

Wile E. Coyote Explains Bush Administration Fiscal Policy

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One of the weirder things one hears from Republicans these days is that our current medium-sized (and our larger prospective future) federal deficits are not the accidental results of lack of policy-making competence on the part of the Bush team but part of a clever strategy to advance the long-run Republican goal of shrinking federal spending as a share of the whole economy. How is this strategy supposed to work?

1. Republicans cut taxes to create a large and unsustainable deficit.
2. The deficit comes to be perceived as a serious problem.
3. Democrats who believe that sound finance leads to faster economic growth clean up the deficit.
4. In the course of cleaning up the deficit, spending falls as a share of GDP--and so Republican aims are achieved.

It is weird to hear this argument because of four things:

- It requires that Republicans accuse their own standard bearers of a considerable degree of public mendacity.
- It is unpatriotic.
- It is self-denying.
- It appears to be false.

Mendacity. To say that our current and future deficits are part of a clever plan to shrink the government spending share of GDP in the long run is to say that all those Republicans lied when they assured Americans throughout the 2000 campaign and the 2001 legislative push for the tax cut that their fiscal policy was a fiscal policy of surpluses, and that federal government finances were in such good shape that we could afford a large rich-weighted tax cut without running a serious risk of erasing the government surplus. It is conventional in politics to claim that the other party's standard bearers are liars. It is most unconventional to boast that one's own standard bearers are liars.

Unpatriotic. The whole point of the strategy is to do something that makes the country worse off--create a large deficit that slows economic growth, raises the chances of higher inflation in the future, and diminishes the government's capacity to undertake any expensive new initiatives in the future that national security might require--and then to count on the fact that one's political opponents care more about the well-being of the country than you do to fix the situation.

Self-Denying. The whole point of saying "don't worry: it's all part of our clever plan" is to keep people from being upset at the Bush administration and to calm them down. But the whole strategy can only work if point (2) above comes to pass: if people perceive the deficit as a serious problem caused by a serious misstep by the Bush administration. But if the deficit isn't the result of a serious misstep, why should anyone worry about it? Thus to the extent that the claim that the deficit is part of a clever plan is believed, the plan is not so clever at all.

False. Fourth and last, what reason is there to believe that a deficit puts downward pressure on federal spending measured as a share of GDP? A one percentage point of GDP increase in the federal deficit directly and immediately boosts federal interest spending the following year by roughly 0.06 percentage points of GDP (at the average interest rates of the past two decades). A one percentage point of GDP increase in the federal deficit reduces investment in America and economic growth

next year by a more uncertain amount--0.1% of GDP is my usual rule-of-thumb guess. Such a reduction in real GDP means that, with federal spending at roughly 20% of real GDP, the federal spending share grows by roughly 0.02 percentage points of GDP.

Thus one dollar of extra deficit would have to induce at least eight cents of cuts in federal program spending the following year in order for the spending share to stay even. If the pressure for spending cuts is less than eight cents on the dollar of deficit--either because constituency groups that approve of the spending program are well-organized, or because Democrats turn out to care no more for the well-being of the country than Republicans, or because people hear that the deficit is not the result of a serious misstep and hence doesn't need to be dealt with quickly--then the "clever plan" is really clever only in the sense that Wile E. Coyote's plans are clever.

What are the facts? Below is a chart covering the period 1980-2000 and showing the deficit on the horizontal axis and the following year's change in the federal spending share on the vertical axis. There is no visible relationship between the deficit and the change in the federal spending share. There is no statistically significant relationship at all. It is true that the high deficits of the early 1990s prompted Bill Clinton to make spending restraint a priority: but spending restraint remained a priority as the Reagan-Bush deficits were erased. And certainly during the 1980s there are no signs that the higher the deficit, the greater the restraint on spending growth.