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The Wainwright Perspective

Forget the fiscal cliff and fear the debt crisis*

by Doug Bandow†

The liberty of Americans is at risk when Congress is in session. Top of the agenda after the election as Capitol Hill's lame duck session was dealing with the "fiscal cliff," the year-end expiration of tax cuts and imposition of automatic budget cuts ("the sequester"). President Barack Obama faced down the Republican House and won a tax increase on "the rich" in order to reduce the deficit.

But the public was understandably skeptical. Half of Americans believe any additional tax revenue would go to new programs, not deficit reduction. Indeed, the new Congress quickly approved a pork-ridden hurricane relief bill that used up almost all of the extra tax revenue to be collected in 2013.

Government spending has continued relentlessly upwards for decades, irrespective of president, party, program, or promise. There was no reason to believe that this time would be different.

Moreover, the spending crisis is too big to solve by taxing the "rich," whoever they are. Former congressmen Chris Cox and Bill Archer warn: "When the accrued expenses of the government's entitlement programs are counted, it becomes clear that to collect enough tax revenue just to avoid going deeper into debt would require over $8 trillion in tax collections annually. That is the total of the average annual accrued liabilities of just the two largest entitlement programs, plus the annual cash deficit."[1] In contrast, the total adjusted gross income of those earning more than $66,000 a year was $5.1 trillion and net corporate income was $1.6 trillion. Confiscate it all and there still isn't enough to pay the annual increase. And you could only steal the money once, since people wouldn't keep working if government left them with nothing.

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>
> ~ Nick Eberstadt

Unfortunately, the near-term budget problem pales compared to the longer-term challenge. The national debt is $16.5 trillion, more than the annual GDP. Toss in all current unfunded federal liabilities and the number is $222 trillion, according to economist Laurence Kotlikoff.[2]

Uncle Sam just can't help himself. The only answer is to cut spending.

Bipartisan responsibility. Republicans talk a lot about spending restraint, but have been no less irresponsible than Democrats. For instance, George W. Bush raised spending in virtually every area. The Medicare drug benefit was the largest expansion of the welfare state in 40 years.

Nick Eberstadt of the American Enterprise Institute recently analyzed entitlement spending and concluded: "the administrations of Richard Nixon, Gerald Ford and George W. Bush presided over especially lavish expansions of the American entitlement state. Irrespective of the reputations and the rhetoric of the Democratic and Republican parties today, the empirical correspondence between Republican presidencies and turbocharged entitlement expenditures should underscore the unsettling truth that both political parties have, on the whole, been working together in an often unspoken consensus to fuel the explosion of entitlement spending."[3]

Still, most Republicans now seem to recognize that something must be done about entitlements. Not so most Democrats and their special interest al-

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1. "Why $16 Trillion Only Hints at the True US Debt," *Wall Street Journal*, November 27, 2012, p. A17.
2. Lawrence Kotlikoff and Scott Burns, "Blink! US Debt Just Grew By $11 Trillion," Blomberg.com, August 6, 2012.
3. Nicholas Eberstadt, "Are Entitlements Corrupting Us? Yes, Americcan Character is at Stake," *Wall Street Journal*, August 31, 2012.

lies. For instance, Senate Majority Whip Richard Durbin (D-Ill.) said he doesn't want to consider entitlements as part of the "fiscal cliff" negotiations. They are too complex, he claimed. Moreover, Social Security "does not add a penny to our deficit."

Of course, that is nonsense: the program is running a deficit and the "trust fund" is an accounting fiction. The money has been spent. Anyway, if policymakers aren't willing to address Social Security, Medicare, and Medicaid, the three largest domestic programs, why bother doing anything? The so-called fiscal cliff is of little consequence compared to the coming spending tsunami powered by Social Security, Medicare, and Medicaid. Observed outgoing Senate Budget Committee Chairman Kent Conrad (D-ND), "If you're going to solve this problem, you're going to have to deal with where the spending is."

Unreal spending cuts. At least the 2011 Budget Control Act theoretically targeted so-called discretionary spending. However, this is a relatively small category of federal outlays—governed by annual appropriations rather than statutory eligibility—and Congress capped future expenditures rather than cut specific outlays. A future Congress could undo the change by simply appropriating more money.

Which is likely. The promised cuts presume that "Discretionary spending will fall to 5.6 percent of GDP by 2022—the lowest level in at least 50 years." Even growth at the rate of inflation would mean "discretionary outlays would fall to 6.4 percent of GDP by 2022." Yet discretionary spending has been that low in only "four of the past 50 years." There's no evidence that Congress has grown the budget backbone necessary to enforce such limits.

The problem is not just discretionary spending. There's also the possibility of refusing to enforce Medicare cuts originally approved in 1997—which Congress has done every year since, including in 2010, when it was approving ObamaCare, which mandated other, equally unrealistic, Medicare reductions.

CBO also worried about the deficit impact if taxes are not raised. Under the agency's "alternative fiscal scenario" the near-term budget looks frightening. Warned CBO: "deficits over the 2014-2022 period would be much higher than those projected in CBO's baseline, averaging about five percent of GDP rather than one percent." The 2013 deficit would run another trillion dollars. The added ten year total would be nearly $10 trillion. With higher deficits would come a bigger national debt: "Debt held by the public would climb to 90 percent of GDP by 2022—higher than at any time since shortly after World War II."

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Even this estimate is unduly positive. There could be one or more recessions. Oil prices could surge, cutting demand for other goods and services. CBO also warned that a worsening Euro crisis "could lead to further turmoil in international financial markets that could spill over to U.S. financial markets," triggering "a self-reinforcing downward spiral, weakening the growth of households' income and diminishing consumers' and businesses' spending and therefore reducing the need to hire new workers."[4]

Overall, warned CBO, "the policies assumed in the alternative fiscal scenario would lead to federal debt that would be unsustainable both from an economic and from a budgetary perspective."

Indeed, the financial horror facing America is evident in another recent CBO study, "The 2012 Long-Term Budget Outlook." Bail-outs are continuing with the Postal Service, Federal Housing Administration, Pension Benefit Guaranty Corporation, and more. America's wars are acting as unfunded liabilities, with Americans facing trillions of dollars in future spending to care for injured veterans. The federal government owes several trillion dollars in unfunded pension payments for its own workers.

Worse is the expected explosion of entitlement spending. Explained CBO: "The aging of the baby-boom generation portends a significant and sustained increase in the share of the population receiving benefits from Social Security and Medicare, as well as long-term care services financed by Medicaid." Per capita health care outlays will continue to race ahead faster than expenditures on other goods and services.

Overall, disaster looms. Said CBO: "Without significant changes in government policy, those factors will boost federal outlays relative to GDP well above their average of the past several decades—a conclusion that holds under any plausible assumptions about future trends in demographics, economic conditions, and health care costs."

Over the long-term the differences between baseline and alternative scenarios grows ever larger. The baseline is not good: while CBO foresaw noninterest outlays falling below 20 percent of GDP by 2017, because of increasing entitlements "such spending would reach 23 percent of GDP in 2037."

In contrast, the alternative threatens a dramatic rise: "the growing imbalance between revenues and spending, combined with spiraling interest payments, would swiftly push debt to higher and higher levels. Debt as a share of GDP would exceed its historical peak of 109 percent by 2026, and it would approach 200 percent in 2037." In contrast, the ratio for Greece peaked at 143 percent.

Higher debt also would inflate interest payments, raising federal outlays even more. Under the baseline scenario net

4. The source of this and other subsequent quotations is "An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022," Congressional Budget Office, Washington DC, August 2012.

interest payments would hit about three percent of GDP in the 2020s and then drop. Not so under the alternative scenario, when interest costs would steadily rise, hitting almost ten percent of GDP by 2037. At that point they would account for 27 *percent of federal outlays*. They would "rise to even higher levels in later years because of ballooning debt."

Interest charges likely would rise even higher because rising government borrowing would tend "to raise interest rates by leading people to allocate a larger portion of their savings to the purchase of government securities, such as Treasury bonds, and thereby 'crowding out' investment in productive capital goods, such as factories and computers."

As if all this wasn't bad enough, "Growing debt also would increase the probability of a sudden fiscal crisis, during which investors would lose confidence in the government's ability to manage its budget and the government would thereby lose its ability to borrow at affordable rates." The result could be new bail-outs, higher interest payments, and even more debt. The only hope: the inability to borrow easily might finally force previously unattainable reforms.

Washington's nightmare budget future is driven by excessive spending, not inadequate taxing. Over the last four decades noninterest federal outlays have averaged 18.7 percent of GDP. They now run 22 percent. As costs tied to the financial crisis and recession fall that number will drop to 19 percent or 20 percent (baseline versus alternative scenarios) in 2018. The spending share similarly will jump to 23 percent or 26 percent in 2037. Alas, "In both cases, noninterest outlays would continue to grow steadily in later years."

Toss in interest payments and the numbers are worse, far worse in the case of the alternative scenario. In 2037 "total spending would be 36 percent of GDP," about ten percentage points higher than under the baseline scenario and 14 percentage points higher than the average over the last 40 years.

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As for taxes, the alternative scenario presumes revenues at their past 40-year-average. The exploding deficit is caused by rising expenditures, not falling taxes.

Federal spending must come down. Uncle Sam must live within his means. Americans can't afford foreign aid—the government is borrowing money to give to other governments. Americans can't afford pork and earmarks—largely political gifts by legislators used to win reelection. Americans can't afford the endless grants, loans, and loan guarantees for every interest group that passes through Washington—homeowners, landlords, big and small businesses, doctors, farmers, students, banks, property developers, activist groups, and just about everyone else.

Americans can't afford the Pentagon—which has turned "defense" into a costly mix of foreign aid and social engineering, subsidizing rich allies and engaging in nation-building. Americans can't afford entitlements—which are middle class welfare rather than social insurance, funded by the young. All of these programs need to be cut. There can be no sacred cows.

Politicians don't need more money. They need to spend less and more wisely. That is the only answer to the "fiscal cliff." And it is the only answer to the longer-term debt crisis.

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