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A Perspective on the Budget Deficit and Job Creation

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Debt and deficits have moved front and center on the nation's agenda. Ron Haskins calls them the most serious domestic problem facing the next president. As he argues, the problem and its possible solutions are, by now, well known. The problem is that the kind of spending cuts and revenue increases needed to reduce the red ink are unpopular, and agreement between the parties is stymied by their differing views of the proper size and role of government. Haskins argues that despite their commitment to limited government, spending has grown as rapidly (or more rapidly) during Republican as during Democratic administrations. But, he also argues that presidential leadership is critical and faults President Obama for his failure to take advantage of a variety of opportunities to put the nation on a better fiscal path. In particular, the president failed to endorse the bipartisan proposal put forward by his own fiscal commission. Haskins sensibly argues that presidential candidates should base budgetary decisions on evidence of effectiveness, should be open to compromise on the future of the health care system and should set specific fiscal targets backed up by a trigger that would impose automatic spending and tax increases if the target is not met.

I agree with much of what Haskins proposes, but on two key points, I take a different perspective.

First, at least in my view, jobs, not deficits, are the most important domestic problem facing the country. Republican rhetoric about job-destroying deficits is simply wrong. Yes, we need to rein in deficits and debts over the longer run, and we should take legislative steps now to insure a fiscally responsible future. But as Michael Greenstone and Adam Looney have shown, it will take five years even under the most optimistic assumptions before the unemployment rate returns to pre-recession levels. The problem is not a lack of capacity for the economy to grow. The problem, as Martin Baily argues in another chapter of this volume, is primarily a lack of demand. When businesses and consumers are not spending, government needs to be the spender of last resort. At a minimum, it should do no harm. Cutting spending or raising taxes when private demand is weak will only make matters worse. For these reasons, most economists have argued for short-term fiscal stimulus combined with long-term fiscal restraint. Unfortunately, it now appears that the short term could easily be as long as five years.

Second, I want to defend the president's record and contrast it with that of his likely opponent, Mitt Romney. I agree that the president has missed some opportunities – especially the opportunity to endorse Bowles-Simpson. But, he did put forward a plan for economic growth and deficit reduction in September 2011, as well as a deficit reduction framework much earlier in the year. His plan was far more specific than anything any Republican candidate has been willing to put on the table. (The House budget plan, authored by Paul Ryan, is an exception but Ryan is not running for president.) The president's plan is also, in my view, far more sensible. He has called for well over $4 trillion in debt reduction over the next 10 years, including the $1.2 trillion in discretionary cuts enacted as part of the Budget Control Act, $580 billion in mandatory spending cuts (mostly from Medicare), $1.1 trillion from the drawdown of troops in Iraq and Afghanistan, $1.5 trillion from tax reform, and $430 billion in interest savings. Granted, some of these savings were already baked into the cake (for example, the war savings and the BCA cuts), but let's compare this plan to what Gov. Romney has proposed. Romney's fiscal plan includes a reduction in the corporate tax rate, from 35 to 25 percent, a reduction in tax rates on capital gains and dividends (for couples with less than $200,000 in income) and an elimination of the estate tax and of the taxes on high-income households that were part of health care reform. These are partly offset by an increase in taxes for low-income

Americans. On net, these would increase the deficit by $180 billion in 2015 alone (and closer to several trillion over a decade), *with 57 percent of the benefits going to the top 1 percent*, according to the Tax Policy Center.[i]

With his tax proposals producing even more red ink, how then would Gov. Romney get deficits under control? By calling for some immediate cuts to non-security spending that would produce no more than $200 billion in savings over a decade, and by promising to seek a balanced budget amendment to the Constitution and to limit government spending to 20 percent of GDP. The proposed cuts to domestic spending are a tiny fraction of what is needed and pale in comparison to the revenue losses his tax proposals would create. The balanced budget amendment and the limit on spending are nice rhetoric, but they avoid specifying how any savings are to be achieved and thus leave the public in the dark about what's really at stake. In particular, it's hard to see how limiting spending to 20 percent of GDP, which Romney says he would try to implement immediately, and simultaneously offsetting the reduced revenues from his tax proposals, can be achieved without cutting Medicare, Medicaid and Social Security substantially.[ii]

Even were I not concerned with imposing a burst of fiscal austerity on a very fragile economy, I would argue that the president has rightly called for shared sacrifice from the public. Gov. Romney, in contrast, is calling for just the opposite: further tax reductions for those already well-off and draconian cuts in spending that will primarily affect the less affluent and programs, such as infrastructure spending, that promote our competitiveness and a healthy recovery.

Finally, it is all very well to talk about presidential leadership, but as we should have learned by now, it is Congress, not the president, that holds the keys to the fiscal kingdom. The election of 2012 is unlikely to resolve this barrier to solving the problem unless voters elect a unified government and give a filibuster-proof margin to the winning party in the Senate. As Tom Mann and Norman Ornstein[iii] have argued so cogently, the most likely scenario is continuing deadlock as long as Republicans insist on no new taxes. Although Democrats have been very resistant to cutting Social Security or Medicare, many of them, including President Obama, have made it clear they would be open to doing so, if revenues were also on the table. Yet, they face a Republican party united in its opposition to any new revenues. Some moderates seem to believe that if elected, Romney would be more "reasonable" than his campaign rhetoric implies. What this assumption misses is the fact that no president can buck the core principles of his party or completely ignore his campaign promises. Bottom line: given today's sharp partisan disagreements, whoever is elected will need very long coattails to govern effectively.

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[i] The TPC provides estimates relative to current law and relative to current policy. These are the current policy estimates. Compared to current law, which assumes the Bush tax cuts expire, the revenue losses would be much higher ($600 billion).

[ii] In combination with the BCA sequester already in place, the amount of savings this implies for 2013 is $628 billion (2.8 percent of 16 trillion of GDP plus $180 billion in offsets). Assuming domestic and defense cuts beyond those already scheduled as part of the BCA are limited, what's left is primarily the big three entitlements (accounting for about 80 percent of total mandatory spending). Romney assumes his tax cuts will produce greater economic growth and thus partially pay for themselves. Although there could be some dynamic effects, the hope that tax cuts will pay for themselves is considered highly unlikely by most economists.

[iii] Washington Monthly, Jan.-Feb. 2012.