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Now or Never: The Moment for Democrats to Get a Grand Bargain

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What is the outcome Democrats want to achieve when the triple-witching hour occurs at the end of the year—as the Bush tax cuts expire, sequestration is scheduled to begin, and Congress is faced with another debt limit fight?

In this memo, we argue that this moment represents the best time for Democrats to set in motion—and ultimately achieve—a balanced, bipartisan grand bargain deal. Although the President and many members of Congress have already tried to consummate a deal, they did not have the advantages offered by this moment. This time, if handled correctly, Democrats can attain maximum leverage to forge a bipartisan deal that works both politically and substantively—a deal that can be concluded in 2013 that restores fiscal order, propels the economy forward, and protects spending for those in need.

This memo makes four arguments—essentially the 4 P's—on politics, policy, priorities, and positioning. It explains why Democrats should seek a grand bargain and how to best achieve it in this *now or never* moment:

1. **Politics:** Absent a balanced grand bargain, the deficit issue will plague Democrats for a generation. We show how the deficit is certain to dominate the political discussion unless it is solved and how that discussion puts Democrats at a disadvantage.

2. **Policy:** Delaying action on entitlements will gut public investments. Without entitlement reforms as part of a grand bargain, future Democratic spending priorities on infrastructure, research, education, new energy technologies, NIH, aid to the poor, and foreign aid will wither and fall from the vine.

3. **Priorities:** Ignoring entitlements in the budget debate guarantees a future middle class tax increase. Taxing the wealthy alone cannot raise enough revenue to secure baby boomer entitlements. The party of the middle class will need to make a choice: does it make modest changes to entitlements now, or does it leave entitlements to grow unabated and set in motion a destiny of significant middle class tax hikes?

4. **Positioning:** If handled deftly, Democrats can gain maximum leverage for a balanced deal. We detail ideas to put intransigent Republicans on the defensive on the year-end debt ceiling limit, sequestration, and tax cut expiration in service to a balanced deal.

Politics: Avoiding a deal hurts Democrats politically.

Absent a grand bargain, the debt and deficit will be the leading topics of domestic political discussion for the next decade or more, as they will remain historically high by any meaningful standard:

- Sequestration (if not bypassed) includes not only the wrong cuts, but they are modest cuts compared to the scope of the problem.

- Troop reductions in Afghanistan and Iraq are worth $982 billion, [1] using the most generous scoring. But, there is bound to be some other expensive military effort to secure world stability. At least some of these projected cuts are likely illusory.

- Letting all the Bush tax cuts expire would achieve as much deficit reduction as the President's budget, [2] but that's a fantasy. It would require the President to renege on his promise to extend tax cuts for the middle class. That's not going to happen.

- The Buffet rule is worth less than $50 billion of revenue over ten years, a modest contribution that is hardly enough to begin to fix the hole we are in (this assumes expiration of the Bush tax cuts for high earners). [3]
- We won't grow our way out of the problem. The U.S. grew by nearly four percent annually during the tech boom from 1992 to 2000. No one is projecting anywhere near that type of sustained, heated growth now.

What this all means is that continuing on the current fiscal course without a budget deal will produce a national-conversation-inducing deficit of 4.7% of GDP ($979 billion) in 2018, a moment when a fully-recovered economy should be driving the deficit down to normal levels. [4] Deficits after 2018 then resume their growth as the full extent of the baby boom generation retirement begins in earnest. This is a rosy budget scenario because CBO's projections assume that there are no adverse economic consequences from the deficit—an unlikely scenario [5] as our cumulative public debt exceeds $15 trillion later in the decade.

Such sustained high deficits are not only problematic for the country; they are especially bad for Democrats. Why? Moderate voters (of whom Democrats must capture 57% to win a typical swing House or Senate seat) and Independents are extremely sensitive to issues around the debt and deficit:

- The deficit is actually a bigger issue now than it was in the 2010 election. Nearly three-fourths of voters (74%) say the budget deficit will be very important in how they vote this November, compared with 69% in 2010. [6] Among Independents, the importance of the deficit has grown even faster (76% now vs. 68% in 2010). [7]
- In our own polling of 1,000 Independent voters, 68% described themselves as very worried about the national debt—by far their biggest concern. [8] They chose "reducing the budget deficit" as the top way to strengthen the economy when given a menu of choices. [9]

Moreover, swing voters don't trust Democrats to put our fiscal house in order.

- Democrats have not won the trust of Independents on fiscal issues despite GOP missteps. They say Republicans are better on the deficit issue by a margin of 48-34%. [10] On government spending, they say Republicans are better by a margin of 51-32%.

- In a May *Politico* battleground poll, voters gave the President his lowest mark on the federal budget and spending (37-59%). [11]

- Independents supported Democrats by eight points in 2008 and routed them by 19-points in 2010. The deficit and government spending on health care were leading reasons.

This is not to say Independents are extremists on the deficit —Independents view the Tea Party unfavorably by 37-49%. But they still want to see a budget deal. More than 70% of Independents support a combination of tax increases and spending cuts to achieve it [12] —the approach that President Obama and Democrats couldn't get past the Tea Partyers in last year's negotiations.

Without a deal, the deficit will be the top national domestic issue for the foreseeable future. That's not a discussion Democrats are poised to win politically at this point. Democratic support for a grand bargain will appeal to Independents and put an end to a conversation that plays to the advantage of Republicans.

Policy: Delaying action on entitlements guts public investments.

Democrats are historically reluctant to touch entitlements. Social Security, Medicare, and Medicaid are the crown jewels of a century-long progressive agenda. However, Democrats must realize that nearly everything that they promote—grow the economy, help low income people make ends meet, educate our children, cure diseases, develop new energy sources, rebuild our infrastructure, keep communities safe, give special needs kids the services they deserve, provide reproductive health to young women, stop human trafficking, feed the hungry, house the homeless, train our workforce, help poor and middle class kids attend college, end malaria in Africa, build bicycle lanes, fund the arts, protect abused children, care for the mentally ill, and provide legal services to immigrants—is on a slow, steady, inexorable decline.

These domestic discretionary accounts are the canaries in the coalmine on every piecemeal effort to reduce the deficit. They stand no chance against entitlements, no chance against tax cuts, and no chance against defense spending—*unless* they are part of a grand bargain that deals with entitlements, taxes, defense, and other mandatory spending. They took the biggest hit in the debt ceiling debacle, the biggest hit when the Super Committee failed, and they are in the crosshairs again within the House GOP budget resolution. And it's only going to get worse:

- By 2030, 64 cents of every federal dollar not going to interest will be spent on entitlements compared to 46 cents today, according to CBO. [13] That means defense, discretionary, and other mandatory spending will battle for a steadily shrinking pie (we know who wins that fight).

- Public investments are already on a long and steady decline. Non-defense discretionary spending was 5.1% of GDP under President Jimmy Carter and down to 3.7% under President George W. Bush. [14] It will be 2.6% of GDP in 2022 according to CBO. [15]

- By 2035, the budget for Social Security, Medicare, Medicaid, and interest payments *alone* will equal 25% of GDP. [16] The *entire* U.S. budget exceeded 25% of GDP just four times—1943, 1944, 1945, and 2009—over the past 70 years. [17]

- Solutions get much harder if we wait. From 2010 to 2050, the number of people receiving Social Security and Medicare benefits will basically double (from 44 million to 83 million people) while the number of working taxpayers to support each retiree will grow by only one-third (155 million to 203 million working taxpayers).[18] Further, all elderly entitlement benefits grow faster than inflation and often faster than wages.

- Each passing year makes it harder to reform entitlements. Our demographic changes reduce the influence of working age taxpayers and increase the influence of retirees on the political system year-by-year.

It's hard to imagine our public investment budget in kids, education, innovation, infrastructure, and the like going anywhere but steadily down under the crushing weight of un-reformed entitlements. This would certainly hurt our future economy and the fortunes of the middle class. And if our economy does suffer a fall because of the government's balance sheet, we need only to look across the Atlantic to see how difficult and ugly those decisions and policies become for the middle class.

Priorities: Ignoring entitlements guarantees higher taxes on the middle class.

It is mathematically impossible to preserve our current path for Medicare, Medicaid, and Social Security without a blistering tax increase on the working age middle class at some point in the near future.

Suppose we raised income tax rates to 50% on all income (ordinary and capital gains) for taxpayers with $1 million or more of income. This "Buffett Rule Plus 20%" would raise only $759 billion over ten years compared to the current policy baseline.[19] That amount of revenue would cover only 19% of the Bowles-Simpson deficit plan over ten years.[20]

If the federal government were to take *every dollar of income* from Americans making more than $250,000, the deficit would still be more than a $1 trillion in 2040. [21] That is because entitlements grow far faster than upper income earnings. Entitlement spending alone in 2040 would consume all the revenue the federal government currently collects for all government programs—defense, capital investments, foreign aid, aid to the poor, Pell grants, as well as entitlement programs. [22]

If entitlements are off the table, Congress will have no choice but to go where the money is: the middle class. One example of this approach comes from prominent progressive economist Simon Johnson and coauthor James Kwak who advocate their budget plan to control the deficit while preserving Social Security, Medicare, and Medicaid with only minor changes.

The Johnson plan calls for nine separate tax increases on the middle class. [23] This list shows the scope of tax increases needed to avoid trimming entitlement spending:

- Increase earnings cap on the FICA payroll taxes (that's roughly a $2,500 tax increase for people earning $150,000).
- Increase the Social Security payroll tax rate by 1 percentage point (that's a $500 tax increase for people earning $50,000).
- Increase the Medicare payroll tax rate by 1 percentage point (that's a $200 tax increase for people earning $20,000).
- Tax all health care benefits with a rebate for half the proceeds (that's a $2,100 tax increase for a family of four earning $75,000).
- Reduce the mortgage interest deduction without reducing income tax rates.
- Tax carbon (with a rebate for half the proceeds).

- Increase the gas tax (with a rebate for half the proceeds).
- Start a value-added tax (at a 5% rate with one-half rebated).
- Increase capital gains rates to 28% for middle class and wealthy taxpayers.

Whether or not one would support any of these tax hikes individually, this list makes it clear that there is no realistic path to obtaining the revenue necessary to finance the big three entitlements by taxing the wealthy alone. The brutal economic reality is that it is not possible to leave entitlements untouched and expect the middle class to remain unscathed. Today's delay on entitlement reform only ensures a steeper tax hike for the middle class tomorrow.

Positioning: Framing the debate for a grand bargain.

This time is different than the 2011 debt ceiling debate. There is no threat of a downgrade or charade of one Republican leader undermining the other. After November, there is no looming election and no need for the President to seek re-election. The fiscal cliff contains more peril for Republicans than Democrats. This is a winnable fight both on the substance of a grand bargain deal and the politics.

Democrats can gain the upper hand in the negotiations starting now. To do so, they must maintain the key parts of the fiscal cliff (tax cut expiration and sequestration) through the length of negotiations. They should push the debt ceiling deadline beyond the window of negotiations so as to prevent default. And, any short-term extensions should maintain the fiscal cliff and be explicitly in service of reaching a deal.

And to define obstinate Republicans, we have identified one overall strategy and a series of supporting tactics that allow deal-seeking Democrats to make the most of this moment by turning up the heat on Republicans reluctant to seek an agreement.

The strategy is to define reluctant Republicans as kick-the-can pawns of the Tea Party.

In two years, approval of the Tea Party has plummeted from +13 (35-22%) to -21 (30-51%), according to a time series of Fox News polls. [24] In our March poll, swing Independents (those Independents who are truly up for grabs in elections) disapproved of the Tea Party by 28-54%. [25] Voters believe that the Tea Party has too much influence on the GOP. In February 2010, only 14% of voters felt that the Tea Party had too much influence on the Republican Party. By August, 43% of voters felt that the Tea Party had too much influence. [26] By March 2012, 79% of swing Independents said the Tea Party had "a lot" or "some" influence on the GOP. And, of course, they are right. Speaker Boehner would not have made his speech on the upcoming debt ceiling limit if the Tea Party weren't calling the shots.

Over the coming year, it is possible that the economy will improve or get worse. It is possible that an international incident may redefine the political calculus. It is not possible that the Tea Party will become popular or be seen as a benign influence on congressional Republicans.

Here are five tactics to successfully tie ideologically rigid Republicans to the Tea Party and generate Democratic leverage for a balanced deal.

1. **Position Tea Party Republicans as holding middle class tax cuts hostage to tax cuts for the wealthy.** Assuming President Obama wins and/or Democrats hold the Senate or pick up seats in the House, Democrats should argue that the voters have spoken. They want upper income tax cuts to end; they want the middle class tax breaks continued. Only the Tea Party and those afraid to buck them are putting middle class tax increases on the table.

2. **Position Tea Party Republicans as kick-the-can, deficit hypocrites when they try to wiggle out of sequestration.** For years, Republicans have called the deficit the nation's number one security risk. Now they are backing out of the agreement they made during the debt ceiling debacle. Tea Party Republicans are only interested in a cuts-only, no-revenue, no-defense spending ideological fantasy on the budget.

3. **Highlight the split between reasonable Republicans and the Tea Party.** Remind voters that House Speaker Boehner and reasonable Republicans were willing to shake hands on a grand bargain with President Obama until the Tea Partyers yanked their chains. It shows who rides the herd in the Republican Party.

4. **Define the GOP's opposition to a grand bargain as a fealty test to the Tea Party.** Republican opposition to a balanced deal is not a matter of principle, but a matter of fealty to Tea Party special interests. Reasonable Republicans would make a balanced deal for the benefit of the nation. What's holding back reasonable Republicans (like Speaker Boehner) is their paralyzing fear of the Tea Party.

5. **Define Republicans as the default party.** Drive the narrative now that Republican fortunes began to change after the debt ceiling debate (which is accurate). It was their Waterloo—the point where a real shot to defeat Obama became a much longer shot; where an imminent takeover of the Senate became a dogfight; where their House majority started to come into doubt. Make their Tea Party extremism on the debt ceiling the turning point so that, like Gingrich in 1996 on the government shutdown, party leaders never want to go there again.

With Moderates and Independents clamoring for balanced action on the debt and deficit—paired with their sizeable concern of the Tea Party's influence over the GOP—

Democrats have the opportunity now to seize and own the debate.

Conclusion

It is never going to be easy to strike a grand bargain, but it is hard to conceive of a better moment for Democrats to achieve the right kind of deal than the end of this year. Handled deftly, a final deal would raise revenue, shore up entitlements, trim other mandatory spending and defense, and create space for growth-inducing investments.

Waiting has consequences—political, economic, and for the middle class. It's now or never.

END NOTES

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