

By Robert S. Dudley, Editor in Chief

The Feldstein Solution

MARTIN Feldstein, the Harvard professor who chaired President Reagan's Council of Economic Advisors, may well be the nation's most influential economist. He was not heretofore known to hold a hard-line view on defense.

That being the case, one is taken aback at Feldstein's most recent paper, an unsparing, 2,500-word analysis bluntly entitled, "The Underfunded Pentagon," published in *Foreign Affairs*. It is impressive stuff. Coming from the nation's reigning economic heavyweight, it cannot be easily ignored.

Feldstein's point is that the Pentagon is, well, underfunded—*really* underfunded. The author prescribes "a substantial increase" in the \$550 billion defense budget, and claims the US could raise it by 50 percent fairly quickly.

Far from bemoaning "record defense spending," the 67-year-old economist reports today's expenditure "is probably not enough to ensure the security of the United States," given the tasks that face the armed forces. Heading up Feldstein's must-do list is "detering other great powers, such as Russia and China." Rather than assuming away the danger of a big-power conflict, as many do, Feldstein calls for keeping US conventional dominance which requires modern warplanes, ships, and the like.

That, by itself, requires spending at today's level, he noted, but Feldstein itemizes three other threats: (1) regional powers—North Korea, Iran, Pakistan—with mass-destruction weapons, (2) stateless, globally entrenched terrorist networks, with "visions of re-creating the world order," and (3) localized terrorist practitioners motivated by hate.

In Feldstein's view, US forces are "either ill-suited or insufficient" to handle some of these problems. The nation, as a result, has to modernize its weapons generally, replace war-worn materiel, expand its ground forces, reshape forces for rapid deployment, and expand US intelligence. That takes money.

Such observations, while true enough, are hardly original. Of far greater value is Feldstein's take on two key economic questions: How much can the US afford to spend on defense? And in what way should Congress raise the money? The article does not recommend specific

figures, saying such amounts can be determined only by a detailed budget process. Yet the need is certainly great. (The Air Force, for instance, claims it requires an extra \$20 billion a year for 20 years.)

Feldstein focuses on three fundamental points, presented here in paraphrased form:

■ Today's defense burden is light. Spending now claims four percent of Gross Domestic Product (the nation's output), and that includes the costs of the wars in Afghanistan and Iraq. For the basic program, the figure is three percent, a near-historic low. In 1962, before the Vietnam War, defense took

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9.3 percent of GDP, without causing economic damage. Obviously, there is plenty of room in the economy for a more robust defense effort.

■ The fiscal outlook isn't dire. The current budget situation in the United States, wrote Feldstein, "is healthier than often presumed." Today's federal deficit, for example, amounts to just two percent of GDP. That is low enough to allow, each year, a slight improvement in the national debt, though a variety of factors could change this situation.

■ Resources are growing. In the Reagan years, defense outlays rose to six percent of GDP, but then went down. What about going back to six percent? "The United States clearly could afford to do so if it wanted to," Feldstein wrote. The \$13.8 trillion US economy is expected to grow by 15 percent in the next five years. New defense outlays would take one-sixth of that increment. Meantime, the Pentagon would get a huge annual infusion.

Feldstein's conclusion: "The decision to increase national security spending is ... a question of politics and budgets rather than available resources."

As for the second question—how would Congress raise money for a defense increase?—Feldstein has some controversial answers. The first is that

it would be "a serious mistake" to plan on boosting defense by raising personal taxes. Feldstein calculates that a major DOD increase would require hikes on the order of 25 percent. That could kill public support.

In his view, tax increases aren't needed anyway. Because tax rates are graduated, taking more from higher incomes, the general rise in incomes automatically boosts tax revenues. Congressional Budget Office models show personal tax revenue will rise from eight to nine percent of GDP by 2016 and 10 percent in 2026.

The year 2026, however, is a long way off. Washington could accelerate the process by slowing or stopping the recent rise in non-defense programs, without cutting them. It could also limit a long list of "tax expenditures"—more than \$700 billion in revenue lost as a result of special tax breaks.

With these expedients, said Feldstein, defense spending would rise to five percent of GDP in 2011 and six percent by 2016. That would add hundreds of billions of dollars in buying power.

There are soft spots in the Feldstein solution. He himself acknowledges the danger posed by ballooning entitlement programs in years ahead. CBO projects that the combined costs of Social Security, Medicare, and Medicaid will rise from 8.7 percent of GDP now to 16 percent in 2036, dramatically squeezing other claims.

Then there are the political hazards of closing popular tax loopholes and reining in popular programs, something one Internet pundit, David Eisenthal, slams as "the classic brief on behalf of the military industrial complex ... against the middle class."

No one—certainly not Feldstein—expects this paper to provoke a sudden swelling of Pentagon coffers, but it could prove to be a point of departure for a more honest and realistic debate.

"I don't underestimate the political difficulty of getting that increase," Feldstein told a military audience at West Point last November. "It will take political leadership." Yet to be seen is whether Feldstein, whose warnings about deficits in the Reagan years won him the nickname "Dr. Gloom," is now indulging in blue-sky optimism. ■