**Time for a Budget Game-Changer**

By Gary S. Becker, George P. Shultz and John B. Taylor

**W**anted: A strategy for economic growth, full employment, and deficit reduction—all without inflation. Experience shows how to get there. Credible actions that reduce the rapid growth of federal spending and debt will raise economic growth and lower the unemployment rate. Higher private investment, not more government purchases, is the surest way to increase prosperity.

Assurance that current tax levels will remain in place would provide an immediate stimulus. House Republican budget planners are on the right track.

When private investment is high, unemployment is low. In 2005, investment—business fixed investment plus residential investment—as a share of GDP was high, at 17%, and unemployment was low, at 5%. By 2010 private investment as a share of GDP was down to 12%, and unemployment was up to more than 9%. In the year 2000, investment as a share of GDP was 17% while unemployment averaged around 4%. This is a regular pattern.

In contrast, higher government spending is not associated with lower unemployment. For example, when government purchases of goods and services came down as a share of GDP in the 1990s, unemployment didn’t rise. In fact it fell, and the higher level of government purchases as a share of GDP since 2000 has clearly not been associated with lower unemployment.

To the extent that government spending crowds out job-creating private investment, it can actually worsen unemployment. Indeed, extensive government efforts to stimulate the economy and reduce joblessness by spending more have failed to reduce joblessness.

Above all, the federal government needs a credible and transparent budget strategy. It’s time for a game-changer—a budget action that will stop the recent discretionary spending binge before it gets entrenched in government agencies.

Second, we need to lay out a path for total federal government spending growth for next year and later years that will gradually bring spending into balance with the amount of tax revenues generated in later years by the current tax system. Assurance that the current tax system will remain in place—pending genuine reform in corporate and personal income taxes—will be an immediate stimulus.

All this must be accompanied by an accurate and simple explanation of how the strategy will increase economic growth, an explanation that will counteract scare stories and also allow people outside of government to start making plans, including business plans, to invest and hire. In this respect the budget strategy should be seen in the context of a larger pro-growth, pro-employment government reform strategy.

We can see such a sensible budget strategy starting to emerge. The first step of the strategy is largely being addressed by the House budget plan for 2011, or HRI. Though voted down in its entirety by the Senate, it is now being split up into “continuing” resolutions that add up to the same spending levels.

To see how HRI works, note that discretionary appropriations other than for defense and homeland security were $460.1 billion in 2010, a sharp 22% increase over the $378.4 billion a mere three years ago. HRI reverses this binge by bringing these appropriations to $395.5 billion, which is 4% higher than in 2008. Spending growth is greatly reduced under HRI, but it is still enough to cover inflation over those three years.

There is no reason why government agencies—from Treasury and Commerce to the Executive Office of the President—cannot get by with the same amount of funding they had in 2008 plus increases for inflation. Anything less than HRI would not represent a credible first step. Changes in budget authority convert to government outlays slowly. According to the Congressional Budget Office, outlays will only be $19 billion less in 2011 with HRI, meaning it would take spending to 24% of GDP in 2011 from 24.1% today.

If HRI is the first step of the strategy, then the second step could come in the form of the budget resolution for 2012 also coming out of the House. We do not know what this will look like, but it is likely to entail a gradual reduction in spending as a share of GDP that would, in a reasonable number of years, lead to a balanced budget without tax rate increases.

To make the path credible, the budget resolution should include instructions to the appropriations subcommittees elaborating changes in government programs that will make the spending goals a reality. These instructions must include a requirement for reforms of the Social Security and health-care systems.

Health-care reform is particularly difficult politically, although absolutely necessary to get long-term government spending under control. This is not the place to go into various ways to make the health-care delivery system cheaper and at the same time much more effective in promoting health. However, it is absolutely essential to make wholesale changes in Obama Care, and many of its approaches to health reform.

The nearby chart shows an example of a path that brings total federal outlays relative to GDP back to the level of 2007–19.5%. One line shows outlays as a share of GDP under the CBO baseline released on March 18. The other shows the spending path starting with HRI in 2011. With HRI federal outlays grow at 2.7% per year from 2010 to 2021 in nominal terms, while nominal GDP is expected to grow by 4.6% per year.

After GDP growth will bring a balanced budget more quickly by increasing the growth of tax revenues. Critics will argue that such a budget plan will decrease economic growth and job creation. Some, such as economists at Goldman Sachs and Moody’s, have already said that HRI will lower economic growth by as much as 2% this quarter and the next and cost hundreds of thousands of jobs. But this is highly implausible given the small size of the change in outlays in 2011 under HRI, as shown in the chart. The change in spending is not abrupt, as they claim, but quite gradual.

Those who predict that a gradual and credible plan to lower spending growth will reduce job creation disregard the private investment benefits that come from reducing the threats of higher taxes, higher interest rates and a fiscal crisis. This is the same thinking used to claim that the stimulus package worked. These economic models failed in the 1970s, failed in 2008, and they are still failing.

Control of federal spending and a strategy for ending the deficit will provide assurance that tax rates will not rise—pending tax reform—and that uncontrolled deficits will not recur. This assurance must be the foundation of strategy for a healthy economy.

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