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Who's Afraid of the Deficit? Cassandras Are Out of Style

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WASHINGTON, Nov. 18 — These are gloomy times for those who plead for fiscal discipline in the federal government, and not simply because the budget has swung from surplus to deficit in the last year.

Even the most passionate champions of a balanced budget see little danger in this year's deficit of $159 billion and similar shortfalls for the next two or three years.

The real problems, they say, are just over the horizon: soaring costs for Social Security, Medicare and other benefit programs as the oldest baby boomers start reaching retirement age around 2010.

"It is a slowly growing cancer that is eating away at us," said Lawrence J. Kotlikoff, a professor of economics at Boston University who has analyzed the issue intensively. "We are not detecting it because it is small right now. But it is entering the bloodstream and it will kill us."

Alan Greenspan, chairman of the Federal Reserve, asserts that the sum of commitments made to Americans today, from Social Security and Medicare to farm subsidies, amounts to more than $10 trillion in "contingent liabilities" for the government.

The Congressional Budget Office has repeatedly warned that if nothing is changed, the government will spend as much on Social Security, Medicaid and Medicare by 2030 as it does for its entire budget today.

But the problems begin much sooner. The oldest baby boomers will begin retiring eight years from now, and the number of retirees is expected to swell rapidly after that.

Though leaders in both parties acknowledge the looming demands, neither Democrats nor Republicans have much appetite for reducing deficits anytime soon.

President Bush, fortified by Republican majorities in both the House and Senate, is pushing for a Reagan-like mixture of more tax cuts to stimulate the economy and more spending on the military and selected domestic programs, like prescription drugs for the elderly.

Congressional Democrats, though quick to denounce Republicans as irresponsible tax cutters and spendthrifts, are themselves deeply divided about taxes and pushing for their own list of spending increases.

"The consensus that had developed in support of fiscal discipline has broken down," said Robert L. Bixby, executive director of the Concord Coalition, a bipartisan research group in Arlington, Va. "Once you break that discipline, it is hard to get back again."

It is hard to imagine a less fashionable issue in Washington these days than balancing the budget.

President Bush, harking back to the supply-side economic theories that his father once denounced as "voodoo economics," said last week that last year's $1.35 trillion tax-cut package had made the deficit smaller rather than larger. "Make no mistake about it, the tax relief package that we passed — that should be permanent, by the way — has helped the economy, and that the deficit would have been bigger without the tax-relief package," Mr. Bush said.

Many Congressional Democrats have denounced the tax cuts as fiscally irresponsible, but few have actually called for repealing them.

A few Democrats even argue that fiscal discipline is a false goal.

Robert B. Reich, secretary of labor under President Bill Clinton, ridicules the "neo-Hooverian orthodoxy" that prevailed under his former boss and proposes stimulating the economy by allowing every person to pay no taxes on the first $15,000 in income.

Given the continued weakness of the economy, even usually hawkish budget analysts say it would be a mistake to clamp down on spending or raise taxes right now.

For one thing, even this year's deficit of $159 billion is small in relation to the overall economy. At about 1.5 percent of total economic output, that figure is proportionately a much narrower deficit than those run up under President Ronald Reagan in the early 1980's. Those deficits peaked at more than 6 percent in 1983. European countries are striving to keep deficits below 3 percent of gross domestic product, and Germany missed even that target.

"In the short term, there is very little risk at all," said Carol Cox Wait, president of the Committee for a Responsible Budget, who has battled for fiscal toughness for more than 20 years. "To ignore those facts is to make a fool out of yourself."

But budget analysts from across the political spectrum say the longer-term risks are substantial.

President Bush is currently campaigning to make permanent last year's $1.35 trillion in tax cuts, most of which are scheduled to expire around 2010. If they continue after that date, the Treasury will lose more than $200 billion in annual tax receipts, according to Congressional analysts, precisely at the time when Social Security and Medicare costs are expected to surge.

Meanwhile, both Republicans and Democrats want to enact a major new program to pay for prescription drugs for the elderly. The Republican plan advocated last summer would cost about $380 billion over 10 years, while the Democratic alternative would cost nearly $800 billion.

Current forecasts by both the Congressional Budget Office and the Bush administration assume that discretionary spending — outlays separate from mandated entitlement programs and interest payments — will increase at the expected rate of inflation, 2 percent a year.

But in the last four years, discretionary spending has grown about 8 percent a year. The Concord Coalition calculates that if that continues, and if the government extends all the tax cuts now scheduled to expire, the government will accumulate a 10-year deficit of $1.8 trillion by 2012.

All those costs would kick in before the anticipated rise in retirement and health care costs associated with the aging of the population.

"We are committing ourselves to a much more expensive government than what we are willing to pay for," Ms. Wait said. "We need a serious conversation with ourselves about what we are ready to pay for."

But that view is hardly shared by all. A fierce debate is under way about the effects of deficits.

Disciples of Robert E. Rubin, President Clinton's Treasury secretary, argue that lower government borrowing leads to lower interest rates because the government no longer crowds out private borrowers.

By that analysis, budget-tightening tax increases under President George Bush in 1990 and under President Clinton in 1993 helped set the stage for the extraordinary economic boom of the late 1990's.

President Bush and other Republicans adamantly disagree. "That's Rubinomics, and we think it's completely wrong," said R. Glenn Hubbard, chairman of the White House Council of Economic Advisers.

Under that view, economic growth is the prerequisite for a balanced budget, not the other way around.

Senator Don Nickles, the Oklahoma Republican who is the incoming chairman of the Senate Budget Committee, says leaders need to stimulate the economy. He has suggested moves like accelerating last year's tax cuts.

"We had a 7 percent drop in revenues, and outlays grew by 11 percent," he said in an interview on Friday. "There are reasons why that happened — the recession, 9/11 and the war against terrorism. But to turn it around, you have to get the economy growing again."

Economists who support the administration argue that there is no evidence that higher government deficits lead to higher interest rates.

"Fear of deficits of the magnitude being projected for the United States is largely overblown," said Stephen J. Entin, president of the Institute for Research on the Economics of Taxation, a conservative economic research group in Washington.

Many conservative economists also argue that the only way to reduce government spending is to cut taxes and thereby starve the government of revenue.

"If we don't cut taxes, we will most assuredly increase spending," said John Cogan, a senior fellow at the Hoover Institute at Stanford University. "That is not a partisan statement. That is just a statement of the way things are."

Mr. Cogan noted that the government's discretionary spending had soared when the government had found itself awash in unexpected revenue from the economic boom.

Even though Congress adopted seemingly tough restrictions to freeze spending on discretionary programs, Mr. Cogan said, spending grew by $190 billion from 1998 through 2001.

If spending continues to grow at the pace of the last four years, about 8 percent annually, budget analysts warn, deficits will persist through the end of the decade.

Mr. Greenspan urged lawmakers last week to establish a long-term fiscal structure that would include limits and automatic "sunset" provisions, to end programs after a set number of years, for many kinds of spending programs.

"It is essential to restore some of the positions we had previously," Mr. Greenspan told the Joint Economic Committee last Wednesday. "Unless we know where we are going, we will have no sense of the implications of those actions over the long term."

When asked by lawmakers what investors believed the government's long-term fiscal framework might be, Mr. Greenspan responded, "That there isn't one."