

The Sweet Spot

By Paul Krugman

“What we have here is a form of looting.” So says George Akerlof, a Nobel laureate in economics, of the Bush administration’s budget policies—and he’s right. With startling speed, we’ve blown right through the usual concerns about budget deficits—about their effects on interest rates and economic growth—and into a range where the very solvency of the federal government is at stake. Almost every expert not on the administration’s payroll now sees budget deficits equal to about a quarter of government spending for the next decade, and getting worse after that.

Yet the administration insists that there’s no problem, that economic growth will solve everything painlessly. And that puts those who want to stop the looting—which should include anyone who wants this country to avoid a Latin-American-style fiscal crisis, somewhere down the road—in a difficult position. Faced with a what-me-worry president, how do you avoid sounding like a dour party pooper?

One answer is to explain that the administration’s tax cuts are, in a fundamental sense, phony, because the government is simply borrowing to make up for the loss of revenue. In 2004, the typical family will pay about \$700 less in taxes than it would have without the Bush tax cuts—but meanwhile, the government will run up about \$1,500 in debt on that family’s behalf.

George W. Bush is like a man who tells you that he’s bought you a fancy new TV set for Christmas, but neglects to tell you that he charged it to your credit card, and that while he was at it he also used the card to buy some stuff for himself. Eventually, the bill will come due—and it will be your problem, not his.

Still, those who want to restore fiscal sanity probably need to frame their proposals in a way that neutralizes some of the administration’s demagoguery. In particular, they probably shouldn’t propose a rollback of all of the Bush tax cuts.

Here’s why: while the central thrust of both the 2001 and the 2003 tax cuts was to cut taxes on the wealthy, the bills also included provisions that provided fairly large tax cuts to some—but only some—middle-income families. Chief among these were child tax credits and a “cutout” that reduced the tax rate on some income to 10 percent from 15 percent.

These middle-class tax cuts were designed to create a “sweet spot” that would allow the administration to point to “typical” families that received big tax cuts. If a middle-income family had two or more children 17 or younger, and an income just high enough to take full advantage of the provisions, it did get a significant tax cut. And such families played a big role in selling the overall package.

So if a Democratic candidate proposes a total rollback of the Bush tax cuts, he’ll be offering an easy target: administration spokespeople will be able to provide reporters with carefully chosen examples of middle-income families who would lose \$1,500 or \$2,000 a year from tax-cut repeal. By leaving the child tax credits and the cutout in place while proposing to repeal the rest, contenders will recapture most of the revenue lost because of the tax cuts, while making the job of the administration propagandists that much harder.

Purists will raise two objections. The first is that an incomplete rollback of the Bush tax cuts won’t be enough to restore long-run solvency. In fact, even a full rollback wouldn’t be enough. According to my rough calculations, keeping the child credits and the cutout while rolling back the rest would close only about half the fiscal gap. But it would be a lot better than current policy.

The other objection is that the tricks used to sell the Bush tax cuts have made an already messy tax system, full of special breaks for particular classes of taxpayers, even

messier. Shouldn't we favor a reform that cleans it up?

In principle, the answer is yes. But an ambitious reform plan would be demagogued and portrayed as a tax increase for the middle class. My guess is that we should propose a selective rollback as the first step, with broader reform to follow.

Will someone be able to find the political sweet spot, the combination of fiscal responsibility and electoral smarts that brings the looting to an end? The future of the nation depends on the answer.