

The Fight Over Fiscal Rectitude: Politics or Economics?

Decades ago, my parents taught me a simple lesson: when something goes awry and its outcome remains uncertain, do what you can and should do to the best of your capability. The future may not be entirely in your control, but by setting some good things in motion you make tough issues easier to handle. I thought about that lesson recently while reading and listening to the latest chapter in the debate over controlling ever-rising government debt levels.

At the recent G-20 meeting in Toronto, most world leaders strongly agreed that the risks posed by increasing debt levels in many developed countries, including the United States, must be reduced. But the Obama administration and some economists warn that the price of fiscal restraint can be economic drag. Paul Krugman, among others, notes that the second recession within the Great Depression, beginning in 1937, was partly the product of deficit reduction.

The complication for most people reading about this conflict is that the economics and the politics are constantly conflated. The economics always says we should adopt and maintain good long-term budget policy as soon as possible, even when we disagree on the timing of short-term stimulus. The politics almost always argues for holding off any decision—short term or long term—that asks the public to give up something.

The confusion stems partly from the need for many developed countries to tackle two related, but separate, problems. First, they are in the very early stages of recovery from a recession—with debt levels higher than they should be because they spent far more than they were willing to collect in years before the worldwide recession began. Coupled with recession-related revenue shortfalls and spending demands, that earlier profligacy means higher costs and risks and less flexibility today. Trying to maintain adequate stimulus and recover from extraordinarily high deficit levels demands extraordinary discipline. Second, apart from the recession, future spending is scheduled to grow faster than revenues almost no matter how well the recovery goes. That's largely because of fast-growing spending on health and retirement programs, along with the revenue drops that come by ever-more people retiring.

If the countries gathered in Toronto don't solve the second problem, the first one never really goes away. Economists who bid us wait for a few more years generally have their eye on the first problem, not the second. But the fear of many at the G-20 summit is that we cannot keep enacting myopic short-term policies while paying lip service to fiscal discipline down the road.

Even in World War II—often cited as an unintended Keynesian policy that helped pull the United States out of a depression—long-term tax increases were enacted to pay for short-term spending increases. My simple point here is that at the tail end of a depression and the beginning of a war, when our problems, threats, and risks were extraordinarily higher than today's, policymakers still kept one eye focused on sustainable long-term economic policies.

Now read deeper between the lines when you hear the Obama administration or others today say we have to wait to start wrestling the deficit beast to the ground. This should be read as a political statement when it comes to the long run: that they can't achieve what they should achieve. They can't possibly mean, after all, that there's no good economic reason to start putting our systems in order now—to bring about Social Security solvency, to contain health care spending, to bring future revenues more in line with promised spending levels.

In simple arithmetic, Congress can pass either a bill with \$100 of temporary stimulus for one year, with only higher debt and interest payments for the future, or a bill with \$120 of temporary stimulus for one year, more than offset by \$20 of reduced spending or increased taxes for every year in the future. The second choice puts as much cash into the economy in the first year, yet it reduces debt over the longer term. Viewed this way, the argument that we can't adopt today policies that cut spending or increase taxes falls apart. There's a difference, after all, between how quickly a policy is implemented

and when it is adopted.

Good long-term budget policy still requires debating how fast fiscal retreat must proceed during a recovery's infancy. So, understanding that any path of retreat, fast or slow, can still fit in with good long-term policy, let's have *that* debate, and not the silly one we're having over whether anything can be done right now to tame the deficit.

Finally, there's a bonus in handling the first, short-term problem by starting to solve the second, long-term problem immediately: it gives greater assurance to the markets that countries are going to get their fiscal houses in order. Many solutions to long-term fiscal problems—such as reducing powerful incentives to retire—could also be designed to boost recovery.

My parents were neither economists nor successful politicians. But what I think they'd tell us right now is that carefully turning down the spigot in no way prevents us from setting in motion ways to refill the reservoir for the future. Following that advice politically is harder than sorting through the economics, but it can be done.

The Government We Deserve is a periodic column on public policy by Eugene Steuerle, an Institute fellow and the Richard B. Fisher Chair at the nonpartisan Urban Institute. Steuerle is also a former deputy assistant secretary of the Treasury. The opinions are those of the author and do not necessarily reflect those of the Urban Institute, its trustees, or its sponsors.

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