

## The Huge Challenges That the Growing Budget Crunch Poses for Advocates of Social Program Legislation<sup>1</sup>

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A leading journalist has described debates about budget forecasts as “eye-rollingly tedious.” To make matters worse, budget prospects are relentlessly depressing. There is nothing about budget prospects that the nation faces one should want to hear. Still, budget prospects shape the political and economic environment within which expenditure priorities are set and legislative decisions are made. They are too important to neglect.

The current budget situation is bad. That situation gets steadily worse. Over the long haul, the nation faces budget challenges so great that they threaten the stability of our nation’s democratic political institutions. Legislation enacted over the past three years has seriously aggravated budget problems. But the problems were serious even before the Administration and Congress cut taxes or added to public spending. Even if *all* of the tax cuts enacted in the past three years were repealed, the country would still face extreme fiscal duress. Perforce, repealing part of those tax cuts — say those benefiting the rich, as Senator John Kerry has suggested — cannot spare us some very hard choices. What current projections mean is that the environment for progressive legislation — that is to say, legislation that spends money to help needy or dependent populations — is just plain awful. It will be necessary for advocates of such legislation to set priorities. If they do not do so, others will. A concerted effort is under way to put in place budget rules that would force major cutbacks in social spending and virtually preclude new progressive legislation.

In what follows, I am going to try to do six things.

- First, I shall lay out the simple budget numbers — how deep is our current budget hole and how much faster does it get deeper?
- Second, I shall explain why these projections are probably too optimistic.
- Third, I shall try to persuade you that deficits are a genuinely bad thing that no responsible citizen can afford to ignore.
- Fourth, I shall outline what steps could be taken to close the projected deficits.

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<sup>1</sup> These remarks were delivered on June 13, 2004 to a retreat on budget and tax issues sponsored by OMB Watch. The views expressed here are my own and do not necessarily represent those of the trustees, officers, or staff of the Brookings Institution.

- Fifth, I shall try to counter reasons why one might think prospects are not so serious as I shall suggest they are.
- Finally, I shall conclude with some comments about the implications of these projections for what I have called progressive social legislation.

I

Some of the projections I am about to present are based on analyses prepared before release of this year's budget proposals and the most recent forecasts. Since this year's projections are, for the most part, even more bearish than did last year's, consider these numbers understatements (table 1). The take-aways from this table are the following.

**Table 1**

<b>The Budget Outlook, 2003-14</b>												
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<b>Adjusted Deficit</b>	-374	-491	-435	-430	-449	-479	-499	-521	-576	-581	-626	-687
<b>Excluding Soc.Sec., Med. HI, Fed. Ret.</b>	-617	-711	-669	-665	-695	-739	-773	-806	-872	-888	-930	-1,003
<b>Total adjusted deficit, 2005-2014</b>										<b>\$5.3 trillion</b>		
<b>Total, excluding reserves for future benefits</b>										<b>\$8.0 trillion</b>		
<b>National debt in hands of public, 2004</b>										<b>\$4.4 trillion</b>		
<b>National debt, total, 2004</b>										<b>\$7.4 trillion</b>		

- First, large current deficits will grow for the remainder of this decade. These projections assume continuation of the tax cuts. They differ from OMB and CBO projections also in that these numbers assume that measures are taken to prevent tens of millions of people from being swept up in the alternative minimum tax. That provision, which in its current form dates from the Tax Reform Act of 1986, is intended to reduce the number of filers who pay little or no tax because of high deductions. The AMT applies a flat rate to income less a very narrow list of deductions and is not indexed. It denies deductions for such items as state and local taxes and personal exemptions for children. Under current law, roughly 40 million filers will pay AMT by 2014. No

one thinks that Congress will allow this to happen. And the projections shown here assume that action is taken to prevent it from occurring.

- Second, the official projections count as available to pay for current government spending all surpluses currently being accumulated in Social Security, Medicare hospital insurance, and federal employees' retirement. Revenues in all three programs now exceed outlays. These surpluses, however, will be needed to pay for future benefits. (To use those funds to pay for current consumption is about like a household that spends its retirement savings to pay for a vacation in Europe.) If one does not treat these surpluses as available to pay for current government consumption, the current deficit would be more than \$200 billion higher and the deficit in 2014 would be more than \$300 billion higher. The 2014 deficit is about 6 percent of national income.

## II

From a budget standpoint, the next ten years are rather unattractive. Then, for two reasons, things get vastly worse. The first reason is demography — the much-written-about-and-discussed retirement of the baby-boom generation. With the baby boomers' retirement, federally-financed pensions and health care spending rise. The first baby-boomers become eligible for Social Security in 2008 and for Medicare in 2011. This demographic boost to pension spending as a share of national income continues until just after 2030. Over that period, social security spending as a share of national income will grow by about 2 percentage points, rising from just over 4 percent of gross domestic product to just over 6 percent of gross domestic product. Small additional increases occur thereafter, but the pace is glacial. As far as pension costs are concerned, the big hit comes over the next three decades. Pension costs never come down under current law as a share of national income, but after about 2035 they are not projected to go up much more either.

The second reason for budget deterioration is the projected increase in per capita health care spending. Health care has been rising and will keep on going up because of a double whammy. Medicare will be subject to all of the demographic impacts that impinge on Social Security. Medicaid is hit just about as badly, as most Medicaid spending covers benefits for the elderly and disabled, the same populations served by Medicare and Social Security. But spending on health programs is projected to go up much more because per capita health costs are projected to increase faster than earnings — about 1 percentage point a year faster in official projections — while per capita pensions rise at approximately the same rate as earnings.

As a result, federal health care spending is projected to grow inexorably as a share of national income under current law (table 2).

**Table 2**

**Projected Expenditures, Revenues, and the Gap**

<i>Year</i>	<i>As Percent of GDP</i>							
	<b>Soc. Sec.</b>	<b>Medicare</b>	<b>Medicaid</b>	<b>ROG</b>	<b>Int.</b>	<b>Total</b>	<b>Rev.</b>	<b>Gap</b>
<b>2004</b>	<b>4.3</b>	<b>2.7</b>	<b>1.5</b>	<b>10.3</b>	<b>1.8</b>	<b>20.6</b>	<b>15.8</b>	<b>4.8</b>
<b>2010</b>	<b>4.3</b>	<b>3.7</b>	<b>1.5</b>	<b>9.0</b>	<b>2.5</b>	<b>21.0</b>	<b>17.2</b>	<b>3.8</b>
<b>2015</b>	<b>4.7</b>	<b>4.2</b>	<b>1.8</b>	<b>8.3</b>	<b>2.5</b>	<b>21.5</b>	<b>17.4</b>	<b>4.1</b>
<b>2020</b>	<b>5.3</b>	<b>5.1</b>	<b>2.0</b>	<b>8.0</b>	<b>2.5</b>	<b>22.9</b>	<b>18.4</b>	<b>4.5</b>
<b>2040</b>	<b>6.5</b>	<b>8.4</b>	<b>2.8</b>	<b>8.0</b>	<b>6.1</b>	<b>31.8</b>	<b>18.4</b>	<b>13.3</b>
<b>2060</b>	<b>6.5</b>	<b>10.9</b>	<b>3.5</b>	<b>8.0</b>	<b>11.0</b>	<b>39.9</b>	<b>18.4</b>	<b>21.5</b>

Source: presenter's estimates, based on CBO Long-term projections and estimates by William Gale and Peter Orszag

- Social Security costs are projected to rise by about 2 percent of GDP, but they then level off. The Congressional Budget Office has released some new estimates. They show the growth in spending to be 0.2 percent of GDP less than do the Social Security actuaries, but the general magnitudes are qualitatively similar. If this is all there was, there would be no long-term budget problem.
- The most serious problems come from Medicare and Medicaid. They are projected to more than triple as a share of GDP by 2040. They will become far larger than Social Security. The increase in spending as a share of GDP on Medicare and Medicaid is more than three times the increase in Social Security. (And wait for the really bad news, which I shall come to presently.)
- The rest of government is assumed to contract as a share of GDP. Part of the reason is that defense is projected to grow less rapidly than GDP. Part is because non-defense discretionary spending and other entitlement outlays are also assumed to shrink as a share of GDP.
- Interest payments on the debt are the potential killer. As long as total debt in the hands of the public does not grow faster than GDP, interest spending as a share of GDP will be relatively well controlled. But when the debt to GDP ratio rises, a potentially lethal interaction occurs. Higher debt breeds higher interest payments two ways. There is more debt on which interest has to be paid. And interest rates tend to increase. This combination then pushes up debt even faster. If not

stopped early, this sort of dynamic can lead to debt service costs that the nation cannot handle, to currency collapses, IMF austerity programs, and political chaos. I am not given to hyperbole and I do not use these terms loosely. We are the strongest economy in the world, but we are not immune to the consequences of fiscal mismanagement.

Lurking behind the numbers in this table are the tax cuts proposed by President Bush and enacted by Congress in 2001 and 2003. They ultimately will increase the deficit by approximately 2 ½ percent of gross domestic product, assuming that they are extended indefinitely. (To be sure, most of these provisions are set to expire, returning rates to levels prevailing in early 2001, but the administration has made clear it wants nearly all of them extended.) These cuts, together with the recession of 2001-2003, are responsible for the drop in taxes to about 16 percent of gross domestic product in 2004. By assuming that the tax share returns to 18.4 percent in the future, their historical average in recent decades, table 2 implicitly incorporates the assumption that some of the 2001 and 2003 tax cuts are repealed. If all of the 2001 and 2003 tax cuts are repealed, the revenue share would rise to the 19-20 percent of GDP range.

I referred above to more bad news. It is this. Table 2 is based upon unduly optimistic assumptions. It is constructed on the assumption that health care spending grows 1 percent a year faster than wages do. Historically, health care spending has risen about 2.5 percent a year faster than wages have. I want to stress that no one knows exactly how fast health care spending will rise in the future, especially ten or twenty or thirty years hence. What the nation spends on health depends on the rate and nature of scientific progress as well as on public policy. We cannot predict either. But it would be foolish to assume that in the wake of the sequencing of the human genome and the application of modern data processing to the development of new pharmaceutical products, the pace of scientific advance will slow or that the products of that advance will be inexpensive.

Table 3 shows you what will happen if health care spending continues, in the future as in the past to grow 2.5 percentage points a year faster than wages do. Things go absolutely haywire. The deficit goes completely out of control. And note that table 3 does not incorporate any effect of mushrooming debt on interest payments.

In fact, this is the scenario of total economic breakdown. It can't happen and won't happen. The only question is how. I shall return to that question after a side trip on why deficits are bad news, even if they do not get so large and intractable as these charts portend.

III

Large persistent deficits are lethal to progressive legislation for at least three reasons.

**Table 3**

<i>Year</i>	<i>As Percent of GDP</i>							
	Soc. Sec.	Medicare	Medicaid	ROG	Int.	Total	Rev.	Gap
<b>2004</b>	<b>4.3</b>	<b>2.7</b>	<b>1.5</b>	<b>10.3</b>	<b>1.8</b>	<b>20.6</b>	<b>15.8</b>	<b>4.8</b>
2010	4.3	3.7	1.5	9.0	2.5	21.0	17.2	3.8
2015	4.7	5.0	2.1	8.3	2.5	22.6	17.4	5.2
2020	5.3	6.4	2.5	8.0	2.5	24.7	18.4	6.3
<b>2040</b>	<b>6.5</b>	<b>13.9</b>	<b>4.6</b>	<b>8.0</b>	<b>6.1</b>	<b>39.1</b>	<b>18.4</b>	<b>20.7</b>
2060	6.5	19.0	6.1	8.0	11.0	50.6	18.4	32.2

Source: presenter's estimates, based on CBO Long-term projections and estimates by William Gale and Peter Orszag

First, deficits slow overall economic growth. Rising incomes are the lubricant for the income redistribution that most progressive legislation entails. When incomes are rising, taxpayers can afford to support increased aid to needy groups out of growing incomes. If incomes are stagnant, increased tax burdens force actual reductions in standards of living, to which no one takes kindly. Deficits hamper growth because they lower national saving, which is simply private saving less government deficits. When the budget is in deficit, the federal government has to use private saving to pay for the excess of current government spending over revenues. The private saving thereby diverted cannot be used to underwrite productive investments at home or abroad. This diversion slows income growth and increases taxpayer resistance to anything that costs money.

Second, opponents of activist government policies use deficits to marshal popular support for their position. They do so by citing the alleged ineptitude of Congress and government bureaucrats. Persistent deficits are *prima facie* proof of the incapacity of Congress to manage government frugally and efficiently.

Whether one accepts or rejects the validity of these first two points, deficits change the objective environment within which Congress acts. Everyone understands that while a government can carry considerable debt, there are limits. Unlimited borrowing threatens explosive increases in interest spending that can lead to economic and political collapse and must be avoided at all costs. When deficits prevail Congress must — and *should* — scrutinize any proposal to boost spending with increased skepticism. This scrutiny may be applied unevenly or unfairly, but on the average deficits do *and should* make it harder to boost spending. In the current environment, the prospect of deficits, emanating disproportionately from the prospective growth of spending on health and pension benefits is fostering proposals to implement budget rules that will put progressive social spending in an impossible situation. These budget rules may not have the votes to be enacted this year, but their advocates have made clear that they will keep trying to find the votes and will pursue this goal patiently. They have to win only once.

#### IV

What steps can be taken to deal with these budget deficits? Clearly, the first step is to stop making matters worse.

That means that *all* tax cuts should be resisted. One may be tempted to amend this principle to read: all tax cuts *for the rich* should be resisted. I believe that making this amendment would be a profound error. I say this despite the legitimate desire to relieve lower-income families of current tax burdens or to extend benefits through refundability to those who now have no positive income tax liability. On occasion, Congress has been willing to extend tax breaks to such households by making tax credits refundable. The dramatic extensions of the earned income tax credit and the introduction of the refundable component of the child credit in 2001 are the principal examples. Given the current configuration of

political forces, however — or any configuration of forces likely to emerge in the foreseeable future — tax cuts that benefit only the lower tail of the income distribution cannot pass.

To do so is virtually impossible for two reasons. First, blocking coalitions oppose making deductions and credits refundable, other than the earned income tax credit and the child tax credit. Without refundability, no tax provision can help the poor because they pay no personal income taxes. Second, quite apart from this problem, cutting taxes for those with small tax bills without providing even larger cuts for those with high incomes and large tax bills is technically cumbersome and difficult to enact. Simple tax cuts inevitably lavish their largest benefits on the well-to-do because the well-to-do pay most taxes. The price of such tax cuts, which is to further deepen the nation's fiscal mess, is simply too great.

Avoiding tax cuts is not enough. Even to preserve a functioning social insurance system, very large tax increases will be necessary. And further increases will be required to create fiscal elbow-room for any significant new initiatives. If progressive groups continue to run for cover every time the issue of raising taxes — or even of not cutting taxes — is raised, there will be no chance for a progressive agenda. This battle must be waged.

To understand why, I list in tables 4 and 5 menus of spending cuts and tax increases that would have to be enacted to hold the projected deficit in the federal budget to about 2 percent of GDP. A deficit that large would prevent the ratio of debt to GDP from rising and eventually getting out of control in periods of full employment and relative price stability. To achieve that goal it would be necessary to enact a series of measures over the next few decades that would cut spending or raise taxes to the tune of about 10 percent of gross domestic product.

By way of comparison, table 2 shows that total federal spending under current policy — that is, with no changes in social insurance legislation, slower-than-historical growth in health care spending, and a reduced share of national income going for the rest of government — will be a bit over 30 percent of GDP by 2040. Revenues are assumed to have risen somewhat from current levels to their historical average of a bit over 18 percent of GDP. That means that if all of the budget balancing occurred on the expenditure side, it would be necessary to cut spending by about one-third. And, if all the budget balancing were done on the tax side, it would be necessary to boost taxes by more than half.

Let's start with the menu of spending cuts. The largest domestic spending item currently is Social Security. Compared to pension systems in other nations, Social Security benefits are quite parsimonious. Social Security replaces a smaller fraction of earnings than do the pension systems of most other developed countries, and workers in the United States have to be older than do workers in other developed nations to claim full benefits. Furthermore, legislation enacted twenty years ago is gradually reducing replacement rates. In addition, premiums for Supplemental Medical Insurance (Part B of Medicare), which are rising faster

than benefits and are deducted automatically from monthly Social Security benefits checks, will continually lower cash payments as a percent of prior earnings.

Privatizing Social Security is no help, as long as benefits for the currently retired and those near retirement are sustained, as all agree is essential. With that constraint, all of the major proposals to partly privatize Social Security would increase the deficit for many years. The three plans developed by President Bush's commission on Social Security would increase the deficit between now and 2040 and add about \$4 trillion to national debt.

They do so because they immediately divert revenues from federal coffers into individual accounts. They also cut traditional Social Security benefits, but the initial savings are small and grow with time. By 2040, in the Bush Commission's three plans, the diversion of taxes and the cuts in benefits are roughly equal. So the net savings are zero. And keep in mind that the president's commission's proposals would aggravate the deficit in every year between now and 2040. Other privatization proposals increase the deficit even more and longer. Privatization of Social Security is most definitely *not* part of the solution to the budget mess.

But that does not mean that savings from cuts in Social Security will be or should be off the table entirely. On the contrary, I believe some cuts are inevitable and can be fashioned so as to protect the fundamental function of Social Security to assure basic income to retirees, the disabled and survivors. Without going into detail on those changes, I have simply inserted a plug number in table 4 that would correspond to a cut in total benefits, relative to those promised under current law, of about 17 percent. That would deal with about one-ninth of the prospective budget gap.

Table 4

<b>How to close a 10-percent-of-GDP Budget Gap by 2040</b>			
Item	Projected Share <i>percent of GDP</i>	Action	Percent of Gap Closed
Social Security	6.5	President's commission	0
		Cut cost growth by half	11
Medicare	8.4	Cut by one-fourth	21
Medicaid	2.8	Cut by one-fourth	7
ROG	8.0	Cut by one-fourth	20
<u><b>Percent of gap closed if all are done</b></u>			<u><b>59</b></u>

While Social Security is the largest single domestic outlay today, the big cost increases come from Medicare and Medicaid. To be quite honest, I doubt whether large net savings in either program will be possible. Medicare is parsimonious insurance, even with the recently enacted prescription drug benefit. It has very high deductibles and unlimited cost sharing for those who are not so poor that they qualify for Medicaid. It has no limit on patient liability. And its coverage of long-term care is very spotty. Something is going to have to be done about each of these problems. Whatever is done will cost money. To offset part or all of the cost of these added services, some increase in premiums and cost sharing on upper income beneficiaries is necessary and desirable. But it is hard to see where significant *net* savings will come from — unless coverage is seriously restricted, services are ferociously rationed, or cost sharing is increased on the mass of elderly and disabled beneficiaries with modest incomes. Each of these steps would undermine achievement of the purposes of social insurance. So, the savings in Medicare in table 4 carry distressing implications.

Medicaid coverage remains spotty — quite generous in some states, quite meager in others. Coverage has been cut back over the past few years, after a long period during which coverage was extended. Once again, significant net savings are hard to imagine without undermining access to acute care by the poor of all ages and to long-term care by the elderly and disabled. Nonetheless, I have put in a plug number on the assumption that outlays are reduced by one-fourth below what is projected under current law.

That leaves everything else that government does — national defense, other entitlements, and all nondefense discretionary spending, currently about 10 percent

of GDP. Defense as a share of national income can be expected to decline in the future as it has in the past. It does not cost proportionately more to defend a more productive nation, and the United States economy of 2040 will be about twice as large as the U.S. economy of 2004. So the defense share *should* trend down.

There is no obvious reason why other functions of government should claim a smaller share of national income than they do today. But the Congressional Budget Office assumes, in its long-term budget projections, that the share will drop by one-fifth. I have plugged in an assumption of additional reductions because of fiscal duress. Once again, you should keep in mind that behind the bland abstraction in my table is a huge curtailment of government services in the areas that you care about.

This is a pretty draconian menu of spending reductions. It hits Social Security, which is already slated for cuts under current law. It assumes cuts in Medicare and Medicaid, although it is unclear how significant savings can be achieved without undermining these programs. It assumes that the rest of government will contract without any indication of how that might be done. It leaves no room for any significant new initiatives, such as long-term care coverage, universal day care, national health insurance, or other genuinely good ideas. I present this list not because I endorse it, but because *even if you do all of these things, you will still have left more than two-fifths of the gap unclosed.*

So, we have to turn to tax increases. Big tax increases. A 6 percent value-added tax, combined with all of the spending cuts listed previously would fill in the rest of the gap. A 15 percent VAT would be sufficient to close the gap with no spending cuts. Yes, a VAT is regressive. It hits the poor, as the personal income tax does not.

So, let's suppose we relied on income and payroll tax increases. Remember, my baseline projections start with the assumption that revenues are higher than they are this year. Repealing all of the cuts would leave the revenue share below 20 percent of GDP and far below projected spending.

Table 5

<b>How to close a 10-percent-of-GDP Budget Gap by 2040</b>			
<b>Item</b>	<b>Projected Share percent of GDP</b>	<b>Action</b>	<b>Percent of Gap Closed</b>
<b>VAT</b>	<b>0</b>	<b>Levy at 6 percent</b>	<b>42</b>
		<i>or</i>	
<b>Income tax</b>	<b>8.5</b>	<b>Raise by one-third</b>	<b>28</b>
<b>Payroll tax</b>	<b>4.5</b>	<b>Raise by one-third</b>	<b>15</b>

The income and payroll tax increases that I am now talking about would be on top of repealing all of those tax cuts. Trying to close the entire future fiscal gap through income tax increases is impossible, in my view. Doubling rates on the current tax base would be insufficient. Base-broadening would have to take on sacred provisions such as the home-mortgage deduction. Even the tax increase of one-third shown in table 5 would mean that top income tax rates would have to go well over 50 percent. The 15 percent rate would go well over 20 percent. Payroll tax rates would exceed 20 percent. Everyone would have to pay, the rich and the middle class.

V

The scenario I have sketched is simple and frightening. In fact, it is so simple and so frightening that I am willing to bet that most readers — consciously or unconsciously — are now trying to think of reasons why things are not really as dire as all that.

For example, here are a few candidates.

- Reason number 1: Even near-term forecasts are unreliable. People forecast endless deficits in the early 90s, endless surpluses in the late 90s. Both were wrong. Why should anyone believe your crystal ball?
- Reason number 2: We might grow our way out of these problems. A successful pro-growth strategy could avoid these nasty choices.

- Reason number 3. Just repeal the tax cuts on the rich and that will solve the fiscal problem.

Unfortunately, none of these reasons holds water.

Let's start with the first — unreliability of all forecasts and especially long-term ones. The charge is correct, but misplaced. First, the major uncertainty concerns how fast per capita health care costs will rise. My menu of spending cuts and tax increases was assembled to close a deficit based on the assumption that health care costs would grow 1 percent a year faster than earnings. But that rate of health care spending growth is quite likely too low. Most of the possible uncertainty goes in the "its-even-worse-than-you-say" direction.

Yes, medical scientists might start to find new technologies that lower spending. But extremely rapid technological advance of the sort that medicine is now experiencing always raises total spending. The automobile and the airplane raised transportation spending. Movies, television, and advanced sound reproduction raised spending on entertainment. The telecommunications and computer revolutions have raised spending on computation and communication.

Second, much of the spending increase is based on the simple fact that the baby-boomers will get old. Unless there is nuclear war, that is *not* uncertain.

Third, because the cost of fulfilling the promises of current government programs will surely rise, those who never accepted the legitimacy of those commitments will lose no opportunity to remind voters of the fiscal train wreck awaiting them. If those who support progressive legislation do not come to terms with these budget realities and factor them into their program planning and political strategy, they will lose the electorate. They will lose the electorate because opponents of those initiatives will have budgetary facts on their side.

Reason number 2 for ignoring the budget projections is that we can grow our way out of this problem. Good point if true, but it isn't. To begin with, no one knows how reliably to boost economic growth over the long run. Improving education and training, especially for those who now don't advance very far, could raise the *level* of output. Not incidentally, it could also improve the distribution of income. But the impact on long-term growth would be trivial because bringing the disadvantaged up to the standards of the majority would bring a one-time increase in the level of output. Though important, it would not add to the long-term rate of growth.

Boosting saving, as I have noted, could raise output as well. Some economists argue that scientific and managerial advances will accelerate if investment (which is financed out of saving) is increased, but unless that happens, more saving increases the level, but not the long-term growth, of national income. The reason is that additional investment adds progressively smaller amounts to output, because of the law of diminishing returns. Furthermore, a larger capital

stock means that depreciation increases and an increasing share of new investment goes simply to offset this higher rate of depreciation.

Long-term growth depends on advances in knowledge, which means science, technology, and management. The projections underlying tables 2 and 3 already assume that these continue at a high level. So, until someone comes along with a method of proven effectiveness to boost economic growth further on a sustained basis, saying “we can grow our way out of the problem” is just an erudite way of summoning spirits from the vast deep. As Shakespeare wrote, we can summon them, but will they come?

I have already commented on reason number 3 — the misplaced belief that we can solve much of the problem by repealing part or all of the Bush tax cuts. The entire collection of tax cuts enacted over the past three years reduces long-term revenues by a bit over 2 percent of gross domestic product. The tax cuts for the rich amount to just over 1 percent of GDP. Repealing them would be an important beginning. But it would be only a modest step toward solving the problems I have described. Before we are done, it will be necessary to boost taxes not just on the rich, but also on the middle class if we hope to preserve essential government services.

## VI

Our bad budget future casts a long back shadow on the present. Some members of Congress have introduced proposals to institute a cap on growth of entitlement spending, linked to prices or some other index that grows more slowly than would spending under current law. These caps will not pass Congress this year.

But supporters of these limits will not give up. Given their objectives, they would be foolish to do so. After all, so-called “pay-as-you-go” rules governing new legislation have gotten a pretty good name. They are generally credited with having restrained spending growth during the 1990s and contributed to budget balance. Those rules applied only to new legislation, not to current laws. They required that new entitlement spending be matched by tax increases or cuts on existing entitlements. Growth of discretionary spending was also subject to growth caps. They also worked. Given current deficits, they should probably be renewed.

So, the argument goes, why not apply these caps to existing entitlement programs? The answer, of course, is that these caps effectively repeal every entitlement to which they apply. The essence of an entitlement is that spending grows as need increases. Caps repeal that covenant. Nonetheless, the appeal of caps should not be underestimated. They offer an antiseptic way for members to solve their budget problems without ever voting explicitly to cut anything. If there is to be any hope for a progressive agenda, caps on current-law entitlement spending must be defeated.

I want to close on what I think is an upbeat note by saying that I believe that even in this terrible budget situation, there is hope for a progressive legislative agenda. To make progress, I think three elements are essential.

- First, supporters of this agenda must resist all tax cuts, even those that would provide some benefits for their constituents. And they must begin to consider how best to raise taxes from current levels. In practice, I believe that will require linking tax increases to popular public services, possibly even through that anathema of good public administration — ear-marking.
- Second, progressives must face up to the fact that some cuts in some entitlements are inescapable. If they don't design those changes, those who never liked the programs anyway will be more than willing to do so.
- Third, progressives must be willing to set priorities among the many good things that participants in liberal coalitions would like to do. Supporters of progressive legislation have long recognized that they need to work together to prevail. They have to form coalitions in which representatives of the aged and of children, of people with disabilities and the blind, of labor, of African Americans and of Hispanics, of faith-based and of secular groups, and of other organizations work together. To cement such coalitions, it frequently seems necessary to include in the coalition's agenda something for everyone in the coalition. To put the point more bluntly, setting priorities has not been a strong suit of liberal coalitions. In the current budget climate, this approach is no longer adequate. Resources will be so tightly constrained that not everything can pass. If progressives do not set priorities, others will.

In summary, liberals and progressives will have to take on a long-term political campaign to augment government resources, to scale back some of their pet programs, and to engage in and accept some hard-headed tradeoffs regarding new initiatives. This is a campaign not for the next year or the next five years, but for a generation.