

by Gene Steuerle

Budget Errors Causing Today's Budget Bind

OK, I know that campaign time provides very little in the way of information. This time, however, it's at the point of absurdity. Both candidates continue to make promises that they cannot possibly keep unless they can first get the budget in order. At no point in our prior history has so much already been promised for the future, with revenues for 100 years from now already given away — and then some. Our would-be next presidents simply promise more, without indicating where the money is coming from. But what is it about the budget that creates such extraordinary imbalance at this point in history? There are five major budget errors or problems that have gotten us into this bind. Each has arisen in different ways over recent history, but all have intensified their pressure on the budget in recent years. Each one is difficult to fix or change, which is one reason that the candidates shy away from them.

Error 1: Focus on the Deficit

Budget policy focuses on the deficit. From a political standpoint, that focus is exceedingly unappealing, and not simply because it concentrates on losers — those who have to pay more taxes or accept reduced benefits to get the budget back toward balance. Deficit cutting aims at getting government decisionmakers to control their own spending and tax-cutting instincts so that they take a smaller share of private saving out of the economy. Is that why government exists? Of course not. It exists for purposes other than to reduce its own negative impact on the economy.

Error 2: Focus on Target Deficits of Zero

A deficit of zero might be a decent target for a current year, assuming the economy is humming along. However, it is not the right target for what should be put into *current law for future years*. As budget policy has moved from 1-year to 3-year to 5-year to 10-year budget windows, Congress and the president have essentially decided that they need today to spend the revenue that will be available in 1, 3, 5, 10 years, and more. But that is absurd. In an economy with a 3 percent growth rate, after 10 years, real revenues would grow by about one-third. With bracket creep (as is now in the alternative minimum tax and regular income tax), the increase would be even greater. Current policymakers don't know how best to spend those higher revenues before the future has arrived. Imagine how well our households would function if we not only spent our current earnings, but all future earnings and, projecting them to grow at 3 percent a year, we additionally signed contracts to spend in 10 years at a one-third higher rate than we do today! Or imagine a

business that left itself no slack to make investments years into the future, but decided today what equipment to buy 10 years from now.

Error 3: Entitlements

Entitlements are like quasi-constitutional government. Not only don't they require annual appropriations, but a supermajority of elected officials is required to prevent them from lasting forever. That is, it takes the active efforts of a majority of the House and Senate, as well as presidential support, to reform them in any way (or two-thirds of each house). Suppose our nonentitled kids have greater needs than, say, giving us a 20th year in retirement. Sorry. No switch is possible in this case without two supermajorities — one to cut the additional spending and one to put it toward the kids. Of course, with entitlements, we also build up the number of people who — surprise, surprise — feel entitled, regardless of what other programs they are squeezing!

Error 4: Entitlement Growth

The main issue with entitlements, however, is not their permanence in absence of new legislation, but the automatic growth that accompanies some of them (including some tax entitlements in the system). Especially bad is scheduled growth at a rate in excess of the growth rate of the economy, which, of course, is eventually impossible to sustain. In Social Security, this unsustainable growth comes from the combination of both wage indexing (a good idea in some circumstances, but not something to which people are entitled) and the granting of more and more years of retirement support as people live longer. For a few decades to come, growth in Social Security spending faster than the economy will also derive from the drop in birth rate, which leads to reduction in the number of taxpayers per recipient. In healthcare, the automatic growth comes not only from a similar increase in years of support and drop in workers per beneficiary, but also from the adoption of a simplistic model of insuring that was copied from the first health insurance policies in the private sector. When you and I go to the doctor, we bargain over what everyone else will pay.

Error 5: Illogical Separation of the Tax and Spending Sides of Budget

Taxes have been separated from spending for the entire history of legislation. Nonetheless, in the modern era, most spending no longer is directed at such basic functions as justice and defense, but rather at some redistribution of benefits. With redistributive policy, the spending and tax sides must be considered together. Otherwise we get the mind-boggling confusion that results from spending being put in the tax code and, what is even less recognized but perhaps more important, tax rates being put into spending provisions. Many spending

and tax decisions today should be made simultaneously — whether considering levels of net benefits to provide, the net combined explicit and implicit tax rate to impose, or the level of benefits relative to costs. Separate legislative and executive branch department jurisdictions make these comparisons exceedingly difficult. In fact, the analysis just isn't done, partly because no one in government is really responsible for thinking comprehensively about these subjects.

Reforming budget policy to deal with these five errors may require years or decades. Especially lethal is the combination of these five items: a focus on the deficit

rather than on government policy more broadly defined; the targeting of zero deficits in future years in ways that encourage policymakers to spend future revenues before they arrive; the creation of eternal programs that need no periodic review and make people feel entitled forever to the associated benefits; provisions that cause entitlements to grow automatically so fast that they tend to absorb all future revenues and preempt other government functions; and an unrealistic separation for legislative and analytic purposes of tax and spending programs whose combined effect is the only realistic way to assess their effectiveness.