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George Bush's big-government conservatism

Can't last

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Between 1998 and 2001, America's federal government ran a surplus on its accounts. The prospect now is of years, even decades, of deficits. Is that scary?

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IN HIS first three years as president, George Bush has cut taxes three times and yet orchestrated a sharp rise in public spending—not just, or indeed mainly, on foreign wars and "homeland security", but also on domestic matters. For instance, spending on education has jumped by three-fifths since 2000, and spending on transport has risen by nearly half. Lower taxes, higher spending: the outcome is that the federal government, despite a steep fall in the interest it pays on its debt, has swung sharply into deficit—$450 billion this fiscal year, by most accounts.

That is not, yet, as big a deficit as that presided over by Ronald Reagan in 1983

(6% of GDP then, compared with about 4% of GDP for this year). Yet the deterioration of the government's finances today—from a surplus of 2.4% of GDP in the 2000 fiscal year—is certainly steeper.

What is more, by 1983 Mr Reagan and Congress were together attempting to do something about the deficit. Nowadays, no one with political power is bothering to try. All the Democratic presidential hopefuls want, to a greater or lesser degree, to repeal Mr Bush's tax cuts. Yet they aim to use the money not to bring down the deficit, but to expand public programmes. Mr Bush's own new legislation to pay for prescription drugs under Medicare, the federal health programme for the elderly, will cost $400 billion over the next ten years. A bipartisan conspiracy exists, it seems, to ignore the risks of a widening deficit.

What risks? After all, a year or two of sharply higher government spending in the early part of Mr Bush's presidency—when economic growth slowed sharply, a stockmarket bubble burst, and America faced unprecedented and confidence-sapping security threats—may well have been for the good. Yet, even as evidence grows that there is a reasonable chance of economic recovery, the long-term prospects for the budget look as bleak as ever.

A new and frank report by the Congressional Budget Office (CBO) shows that rising health-care costs and an ageing population mean that federal "entitlement" programmes—notably for Medicare, Medicaid and Social Security (pensions)—will claim a much higher share of the country's economic output over the coming decades. Currently, Social Security funds run a surplus that helps to finance other parts of government. But by 2015 surplus will swing to deficit, and by 2030, on current policy, the cost of Social Security will have risen from 4.2% of GDP to 5.9%.

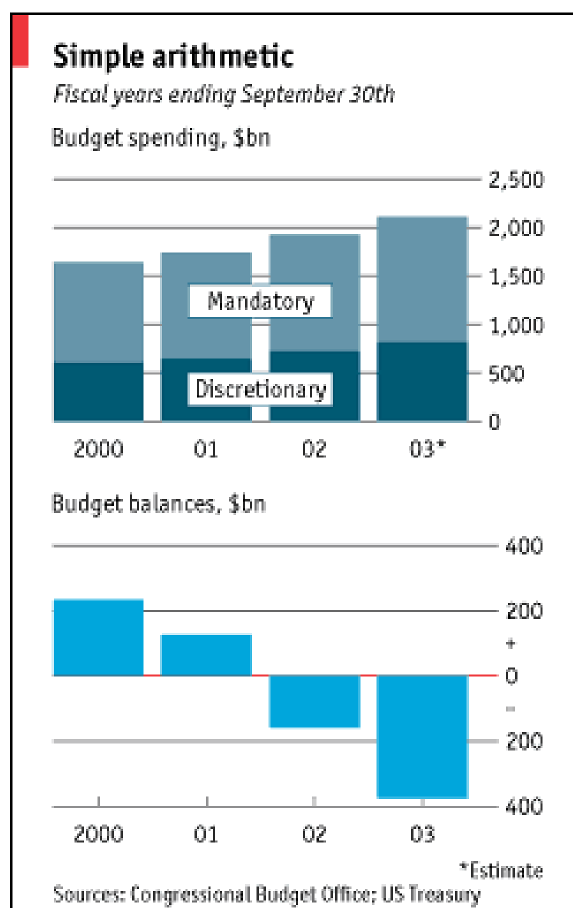
Spending on pensions pales in comparison with health care. The range of estimates is necessarily vague, since they involve assumptions about the future rate at which health-care costs will grow faster than per-head GDP each year: since 1970, the "excess-cost growth" for retired people on Medicare has been around 3%. The CBO calculates that, if future excess-cost growth of both Medicare and Medicaid was only 2.5%, then federal spending on these programmes would jump from 3.9% of GDP in 2003 to 21% in 2050.

It is clear that holding back the growth in non-entitlement (or "discretionary") programmes, such as defence and transport, will not be enough to ensure a sustainable budget in the long run. Unless entitlement programmes are cut too, or taxes raised to unprecedented levels, or both, the country is on a financially unsustainable path over the next half-century. "An ever-growing burden of federal debt held by the public", the CBO concludes, "would have a corrosive and potentially contractionary effect on the economy."

Some observers go further. In a paper presented to the American Economic Association last Monday, Peter Orszag of the Brookings Institution, Allen Sinai of Decision Economics and Robert Rubin, one of Bill Clinton's treasury secretaries, say

that "substantial deficits projected far into the future can cause a fundamental shift in market expectations and a related loss of confidence both at home and abroad"—in other words, a full-blown, third-world-style financial crisis. Impishly, they quote Greg Mankiw, now Mr Bush's chief economic adviser, in a paper he co-wrote in 1995: "We can only guess what level of debt will trigger a shift in investor confidence, and about the nature and severity of the effects. Despite the vagueness of fears about [these effects], these fears may be the most important reason for seeking to reduce the budget deficits."

The White House claims that the budget it is preparing for the 2005 fiscal year will be "committed to fiscal restraint". But this is an election year, after all. A report in the *New York Times* suggests that the administration will claim to be able to halve the deficit over five years by relying on future economic growth and on cruel cuts in such programmes as housing for the poor and job-training for the unemployed. Certainly, these vulnerable groups do not tend to vote Republican. Also certainly, such cuts will barely dent the budget deficit.



Fortunately, others are thinking more seriously about the choices that need to be made to secure long-term deficit reduction. In "Restoring Fiscal Sanity", a report to be published on January 13th by the Brookings Institution, edited by Isabel Sawhill and Alice Rivlin, once Mr Clinton's budget director, three options are offered.

The "smaller government" path emphasises cuts in "corporate welfare" (subsidised insurance, loans, etc), the devolution of responsibilities to the states, savings from that old chestnut of "waste, fraud and abuse", and deep cuts in entitlements. The "larger government" path emphasises tax increases as the main route to sustainability. The "better government" path argues, in Clintonian style, that the government can be more effective without absorbing a larger share of GDP. The problem with this path, as the authors admit, is the difficulty of measuring the effectiveness of various government programmes, and of dealing with resistance to cutting them.

Given such resistance, it is more likely that higher taxes will play the largest part in plugging the deficit. The question, then, is whether the process of plugging begins sooner or later. Either way, Americans will soon have to accept that federal spending is rising to a permanently higher level, one closer to European levels of government spending. Perhaps they can soften the shock by taking their holidays

in Paris.

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