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ECONOMIC VIEW

What’s Sustainable About This Budget?

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PRESIDENT OBAMA’S 2011 budget, released this month, bears the title “A New Era of Responsibility.”

“Let’s invest in our people without leaving them a mountain of debt,” the president said in his State of the Union address. “Let’s meet our responsibility to the citizens who sent us here.”

Noble aspirations, indeed. But do the numbers inside the document support the rhetoric surrounding it?

To answer that question, let’s start with the definition of fiscal responsibility. What should the budget numbers look like before one gives them the Good Economist’s Seal of Approval?

It may be tempting to assume that a balanced budget is the natural benchmark. Certainly, the Obama budget comes nowhere close to achieving that goal. But there are reasons to think that this standard is far too strict.

Sometimes, a budget deficit, even a large one, is called for. War and recession are the two classic cases. Wars lead to temporary surges in government spending, and recessions lead to temporary declines in government revenue. It makes sense for the government to borrow to make it through these tough times.

President Obama, like his immediate predecessor, is dealing with both war and recession. A transitory surge in the government’s budget deficit is natural under these circumstances and need not be a cause for alarm.

Moreover, even in the long run, a balanced budget is too strict a standard. Because of technological progress, population growth and inflation, the nation’s income and tax base grows over time. If the government’s debts grow at or below that pace, servicing the debt will not become a major problem. That means the government can run budget deficits in perpetuity, as long as they are not too large.

Recent history illustrates this principle. From 2005 to 2007, before the recession and financial crisis, the federal government ran budget deficits, but they averaged less than 2 percent of gross domestic product. Because this borrowing was moderate in magnitude and the economy was growing at about its normal rate, the federal debt held by the public fell from 36.8 percent of gross domestic product at the end of the 2004 fiscal year to 36.2 percent three years later.

That is, despite substantial wartime spending during this period, budget deficits were small enough to keep the debt-to-G.D.P. ratio under control.

The troubling feature of Mr. Obama's budget is that it fails to return the federal government to manageable budget deficits, even as the wars wind down and the economy recovers from the recession. According to the administration's own numbers, the budget deficit under the president's proposed policies will never fall below 3.6 percent of G.D.P. By 2020, the end of the planning horizon, it will be 4.2 percent and rising.

As a result, the government's debts will grow faster than the economy. The administration projects that the debt-to-G.D.P. ratio will rise in each of the next 10 years. By 2020, the government's debts will equal 77.2 percent of G.D.P. This level of indebtedness has not been seen since 1950, in the aftermath of the borrowing to finance World War II.

Making matters worse, these bleak budget projections are based on relatively optimistic economic assumptions. The administration forecasts economic growth of 3.0 percent from the fourth quarter of 2009 to the fourth quarter of 2010, followed by 4.3 percent the next year. By contrast, the Congressional Budget Office predicts growth of 2.1 percent and 2.4 percent for these two years. Lower growth would mean less tax revenue, larger budget deficits and a more rapidly increasing debt-to-G.D.P. ratio.

The president seems to understand that the fiscal plan presented in his budget is not sustainable and, as such, is not really a plan at all. That is why the budget prominently calls for a fiscal commission that will be charged with "identifying policies to improve the fiscal situation." The goal, the budget says, is "to stabilize the debt-to-G.D.P. ratio at an acceptable level once the economy recovers."

In other words, President Obama's long-term fiscal strategy is to appoint a commission to figure out a long-term fiscal strategy.

It is impossible to say what such a commission will propose, and voters probably won't know until after the midterm elections this year. But Nancy Pelosi, the House speaker, gave a hint in an interview last October when she said a value-added tax was "on the table."

A value-added tax is like a sales tax, but rather than being collected entirely at the retail store, it is collected in stages along the chain of production. Many European countries use it, and it is one of the more efficient ways to raise revenue. So efficient, in fact, that some conservatives fear that it would too easily fuel the growth of government.

Yet despite its efficiency compared with other taxes, a VAT does not offer a free lunch. It would raise consumer prices, lower real wages, discourage work and depress economic growth. It would also break President Obama's pledge not to raises taxes on the middle class.

But unless the president revises his spending plans substantially, he will have no choice but to find some major source of government revenue. Ms. Pelosi's suggestion of a VAT may be the best of a bunch of bad alternatives. Unfortunately, in this new era of responsibility, the president is not ready to face up to the long-term fiscal challenge.