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One Way to Trim Deficit: Cultivate Growth

By DAVID LEONHARDT

We look back on the late 1990s as a rare time when the federal government ran budget surpluses. We tend to forget that those surpluses came as a surprise to almost everybody.

As late as 1998, the Congressional Budget Office was predicting a deficit for 1999. In fact, Washington ran its biggest surplus in five decades.

What happened? Above all, economic growth. And that may be a big part of the answer to our current problems.

Yes, the government became more fiscally conservative in the 1990s. Both President George H. W. Bush (who doesn't get enough credit) and President Bill Clinton, working with Congress, raised taxes to attack the 1980s deficits.

But those tax increases were the second most important reason for the surpluses that followed. The most important was the fact that the economy grew more rapidly than expected. The faster growth pushed up incomes and caused more tax revenue to flow into the Treasury.

Today's looming deficits are almost surely too large to be closed exclusively with growth. The baby boom generation is too big, and the rise in Medicare costs continues to be too steep. Yet growth could still make an enormous difference.

If the economy grew one half of a percentage point faster than forecast each year over the next two decades — no easy feat, to be fair — the country would have to do roughly 40 to 50 percent less deficit-cutting than it now appears, based on my reading of budget data from the economists Alan Auerbach and William Gale.

To get a concrete sense for what this would mean, you can play around with the The Times's online deficit puzzle. It asks you to find almost $1.4 trillion in annual spending cuts and tax increases by the year 2030. If growth were a half point faster than expected, the needed savings would instead drop to less than $700 billion. That would mean many fewer painful choices, be they tax increases or Medicare cuts.

So arguably the single best way to cut the deficit is to make sure that any deficit-cutting plan does not also cut economic growth. Ideally, it will lift growth.

There are two main ways to do so. First, we shouldn't plunge ourselves back into another economic slump by raising taxes and cutting spending too quickly. President Franklin Roosevelt made that mistake in 1937, and this time (one hopes) the country won't be able to rely on war mobilization spending to undo the error.

In the short term, we should actually spend more. "Some politicians and economists present a false choice: reduce unemployment *or* stabilize the debt," argues a new bipartisan deficit plan that will be released Wednesday, the second such plan to come out in the last week. As Alice Rivlin, a Democrat who oversaw the writing of the plan with Pete Domenici, a Republican, put it: "We can do both. We can put money in people's pockets in the short run and trim government spending in the long run." .

The plan calls for a one-year payroll tax holiday for employers and workers, costing $650 billion. But remember that's a one-time sum, while the needed deficit cuts will be hundreds of billions of dollars a year. Relative to those cuts, a payroll tax holiday — or more spending on roads and bridges, as

President Obama favors — is a rounding error. And, of course, putting people back to work has its own benefits.

Even more important than the next couple of years is the second part of a pro-growth strategy: the long term. A good deficit plan doesn't simply make across-the-board cuts for years on end. It cuts funding for programs that do not spur economic growth and increases funding for those relatively few that do. Likewise, it raises tax rates that do not have a clear record of promoting growth and cuts those that do.

This task is not an easy one, because advocates and lobbyists inevitably claim that their idea, whatever it is, will help the larger economy. Just look at farm subsidies, a form of welfare for agribusiness that is supposedly crucial to the American economy. Or look at President George W. Bush's tax cuts, which, after being sold as an economic elixir, were followed by the slowest decade of growth since before World War II.

The two bipartisan deficit proposals that have come out over the last week each do a pretty good job, but not quite good enough, of focusing on economic growth. The most pro-growth part of both proposals — the Domenici-Rivlin plan and the one from Erskine Bowles and Alan Simpson — is their emphasis on tax reform.

Today's tax code is a thicket of deductions, credits and loopholes that force people to change their behavior and waste time trying to avoid too large of a tax bill. A tax code with fewer deductions and lower rates — which, to be clear, is not the same thing as a tax cut — would instead let businesses and households focus on being as productive as possible. The potential to make good money would drive more decisions, and the ability to qualify for a tax break would drive fewer.

Beyond tax reform, both deficit plans mention the importance of making investments that will lead to future growth. In particular, the Bowles-Simpson plan calls for a gradual 15-cents-a-gallon increase in the federal gasoline tax to pay for highways, mass transit and other projects. The plans also urge the government to prioritize education and science.

These are clearly among the best ways to promote growth. The United States created the world's most prosperous economy last century in large measure because it was the world's most educated country. It no longer is. Federal science dollars, meanwhile, led to the creation of the intercontinental railroad, the airline industry, the microchip, the personal computer, the Internet and numerous medical breakthroughs. Yet science funding is scheduled to decline as stimulus money runs out.

Unfortunately, the plans don't get more specific than saying that education and science are important. The only dedicated money for specific investments in either plan is the infrastructure fund financed by the gas tax. And, realistically, exhorting a future Congress to avoid wasteful spending and prioritize growth has about as much chance of success as exhorting it to find the political will to revamp Medicare.

The two bipartisan deficit groups deserve a lot of credit for starting to move the debate beyond vagaries. There is one more step they can take, though: making sure we remember that cutting the deficit is not only about making cuts.

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