of self-reliance and that what you do will help determine outcomes.”

VII. The New New Deal

Last summer, just before a highway bridge in Minneapolis collapsed, Obama was meeting with a small group of economists. At one point, according to several people who were at the meeting, Obama said he agreed that blue-collar workers were struggling primarily because their skills weren’t as much in demand as they used to be. Technology has remade the economy, and education and retraining were the best ways for
workers to keep up. But any public-policy response couldn’t be about just education; it also had to take account of the psychology of the workplace, Obama continued. Some laid-off steelworkers might indeed be able to go back to school to become health-care workers. But many of them don’t want to work in health care or any service job. Factory workers, he said, want to make something. It’s part of their identity.

From there, Obama moved the conversation toward a discussion of how the government could improve the nation’s infrastructure — its backbone of bridges, roads, tunnels, airports and the like, much of which has seen better days. Since the dawn of the Age of Reagan, the idea that government spending can be a good thing for the economy has been out of favor, even among Democrats. But it’s now making something of a comeback, particularly within Obama’s camp. His agenda calls for about $50 billion in new annual spending on various investments, including infrastructure, alternative energy and scientific research. (To put that in perspective, the cut in the payroll tax would cost about $70 billion a year.)

These investments might pay off in all sorts of ways. They are a classic form of stimulus that could help the economy emerge from the housing hangover. They would provide jobs for former factory workers and others without college degrees, many of whom have struggled over the past generation, and for whom the current home-building slump has been yet another blow. Above all, the investments would have the potential to pay big long-term dividends, in the form of a national economy that operated more smoothly.

I came to think of this part of Obama’s agenda as the Virginia model, thanks to Tim Kaine, Virginia’s governor, who was one of the first Democrats to endorse Obama. Last year, Kaine began making the case to Goolsbee that the campaign should view Virginia as a model for the rest of the country. In just a few decades, the state has managed to transform itself in precisely the way that economists think the United States now must — to a higher-wage economy with a more-educated population, a place that has prospered even while losing many of its old-line manufacturing jobs. And it did so with a crucial shove from the government.

For much of the 20th century, Virginia was a poor state, but after World War II, with the cold war under way and the military growing, well-paying defense contractors began to sprout up around the Pentagon, in northern Virginia. By the 1970s, Darpa, the Pentagon’s research arm, began working on a computer network, which soon spawned a new form of communication: electronic mail. That computer system eventually became the Internet, and Northern Virginia suddenly had the beginnings of a brand-new industry. In recent decades, Virginia has also invested money in the port near Norfolk and has vastly expanded its colleges and universities. Today the state’s per-capita income is 7 percent higher than the national average.

The trick for someone trying to replicate Virginia’s success is figuring out which investments to make. As any Chicago School economist would remind you, the federal government has made its share of mistakes in this area, a recent example being subsidies for ethanol, which Obama, a farm-state senator, has championed and McCain has opposed. But Obama at least seems to have learned one lesson from the experience: His proposed new infrastructure spending would be overseen by a bipartisan board of unelected officials, rather than members of Congress.

More important, perhaps, is the fact that a single success, like the Internet or the Interstate highway system, can make up for a lot of failures. Jason Grumet, a Washington lawyer who is the Obama campaign’s lead
environmental adviser, made this point to me after I asked him why anyone should have confidence in the government’s ability to pick winners. “We all talk about Apollo 11, but there were some pretty public, pretty awful failures along the way,” Grumet said. “The United States didn’t say: ‘Well, we had some failures. We’re going to give up getting to the moon.’ ”

**VIII. Lots of Beef, Shortage of Message**

When Obama gives a speech about his economic plan, there is often a moment when you can sense him shift from poetry to prose. He can be inspiring when talking about how the country ended up being the envy of the world. But when he comes to the part about what he wants to do next, how he wants to keep America the envy of the world, it can sound a little like a State of the Union laundry list.

His advisers are divided about how much of a problem this is. Some of them told me that he did have a unifying theme — the middle-class squeeze — and that it would become clearer to voters as they began paying closer attention to the race. Others said they didn’t think Obama had yet come up with a simple way to explain how he would alleviate that squeeze. Obama himself seems well aware of the stakes. In 2005, on a call-in public-radio show, he told a listener that Democrats hadn’t been as effective in telling a story about the country as Republicans. In the end, he said, people voted not for a hodgepodge of position papers but for someone who could explain to them where the country should be going.

So I asked Obama whether he thought he had been able to tell an effective story about the economy during this campaign. Specifically, I wondered, did he think he had a message that compared with Reagan’s simple call for less government and lower taxes.

He paused for a few seconds and then said this:

“I think I can tell a pretty simple story. Ronald Reagan ushered in an era that reasserted the marketplace and freedom. He made people aware of the cost involved of government regulation or at least a command-and-control-style regulation regime. Bill Clinton to some extent continued that pattern, although he may have smoothed out the edges of it. And George Bush took Ronald Reagan’s insight and ran it over a cliff. And so I think the simple way of telling the story is that when Bill Clinton said the era of big government is over, he wasn’t arguing for an era of no government. So what we need to bring about is the end of the era of unresponsive and inefficient government and short-term thinking in government, so that the government is laying the groundwork, the framework, the foundation for the market to operate effectively and for every single individual to be able to be connected with that market and to succeed in that market. And it’s now a global marketplace.

“Now, that’s the story. Now, telling it elegantly — ‘low taxes, smaller government’ — the way the Republicans have, I think is more of a challenge.”

Even if Obama does figure out how to meet the challenge well enough to get elected, there are any number of ways in which his plans could fail. He has never run any government entity — no state, no city, not even a municipal agency — and he may not prove to be good at doing so. The economy could deteriorate further, leaving him with a Clinton-like choice between manageable deficits and direct help for the middle class. Or maybe the many economists who like his agenda are simply wrong. Maybe his health-care program won’t bring down costs. Maybe the Virginia model won’t work for the rest of the country.
But it’s not entirely clear what the alternative is, at least in the broad sense and at least for the time being. A much more left-wing agenda than Obama’s would consist of erecting new trade barriers, reregulating various industries and otherwise getting the government even more involved in the economy than Obama would. This program has the dubious distinction of being disliked by both voters and experts alike. Populism hasn’t won a national election, or even the Democratic nomination, in decades, and economists can point to any number of ways why it wouldn’t work anyway.

Republicans, on the other hand, have an economic strategy that may still sell politically. But is there much reason to think that it would lead to a very different result from Bush’s? There have now been two presidents in the last 30 years — Bush and Reagan — who cut taxes and promised that deficits would not follow. But the deficits did come, and they went away only after two other presidents — George H. W. Bush and Bill Clinton — raised taxes. It also seems fairly clear by now that tax cuts for the affluent do not necessarily trickle down to everyone else.

For Democrats who want to think the worst about their opponents, McCain’s reliance on these ideas may be affirming. But it’s really a shame. For the time being, only one party is applying the lessons of history to the country’s biggest economic problems. There is no great battle of new ideas, and that can’t make it more likely that those problems will be solved.

Shortly after I boarded Obama’s campaign plane this month, one of his press aides warned me that the conversation might not last long. She explained that he was exhausted from two days of campaigning in Florida and might decide to nap as soon as he got on the plane. But a few minutes later he summoned me to the plane’s first-class section, evidently choosing an economics discussion over a DVD of “Mad Men,” which was sitting on his side table. His eyes were tired, and he looked a good deal older than he had only four years ago, on the night that he became famous at the 2004 Democratic convention. But we ended up talking for an hour. After I returned to my seat, the press aide walked back to tell me that Obama had more to say.

“Two things,” he said, as we were standing outside the first-class bathroom. “One, just because I think it really captures where I was going with the whole issue of balancing market sensibilities with moral sentiment. One of my favorite quotes is — you know that famous Robert F. Kennedy quote about the measure of our G.D.P.?"

I didn’t, I said.

“Well, I'll send it to you, because it’s one of the most beautiful of his speeches,” Obama said.

In it, Kennedy argues that a country’s health can’t be measured simply by its economic output. That output, he said, “counts special locks for our doors and the jails for those who break them” but not “the health of our children, the quality of their education or the joy of their play.”

The second point Obama wanted to make was about sustainability. The current concerns about the state of the planet, he said, required something of a paradigm shift for economics. If we don’t make serious changes soon, probably in the next 10 or 15 years, we may find that it’s too late.

Both of these points, I realized later, were close cousins of two of the weaker arguments that liberals have made in recent decades. Liberals have at times dismissed the enormous benefits that come with prosperity.
And for decades some liberals have been wrongly predicting that economic growth was sure to leave the world without enough food or enough oil or enough something. Obama acknowledged as much, saying that technology had thus far always overcome any concerns about sustainability and that Kennedy’s notion had to be tempered with an appreciation of prosperity.

What’s new about the current moment, however, is that both of these arguments are actually starting to look relevant. Based on the collective wisdom of scientists, global warming really does seem to be different from any previous environmental crisis. For the first time on record, meanwhile, economic growth has not translated into better living standards for most Americans. These are two enormous challenges that are part of the legacy of the Reagan Age. They will be waiting for the next president, whether he is Obama or McCain, and they’ll probably be around for another couple of presidents too.

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