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Cutting the Deficit, Adding Jobs

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When Joe Biden convened debt ceiling negotiations with Congressional leaders on May 5, the experts were saying that the economy was on an upswing. They're not saying that anymore.

Consumer spending has weakened. Hiring has slowed. Stocks have slid. As tends to be the case in the long aftermath of a financial crisis, the economy once again needs help.

And the debt talks have become the best opportunity for Washington to provide that help.

Doing so will require some political maturity, because the negotiators will have to hold on to two thoughts simultaneously. They will need to increase the deficit in some modest, targeted ways that could increase hiring, like tax cuts for businesses and spending on scientific research. At the same time, negotiators will have to find enough medium-term spending cuts and tax increases to bring down the deficit soon.

Economically, this mix is not all that complicated. Ben Bernanke, the Federal Reserve chairman, has called for a version of it, in his own cautious way. Coming up with a plan to reduce the deficit was urgent, he said, but making cuts now "could be self-defeating if it were to undercut the still-fragile recovery."

Politically, the mix is clearly trickier. Yet both parties have reason to compromise. Democrats are worried — or at least they should be, deeply — that the weak economy will cost them the White House and Senate next year.

Republicans are worried that their plan to replace Medicare with a system of private insurance will let Democrats win even if the economy remains weak. A deal that commits both parties to further cuts in Medicare's growth while also helping the economy seems to have a chance of passing.

For the economy's sake, the best such deal would include two kinds of help. The first would be immediate: further tax cuts for households and businesses, as well as an extension of jobless benefits. On Tuesday, the White House signaled that it was open to new cuts in the payroll tax. These moves could help lift spending and re-establish the confidence that the economy would indeed recover, as it always has before.

The second kind of help might be even more important: policies that would eventually shift the country away from its debt-fueled reliance on consumption and toward more investment, production and high-end service industries.

I understand that some of these steps, especially in the first category, smack of stimulus. Many people are understandably skeptical of stimulus, given that the economy remains in bad shape despite everything the government has tried over the last four years.

But the earlier stimulus made a big difference, even if it couldn't erase the impact of the worst financial crisis in decades. The tax rebates signed by President George W. Bush and President Obama both lifted spending. So did the cash-for-clunkers vehicle rebate program. The billions of dollars of state aid prevented layoffs of teachers, police officers and sanitation workers.

It is no coincidence that this downturn has been far less severe than the Great Depression, even though the initial deterioration this time was worse. It's no coincidence that the only quarter of economic growth in 2008 was the quarter when the Bush rebate checks went out. It's no coincidence that the economy's most rapid improvement and fastest growth under Mr. Obama came as his stimulus plan and the Fed's actions were peaking.

A new plan — sure to be called a jobs plan, not a stimulus — would start by extending the payroll tax cut for households through the end of next year.

Late last year, Congress and the White House extended the Bush income tax cuts through the end of 2012 but cut the payroll tax only through 2011. This makes little sense, substantively. The payroll tax (which finances Social Security and Medicare) has become the main tax that most middle- and lower-income households pay, according to the Tax Policy Center. So cutting the payroll tax delivers more economic bang than the Bush tax cuts, at a far lower cost to the deficit.

Absent an extension, almost everybody's taxes will rise on Jan. 1. "When the economy is not doing well," says Ike Brannon of the conservative American Action Forum, "you hate to see any tax increase."

Employers also pay a portion of the payroll tax, and several people — including Lawrence Summers and the members of the Bipartisan Policy Center's debt panel — have called for the employer portion to be cut, too. That would certainly help. But I think the strongest argument is for a targeted cut.

Any business that increased its net employment could be exempted from payroll taxes on new workers for a few years, creating a big incentive to hire instead of, say, buying new machines. The exemption could be retroactive to June 1, so that companies would not wait to hire until after the bill passed.

Corporate lobbyists defeated this idea last time — because executives wanted federal money even if they were not hiring — but that's just self-interest.

And what about policies to begin restructuring the economy?

Economists can give you a long list. High-skill immigrants, often the entrepreneurs of tomorrow, could be encouraged to stay here, rather than shown the door. The permit process for businesses could become simpler, as executives urged Mr. Obama in North Carolina on Monday. Perhaps most important, Washington could make more high-return investments in science and education.

Only the federal government can afford the large-scale basic science that has often led to breakthrough innovations, like the semiconductor, the Internet and many new drugs. Yet federal spending on basic research, as a share of the economy, has fallen 5 percent in the last five years. Talk about a self-defeating cut.

All told, a growth agenda like this one would cost a few hundred billion dollars over the next couple of years. It's small change relative to any number of ways to reduce the deficit: squeezing wasteful Medicare and military spending, reforming the Social Security disability program, forcing social programs to become more accountable for results, closing corporate tax loopholes, returning tax rates on the rich to Clinton-era levels.

Obviously, any package that survives the debt ceiling talks will not be the ideal one. But there is a whole lot of room between neutral and ideal. Washington really can put people back to work while cutting the deficit. And, of course, moving people back into paying jobs will ultimately help reduce the deficit, too.

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