DOI: 10.2478/ie-2025-0047

sciendo
Intereconomics, 2025, 60(4), 251-252
JEL: H61, E52

Two Ossified American Rituals: The Budget and the Central Bank

As Congress worked its way through the One Big Beautiful Bill Act (OBBBA), while President Trump sniped at Jerome Powell and the dollar slid, Europeans may justly marvel at the great mixture of arcane and insane that is the essence of democracy over here. Among the tangled skeins of politics, procedure, institutions and ideology at play are a Federal Reserve created in 1913, which has been independent of the Treasury de facto since 1951, yet remains accountable to Congress under a law passed in 1978; a debt ceiling created in 1917 (and raised countless times since); a budget process enacted in 1974; and of course, a President, elected in 2024, whose flamboyant disrespect for norms adds flair to the proceedings.

The Budget Reform and Impoundment Control Act of 1974 created the Congressional Budget Office and formalized a ritual of Budget Resolutions whose platonic ideal is "balance" – equality of spending and tax revenue. Actual balance is never achieved. The budget practice is instead to simulate virtue by pairing tax cuts with spending cuts, requiring one to be offset, at least in part, by the other. But it is difficult to cut public spending. Hence, the taxes cut under Trump in 2017 initiated a game of make-believe: the cuts were "sunset" after eight years, meaning that they were technically only temporary. Thus, the continuation of current law beyond 2025 is scored (by the Congressional Budget Office, CBO) as *another* tax cut – which it mostly is not – requiring *more* spending cuts, which are real.

But what to cut? The Pentagon is unfortunately sacred. Social Security and Medicare are, for now, taboo, as Trump has promised not to touch them. Regulations and administration count for little. Foreign aid has been gutted. What is left are programs for the poor and the very old: food stamps (SNAP) and Medicaid. In America, Medicaid cares for millions of elderly in nursing homes, and it pays the freight for rural hospitals that serve low-income populations. As these programs take a hit, hunger will increase, and nursing homes and rural hospitals will close.

There is no good policy reason to cut Medicaid or SNAP. The ritual savagery serves only one purpose: to pare back the rise in the CBO's cumulative projected budget deficit (and national debt) from US $5.5 trillion over ten years to "only" about US $4 trillion – the "tax cuts" still outstrip the spending cuts by that much. However, recall that the tax cuts merely (for the most part) extend *current* tax practice, while the spending cuts are a *change* from current policy. Compared to current practice (as opposed to current law), the OBBBA is negative for the economy – another fact that the CBO ignores. In a crowning absurdity, the CBO works from a baseline that assumes changes to spending and taxes (whatever they may be) have no effect on the economy: growth, inflation and unemployment are assumed to be the same.

What, then, is the point? There is an implicit (no, explicit) view that public deficits and debt are bad per se. Comfortable people intone that without cuts to food and health care, "fiscal irresponsibility" (and not hunger, illness, despair and suicide) will (somehow) be the death of the Republic. And to pass the bill, the White House had to overcome the resistance of an even more hard-line faction, the "fiscal conservatives" who would have far more spending cuts to "balance the budget" and "hold the line" on the national debt. This group would have hit the economy even harder, provoking a crisis of unemployment and general impoverishment. Theirs is the perspective of small-time local officeholders, brought up on balanced budgets, but now at sea on the national stage.

Open Access funding provided by ZBW – Leibniz Information Centre for Economics.

James K. Galbraith, University of Texas, Austin, USA.

In a further bizarre twist, this perspective is reinforced by top Democratic former Treasury secretaries Robert Rubin and Lawrence Summers, who in an article in *The New York Times*, pointed to the late Clinton budget surpluses, i.e. the last time tax revenues momentarily exceeded federal spending, as examples of good policy. Rubin and Summers conveniently forgot that US government debt and deficits supply a worldwide demand for a safe financial asset – the preservation of which was a major policy goal in their time. They also do not mention that their surpluses slowed the economy and led to the 2001 recession. This is the problem of "fiscal drag", of which I reminded a room full of economists at a White House conference in April 2000, just as the NASDAQ boom was starting to unravel. The response was a nervous titter.

How the hard-line faction was brought into line I cannot say. Likely with promises, to be honored in the next round. In another farcical feature of the OBBBA, the US $4 trillion in projected extra deficits were allowed and the debt ceiling was raised by US $5 trillion. But it is certain that the bipartisan rumbling about deficits and debt will continue, softening the ground for an assault on Medicare and Social Security later on, after the mid-term elections, or perhaps a few years later, when Trump is gone.

Meanwhile, Trump seems to have noticed that the stuck-in-neutral high interest rate policy of the Federal Reserve cuts against the economy for no good reason. Interest payments are a large contributor to projected deficits and debt, channeling public funds to banks and bondholders. At worst, high interest rates slow economic growth and discourage business investment. Trump would like interest rates to be cut, and he is right: they should be. But the other ossified ritual, of "Fed independence" from the White House, makes his threats counterproductive. Chairman Powell and his colleagues cannot fold to overt pressure from the President without a fatal loss of face. Therefore, they will not act, even if they realize (as they may) that the situation justifies it.

A more subtle but effective tactic, consistent with US law and constitutional prerogatives, would be for Congress, acting "independently" of Trump, to take up a resolution mandating lower interest rates – or to have put such language in the Budget Resolution, as Congress threatened to do back in 1982.[1] Congress has legal authority over the Fed, so such a move would put the central bank under effective pressure to cut rates – as it did in 1982 to defuse the threat.[2] This would also force Democrats to choose between Fed independence – beloved of bankers and economists – and the lower interest rates favored by middle class voters. Today's Democrats would surely make the most politically damaging choice. Luckily for them, the Republicans have not figured this out yet.

Finally, the falling dollar. The high dollar has been a bulwark of American financial power in the world for decades – and the scourge of manufacturing – supporting the real living standard of Americans through cheap imports. But its fall is good for the stock market (since foreign earnings of US multinationals are inflated), good for exports (hence for manufacturing and farmers), good for foreign investment in the United States (since it makes American assets cheaper) and tolerable for inflation so long as domestic oil and gas production hold up while prices decline. For the moment, the dollar's decline appears to be gathering steam, as long-time dollar holders (notably, China) "decouple" by selling down their holdings. The fall is therefore likely to continue – so long as Federal Reserve Chair Powell does not move to wreck the economy, and the budget, by trying to "save" the dollar and the tottering American financial position in the wider world.

1 The Federal Reserve's Forgotten Credit Mandate. (2025). *Harvard Law Review*, *138*(7), 1887–1910.

2 Dupor, B. (2025, January 16). The Volcker tightening cycle: Explaining the 1982 course reversal. *Federal Reserve Bank of St. Louis Review*, *107*(1), 1–12.