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Pelosi's false tax choice

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Stop the presses: House Speaker Nancy Pelosi has discovered fiscal discipline. On Thursday, she said she opposed the extension of the Bush tax cuts for higher income brackets, because she "can see no justification for going into debt to a foreign country to underwrite and subsidize tax cuts for the wealthiest people in America."

Pelosi is right in at least this much: Our expected $1.3 trillion budget deficit and $13.4 trillion national debt pose a fundamental threat to the US economy and our way of life. But she is wrong in her belief that the deficit is due to low taxes rather than profligate spending.

For the last 40 years, federal spending has averaged approximately 21% of GDP, while revenues have averaged roughly 18%, resulting in a structural shortfall of about 3% of GDP. Following the enactment of the Bush tax cuts, revenues did decline steadily as a percentage of GDP (although measured in dollars, revenues actually increased by roughly $700 billion between 2003 and the start of the recession in 2008). This year, tax revenues will be only about 14.6% of GDP.

Some of this decline, however, is due not to the tax cuts, but to the recession and its attendant high unemployment. For example, Social Security and Medicare payroll tax revenues have declined significantly even though they were unaffected by the Bush tax cuts.

In predicting a four percentage point increase in revenues by 2012, the Congressional Budget Office estimates that roughly half of that increase would come from post-recession economic growth and half from the expiration of the Bush tax cuts. Projecting that back on this year's deficit would mean that, without the tax cuts, revenues would have been roughly 16.6% of GDP.

But all this ignores the other side of the equation. During the final years of the Bush Administration and the first years of the Obama administration, spending has skyrocketed. Spending this year will be roughly 24% of GDP, a slight decline from 25% in 2009, but still the second highest percentage since World War II.

Even if revenues returned to the traditional 18% level, we would still face an enormous budget deficit equal to 6% of GDP, the largest since Jimmy Carter was president. With spending set to rise to more than 40% of GDP by 2050, it is quite simply impossible to tax our way out of this deficit.

Speaker Pelosi is presenting us with a false choice: higher taxes or more debt. Spending cuts just aren't part of her lexicon.

Maybe we shouldn't stop the presses after all.

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