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'Grand Bargains' Are a Budgetary Dead End

The arithmetic of debt is simple: The taxes necessary to feed these deals will stifle economic growth.

By PETER J. WALLISON

Although it was ultimately successful, the Republican effort to cut spending before extending the U.S. debt limit remains highly controversial. Tea party members and the House Republicans have been called "terrorists" by the angry left, and President Obama has accused them of putting politics before the interests of the country.

Even some Republicans have expressed concern about the brinksmanship that produced the agreement, contending that it was wrong to threaten the country's credit for a political or policy objective. But the real question, as usual, is about alternatives.

Consider these facts. The Senate has not adopted a budget in two years, primarily because the Democrats who run that body could not bring themselves to admit the size of the deficit their policies would produce. President Obama's budget this year, required by law, was such a craven effort that it was unanimously rejected by the Democratic Senate when they were forced to vote on it.

A special commission, appointed by the president and led by former Republican Sen. Alan Simpson and former Clinton Chief of Staff Erskine Bowles, adopted a plan for cutting entitlements and reducing tax rates through tax reform. The president promptly shelved it. The Republican-controlled House adopted a budget, crafted by Budget Committee Chairman Paul Ryan, that outlined a way to address rising Medicare costs. Almost all Democrats voted against it, and the Democratic National Committee circulated an ad showing a Ryan look-alike pushing a grannie off a cliff.

The temptation to demagogue spending cuts is overwhelming. How do we get by this? One approach is for Republicans to compromise with the Democrats, offering up some tax increases in a "grand bargain."

Let's assume that a budget deal had been arranged before Aug. 2, in which the Republicans had agreed to repeal the Bush tax cuts for all families with income over $250,000 per year—essentially the president's maximum demand in the debt limit negotiations—in exchange for spending cuts that resulted in a $4 trillion deficit reduction over 10 years. Leaving aside the effects on growth and employment, this looks like a good deal. The tax increases would yield $700 billion over 10 years, so the ratio of spending cuts ($3.3 trillion) to tax increases—almost five to one—would be highly favorable to the Republican position. So what's the problem?

If the precedent set by agreement is that all subsequent deals will be part tax increases and part spending cuts, it would not be long before the taxes on all Americans would be immeasurably greater. According to the Congressional Budget Office, the debt held by the public today is $14.3 trillion. CBO estimates that if current policies are continued the debt will be $8.5 trillion higher in 2021, totaling about $23 trillion. As my AEI colleague Alex Pollock points out, no one is counting the off-budget debt of various government agencies (principally Fannie Mae and Freddie Mac)—another $7.5 trillion. So the real total in 2021 will be over $30 trillion. This is merely the contracted U.S. debt. Without serious reform, CBO estimates that the main entitlements—Social Security, Medicare and Medicaid—will add a cumulative increase in spending of $78 trillion in the 20 years after 2021.

Associated Press

President Obama with Congressional leadership during the debt talks.

If the "grand bargain" idea is that we are going to reduce our deficits and the nation's debt in the future through a combination of tax increases and spending reductions, what resources do we have? If we repeal the Bush tax cuts for those families with incomes over $250,000, we get $700 billion over the next 10 years—not much of a dent in either the deficit or the debt. If we repeal the Bush tax cuts for all Americans—something that Mr. Obama says he opposes—we get an additional $3.5 trillion over the same period. Again, pretty puny in relation to nearly $100 trillion in debt and long-term entitlement obligations. Confiscating all earnings over $250,000 in any year will only yield enough to meet one year's deficit.

The confiscation idea raises in stark terms the trade-off between tax increases and economic growth. There are only two ways for the U.S. to address the debt and entitlement obligations it has already assumed—inflating the currency and increasing the rate of its economic growth.

Inflation will create even greater burdens on the growing number of retirees living on fixed incomes, so that's not acceptable. Yet repealing the Bush tax cuts and placing even greater burdens on American taxpayers as part of future "grand bargains" will stifle the necessary economic growth. Even the 10-to-one spending cut to tax increase ratio famously rejected by Republican presidential candidates in a recent debate will place an unsupportable burden on American taxpayers.

So which is the better alternative—offering up tax increases to buy a temporary peace, or using whatever leverage is available to force the necessary spending cuts?

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