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FATAL VISION:
The Budget Resolutions of 1995

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Plans now under consideration in Congress and at the White House to balance the federal budget pose a grave threat to the nation's economy and to the financial security of American families. The benefits of balancing the budget have been grossly exaggerated to the public, while the prohibitive economic and social costs have been overlooked.

An explosion in the deficit would indeed be of great harm to the economy, but there is at present no such threat. Modest deficit reduction can easily keep federal debt at its present level relative to the gross domestic product through 2005. More serious deficits are foreseen beyond 2005, but remedies will not require balancing the budget then either. These future deficits require attention to one area and one area alone: health care reform.

Deficit Reduction: Why, How Much, When?

Making a federal budget is first and foremost an economic decision affecting national income, job creation, and the level of unemployment. Spending priorities in the budget are important but secondary. The first question to ask, then, is not "how do we get the deficit to zero?" but rather, "how much or little deficit reduction does the economy need, and when does it need it?'

The principal aim of deficit reduction is to reduce interest rates and, consequently, to increase investment. Yet its prospects for doing so are limited and questionable. Experience has shown that lowering deficits does not necessarily reduce interest rates, and lowering interest rates does not necessarily raise investment. Thus, the whole point of reducing deficits is drawn into question, though it remains reasonable to keep them within safe boundaries. Such a "safe deficit" would maintain or reduce the ratio of public debt to GDP. By that measure, the country is safe for at least 10 years, giving us time to make policy changes now that solve the long-term problem posed by health care.

The Seven Lean Years

While deficit reduction may stimulate some capital formation, analyses show that the returns typically are not felt for 15 years or so. Senate Republicans are candid in predicting that their plan will bring no improvement in GDP until after 2002. In fact, they project that their plan will increase unemployment by 0.5%, eliminating three-quarters of a million jobs. If the Senate deficit reduction plan -- or any other of its magnitude and pace — "works" as designed, therefore, American families will face at least seven lean years of lower living standards.

Is there another way for the American economic future to brighten? There is evidence that saving and investment follow economic growth rather than lead it (Eisner 1994). Measures to lower unemployment will support family incomes and enable people to save more. Higher family incomes will reduce budget deficits because tax receipts will grow and expenses for entitlements will fall. In other words, there are two paths to higher saving and investment: one in which employment and income fall, and one in which they rise.

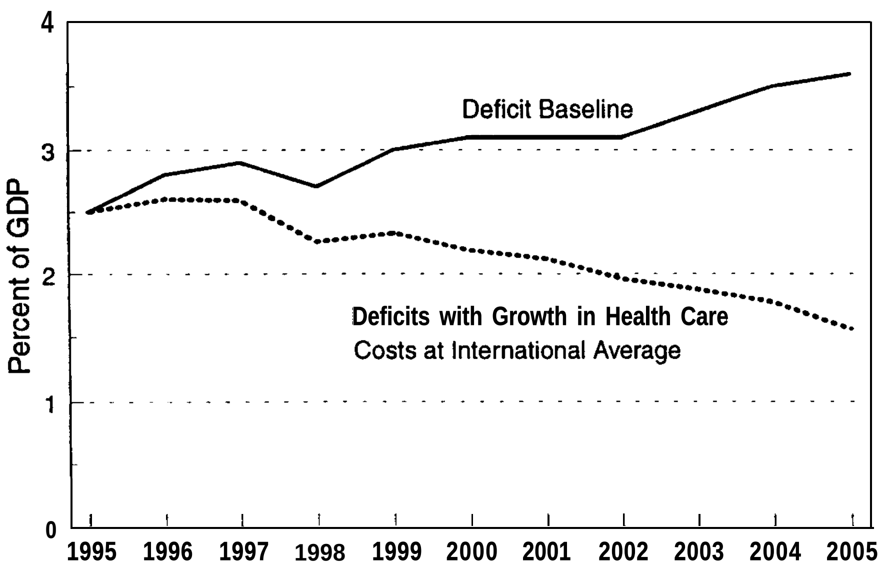
Budget Priorities

Republicans are justly criticized for proposing deficit reduction that takes from the poor and elderly and not at all from the well-off. Certainly some Americans are better positioned for "sacrifice" than others. But critics of the choices in the proposed budget resolutions need to realize that intolerable *damage to domestic programs is inevitable **if the** budget is balanced. No* "preferable" alternative can be configured that spares them.

Even setting aside the pros and cons of specific cuts, there is a question of whether the budget savings that are envisioned will keep the deficit within safe levels over the long term. It is possible to balance the budget only to have deficits begin rising all over again, even exploding. The main problem with all past and present deficit reduction programs, whether Democratic or Republican, is that they have failed to recognize the predominant cause of future deficit increases: spending growth in Medicaid and Medicare. The massive deficit reduction packages of 1990 and 1992 made some cuts in these programs but failed to alter their basic makeup. Republicans have now targeted health care for large cuts, but they have yet to tell us how such cuts will be achieved or how public programs can be reformed in the absence of private sector health care reform. Without these **details,** it is impossible to assess whether the long-term deficit problem has been addressed at all.

Health Care Drives the Deficit

Projections, 1995-2005



Source: Economic Policy Institute.

Political Medicine for Deficit Psychosis

Balancing the budget is likened to "giving people their money back." Insofar as budget resolutions emphasize deficit reduction rather than tax cuts, they do no such thing. Spending cuts take money away from people and will far exceed any conceivable tax cuts. Some of these take-aways will closely resemble tax increases, since they entail higher Medicare premiums, co-payments, and deductibles. Proposals to rig the consumer price index (Baker 1995) imply an explicit tax increase, since income tax brackets would be raised more slowly over time, pushing taxpayers into higher brackets. The CPI adjustment also reneges on promises not to "touch" Social Security, since benefits will no longer keep up with inflation.

Members of Congress talk as if they are battering "bureaucracy" rather than programs, but the pay of civilian federal employees is only about 10% of total budget outlays (OMB 1995). It is therefore fair to expect that about 90% of any large spending cuts will take the form of cuts in programs that benefit the American people or the nation's economy, not reduced "bureaucracy."

Public sentiment for balancing the budget is strong, but so is sentiment against balancing it on the backs of the elderly, the poor, taxpayers, or state and local governments. Since there is no other way to eliminate deficits, the time is right to open up the basic question of how much deficit reduction we really must have, and when.

It is misguided to think that near-term deficits must be reduced or eliminated at *all cost.* Deficit reduction is not more valuable to the nation, for example, than the missions of safeguarding family economic security and investing in the economy (Baker and Schafer 1995). Moreover, rapid spending cuts today are far less important to the long-term deficit outlook than is effective cost-containment in health care. The way to fix the deficit is not by engineering recessions, cutting living standards, or dismantling federal programs. We need a Congress and a White House that will renew their commitment to health care reform. That is the contract needed most by the American people.

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