URBAN INSTITUTE · ELEVATE · THE · DEBATE

Dead Men Ruling

Statement of
C. Eugene Steuerle*
Richard B. Fisher Chair & Institute Fellow, Urban Institute

before the

Task Force on Executive Overreach of the Judiciary Committee
United States House of Representatives

"The Federal Government on Autopilot:
Mandatory Spending and the Entitlement Crisis"

Wednesday, July 6, 2016

*The views expressed are my own and should not be attributed to the Urban Institute, its trustees or its funders. I thank Caleb Quakenbush for help preparing this testimony.

2100 M Street NW
Washington DC 20037
urban.org

Mr. Chairman and Members of the Task Force:

Thank you for the opportunity to testify before you today. The views expressed are my own and should not be attributed to the Urban Institute, its trustees or its funders.

In my testimony, I will emphasize three points:

1. Our nation has never before been so rich, yet we stand with our backs to the ocean of possibilities that lie right at our feet.
2. Dead men rule over us, as past legislators and presidents have put into the law a restriction unique in all of our history: almost no discretion or flexibility to act to address new challenges and possibilities without having to renege on past promises to the public.
3. Restoring greater discretion would be a win-win for both the public and our political parties. The track we are now on involves an ever-larger and increasingly dysfunctional government, an economic policy that does ever less to promote opportunity for all and leaves us with a budget for a declining economy, and a politics where if either party truly leads, it loses.

To recognize our possibilities and restore discretion, we must not confuse the symptoms for the disease. I believe both the deficit and the frustration over lack of prerogative expressed by both this task force and the president are symptoms. Treating only those symptoms has proved and will continue to prove inadequate to the underlying disease of a budget increasingly driven by past commitments.[1] This frustration, I should add, is shared by the public in most developed nations who, told that past legislators' choices have locked out making rational choices for how to change course, try to recapture some sense of control through policies at times even more harmful to their own economic and personal growth.

A Time of Extraordinary Possibility

We live at a time of extraordinary possibility, but you wouldn't believe it by looking at the headlines. We have never before been so rich, richer than we were before the Great Recession, and the richest nation ever on the face of the earth.

Yes, our economy is growing more slowly than desired, many needs remain unaddressed, and many do not share in that growth. Yet sluggish growth doesn't mean we are poorer nor lack options. Consider: federal spending and tax subsidies are scheduled to increase

[1] Much of this testimony expands on C. Eugene Steuerle, *Dead Men Ruling: How to Restore Fiscal Freedom and Rescue Our Future* (New York: Century Foundation Press, 2014).

in real terms (after inflation) by close to $2 trillion or about $12,000 per household just 10 years from now, supplied mainly by the revenues that would accompany even tepid economic growth.

True, this amount must be pared to avoid using higher deficits as a major means of finance. But my point remains: economic growth has always provided enormous possibilities to reform and adjust to modern needs and wants. Over the long run it creates the majority of new resources available, regardless of whether government grows or shrinks relative to the economy. And it provides the ability to act anew, including, as I will discuss, on the commonly stated but increasingly ignored objective of both political parties to provide greater opportunity for all. But our ability to act is weakened if nearly the entire future direction of government is left preordained by past legislators for a future they could not possibly anticipate.

Dead Men Ruling

The rule of dead men (and, yes, they were mostly men) can be demonstrated in various ways. I will show two: a decline in what I call fiscal democracy—the discretion left to current voters and policymakers to determine how the returns of economic growth are used—and the emergence of a long-term budget problem unique to our time.

Fiscal democracy index. Consider a simple index that I developed with Timothy Roeper: it measures how much of our current revenues are precommitted to programs that require no vote by Congress or, in technical terms, to mandatory spending programs (figure 1). This index is politically neutral: fiscal democracy is reduced through both increases in mandatory spending (including interest on the debt) and reductions in taxes, as long as they occur only as giveaways for which no budgetary balance is sought.

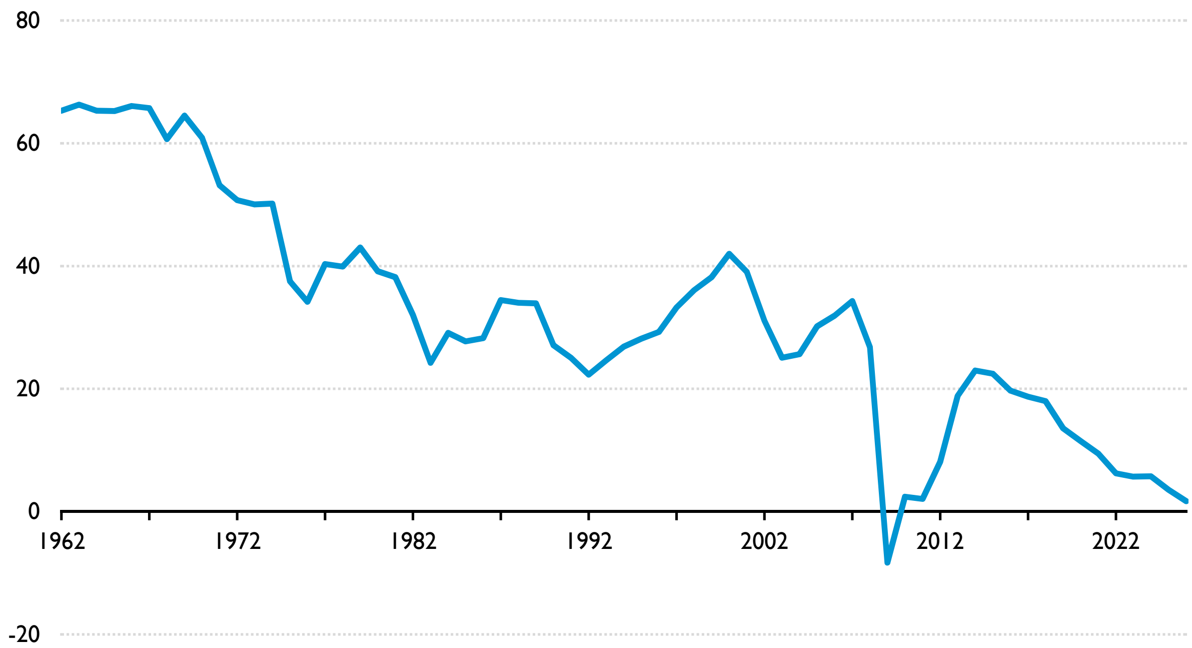
By this measure, in 2009 for the first time in US history, every dollar of revenue was precommitted before the new Congress walked through the doors of the Capitol. After a brief reprieve as the economy recovered from the Great Recession, the level of revenue left after mandatory and interest spending and tax expenditures is on its way back toward zero. This means, roughly speaking, that most or all discretionary spending is paid for out of deficits.

The long history of why this flexibility has declined can only be summarized here. Among the primary causes are automatic increases in some forms of mandatory spending, particularly for health care and retirement, often at rates faster than economic growth; the corresponding growth in tax subsidies, such as those for homeownership, that increase automatically over time just like mandatory spending; an unwillingness to collect enough revenues to pay our bills as we go along; and the corresponding feedback through a rise in interest costs that add to mandatory spending.

FIGURE 1

Steuerle-Roeper Index of Fiscal Democracy

Percentage of federal receipts remaining after mandatory and interest spending



Source: C. Eugene Steuerle and Caleb Quakenbush, 2016 calculations based on data from OMB *FY2017 Historical Tables* and CBO *Updated Budget Projections: 2016 to 2026*.
Notes: Projections assume current law.

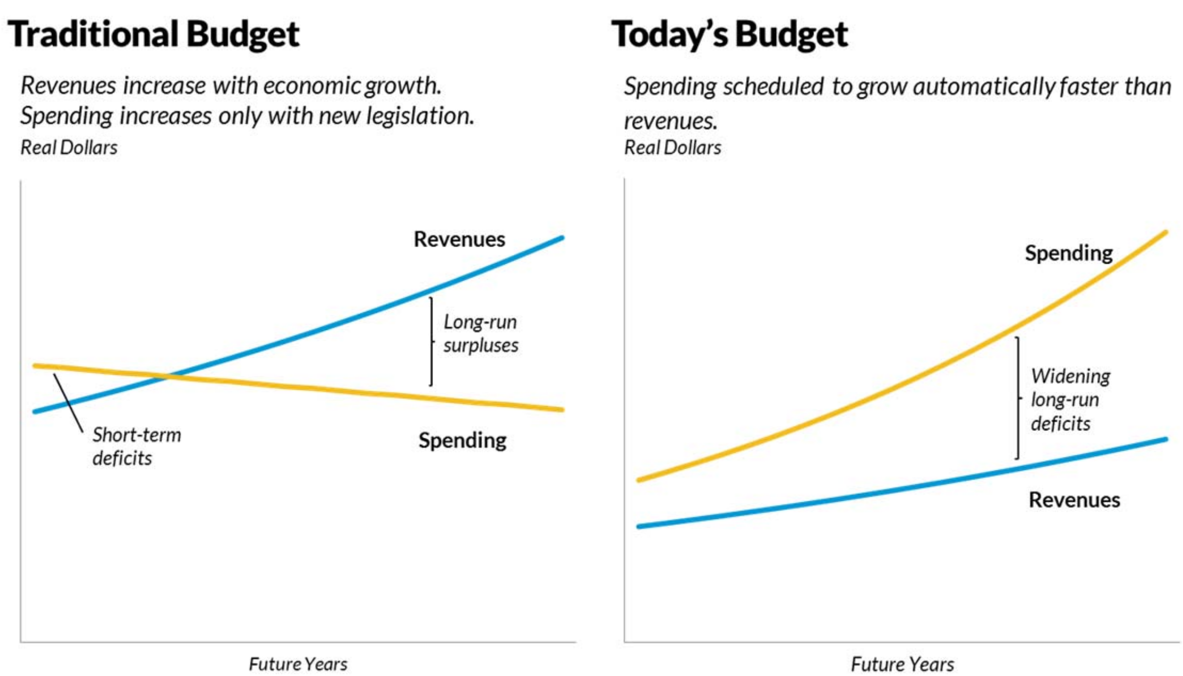
The political dynamics are also fascinating. Over several decades, both political parties came to believe that they must act as Santa, offering higher spending with no taxes to support that growth, or lower taxes with no spending reforms to support those reductions. Crucially, they also came to compete not just over today's budget, but future ones.

Imagine a business whose successive leaders tried to cement their legacy by signing contracts over how all future revenue growth, and then some, should be spent, and you get some idea of the nature of the problem. The results should be obvious: the company would lose out as its competitors continued to innovate while it senselessly catered to the whims of yesterday's market. It would lose the trust of its customers. In the same way, our nation and economy risks losing the confidence of its voters and missing opportunities to lead if we continue bowing to the political winds of years past.

The modern long-term budget problem. Economic growth normally provides the wherewithal to do things anew, whether for a household that can buy higher quality automobiles or electronics over time or a government that can pursue new agendas or return revenues to the public. In a traditional budget such as prevailed over most of this nation's history, spending is largely determined by discretionary appropriations. Revenue in future years eventually and almost inevitably exceeds any future obligations, even if one assumes that the current level of spending is obligated to be sustained. Had the Congressional Budget Office (CBO) existed before 1975, its projections of what it calls "current law" would have shown massive and rising future surpluses. The left-hand graph in figure 2 shows a stylized example of this, where an initial deficit is followed by increasing surpluses under current law. Future Congresses would have had to increase spending or cut taxes to prevent those surpluses from creating significant economic slowdown.

FIGURE 2

Two Budget Scenarios



Pundits who lament the perceived loss of ability to compromise, at least on budgetary matters, often fail to understand that it was much easier to reach some final agreement when elected officials were tasked with returning money to taxpayers.

Don't misunderstand me. Traditional deficit problems existed when new Congresses added new spending faster than revenues would allow. But, politically, Congress and the president seldom had to rescind promises they made to the public. Discretionary spending for almost any program would not grow automatically and often would decline relative to the economy after the problem to which it was addressed rescinded.

A great example comes from Franklin Roosevelt and Harry Truman: after 20 years occupying the Presidency, they left domestic spending lower as a share of the economy than it was when they entered the White House. Most of the growth in discretionary spending during the Great Depression ended after unemployment declined; it didn't have automatic, perpetual growth built into it. Defense spending, of course, grew during World War II, but that discretionary spending too has since declined substantially relative to the size of the economy.

When temporary imbalances did loom large on occasion, a stalemate over new spending or tax cuts was often enough to quickly restore reasonable balance.

Today's long-term budget scenario departs significantly from the traditional scenario described above. Much spending now has automatic growth built into it and, as a consequence, is projected to grow as fast as or faster than revenues and the economy. Even a major deficit reduction package for a few years leaves a long-term imbalance when spending is automatically growing faster than revenues, as shown in the second graph in figure 2.

By focusing mainly on the short or near term when trying to tackle budget problems, Congress and the president have ended up in a never-ending game of Whack-A-Mole or, should I say, Whack-Some-Dough. No wonder there are still budget problems after deficit-reducing actions in 1982, 1983, 1984, 1987, 1990, 1993, 1997, 2005, 2011, 2013, and 2015, among others. Had more discretion existed in the budget, both the tax cuts of the George W. Bush administration and the health reforms of the Obama administration would have been easily affordable, even without some of the so-called pay-fors, if that is how we decided to spend the additional revenues made possible by economic growth.

The Need for Discretion

Consider what lack of discretion is doing to the economy and the goals of both political parties.

Rising debt. Ever-increasing debt at a minimum means that we have less available to spend on noninterest items. Or, correspondingly, we need higher taxes to support what noninterest spending we have. We also shift burdens to future generations while potentially dampening economic growth.

Inability to respond to the next recession or other emergency. We have ever less ability to engage in fiscal policy to respond to the next recession, an inability we can see already in many European countries that responded weakly to recessions that followed the global financial crisis.

Reneging on promises to the public. When the budget is overcommitted, legislators and the president must eventually renege on promises, for program expansion and for low taxes.

If a political party leads, it loses elections. If both parties fail to unite to restore discretion, they both lose. We the voters seldom reward, and usually punish, the party that leads in reneging on past promises. Democrats and Republicans find themselves in a prisoners' dilemma, which can be defined loosely as, "if you lead, you lose." Restoring greater discretion would actually enable both parties to succeed more on their agendas than the status quo.

A budget for a declining nation. Even if all the above economic problems were solved—for instance, there was no danger from rising debt and money was available to respond to future emergencies—we would still be left with a budget for a declining nation. My and my colleagues' research shows this in various ways. In an annual *Kids' Share* study we have conducted for a decade, we have shown that, excluding modest growth in health spending, kids are scheduled to get nothing out of the revenues that accompany economic growth.[2] Their share of the federal budget as a share of the economy is scheduled to fall significantly.

In a related exercise, I also have approximated how much of future increases in spending and tax subsidies are going toward programs that provide opportunity for all.[3] As noted, CBO projections show that real spending and tax subsidies of the federal government will rise by close to $2 trillion by 2026, or more than $12,000 annually per household. Yet almost nothing goes for programs that broadly encourage the development of earnings, wealth, human and social capital, or what I have labeled "opportunity for all" programs (figures 3 and 4). The opportunity programs that exist are dominated by tax subsidies that largely exclude lower-income households.

Similar exercises, such as that conducted annually by the Office of Management and Budget, show that the investment side of the budget is also in decline as a share of outlays and national income.[4]

These observations on a budget for a declining nation reflect the shares of the budget devoted to various categories and tend to hold whether government becomes larger or smaller relative to the economy.

---

[2] http://www.urban.org/policy-centers/cross-center-initiatives/kids-context/projects/kids-share-analyzing-federal

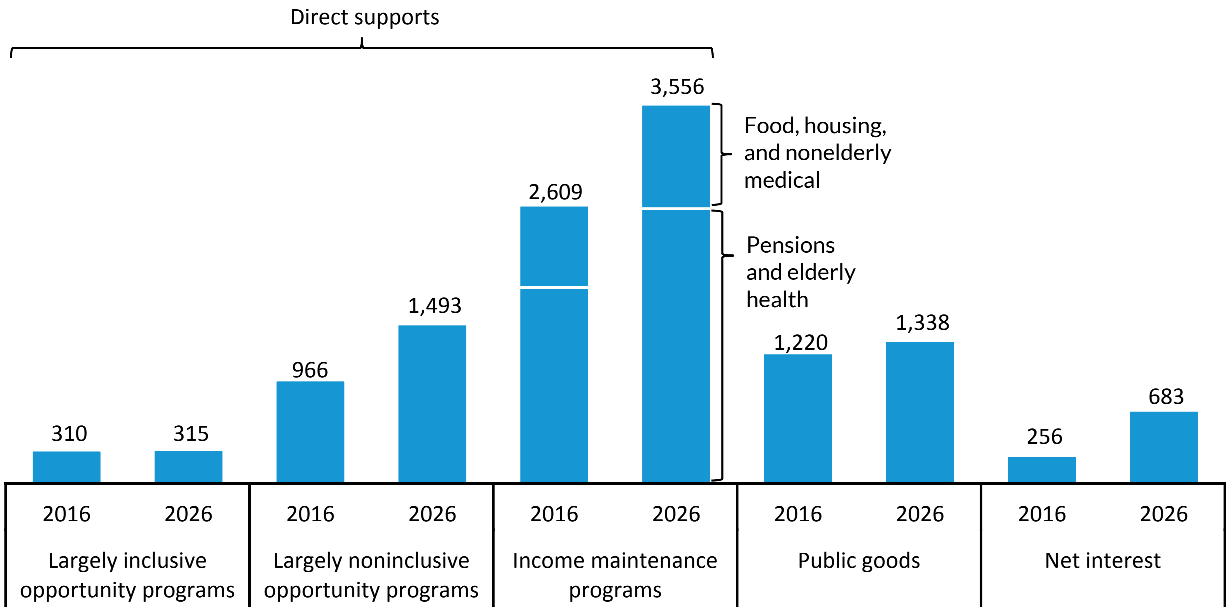
[3] C. Eugene Steuerle, *Prioritizing Opportunity for All in the Federal Budget: A Key to Both Growth in and Greater Equality of Earnings and Wealth* (Washington, DC: Urban Institute, 2016).

[4] The most recent volume of the *Analytical Perspectives to the President's Budget*, for example, shows that total federal investment was about 13.3 percent of federal outlays and 2.8 percent of GDP in fiscal year 2015. OMB projects that investment will be about 12 percent of federal outlays and 2.6 percent of GDP in fiscal year 2017, with non-defense investment declining in absolute terms by $1.4 billion.

FIGURE 3

Total Outlays and Tax Expenditures for Major Budget Categories under Current Law

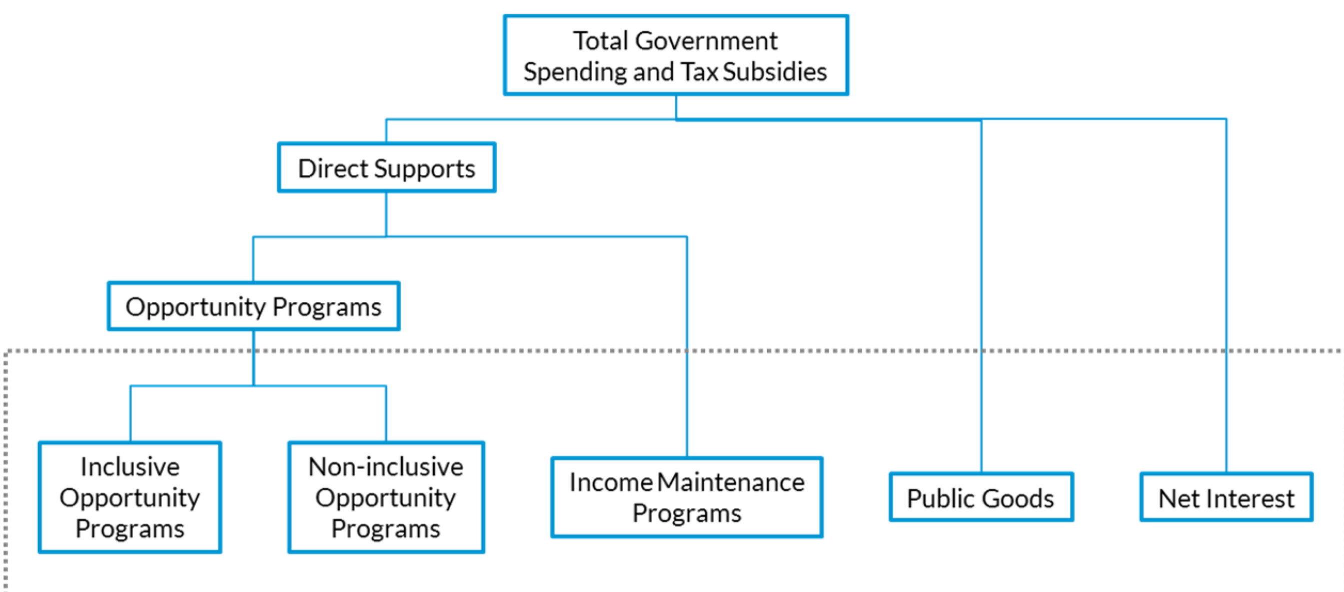
Billions of 2016 dollars



Source: Author's tabulations of Congressional Budget Office data.
Notes: Public goods include such items as defense, infrastructure, and research and development that benefit the population broadly. Direct supports are programs and transfers that benefit households and communities, such as health care and education. Within direct supports, income maintenance programs such as Social Security, Medicare, and SNAP (formerly food stamps) protect a certain level of income and consumption, while opportunity programs aim to increase private earnings, wealth, and human capital. Largely inclusive opportunity programs benefit low- and middle-income groups, while noninclusive opportunity programs largely exclude them or provide them with fewer supports than upper-income groups.

FIGURE 4

Classification of Government Tax and Spending Programs



Conclusion

Restoring fiscal democracy and removing the long-term budgetary problem requires nothing more or less than restoring greater discretion to the budget. More discretion does not preordain the size of the government—the primary battle between the major political parties—but simply leaves more decisions democratically to future voters.

How can greater discretion and flexibility be restored? And what opportunities does it open up?

- Enact fundamental reforms to limit the share of the spending on automatic pilot, with particular attention to programs with high automatic growth, in areas like health and retirement policy;
  - For instance, each health program can be put within a budget, though this requires empowering someone, somewhere, through vouchers, price controls, bundling payments, or other methods to stay within the budget. Adopting no method in many ways is worse than allowing elections over time to decide which methods will be favored and hopefully adapted to the knowledge newly accrued.
- Use caps and reauthorization requirements to serve as back-ups to the ultimate requirement to reform each program to best fulfill its basic goals;
  - For instance, when Social Security is stated as out of balance in several succeeding Trustees Reports, and no comprehensive reform is enacted, limits can be put on future scheduled increases in years of support and on real growth in benefit levels for those with above-median incomes;
- Apply to tax expenditures or subsidies the same types of constraints required for direct spending;
  - For instance, housing tax subsidies should not rise automatically from one generation to the next without any decision by Congress. Why not consider allocating increases toward programs like first-time homebuyers' credits that would do more to increase investment in housing?
- Barring recessionary considerations, collect enough revenues to cover expenses;
  - For instance, health cost growth could be tied directly to tax increases. Recognizing the true burden of spending by assessing the taxes necessary to pay for it would likely pressure official to keep government leaner than would hiding those spending increases in burdens passed onto future generations;
- Present the budget in a way that holds the president and the Congress responsible for all changes in the budget, both those they propose or enact, and those that they allow to continue.

- For instance, when the president submits a budget, CBO should show up front how the total change in real spending, both that newly proposed and that deriving from automatic growth in spending, is being allocated. Current law allocates essentially all of it to health and retirement and interest on the debt, with essentially nothing for anything else. The president and Congress should accept accountability for maintaining that choice, if that is the result of their decisionmaking or lack thereof.

Restoring discretion does not simply mean paring programs or raising taxes. It turns us so we can now see that ocean of possibilities at our feet. Consider how even a budget balanced but still preordained promotes a declining economy. Greater discretion gives us the chance to strengthen protections for the most vulnerable in a pro-growth way, with particular attention to programs like wage subsidies, education, preventive health, and private pension reform that promote opportunity, not simply consumption. Here I see budget reform as opening the door to modernizing programs to better meet the realities of today's economy and the evolving needs of the public.

I am not naïve. It will be difficult politically to reverse a multidecade decline in fiscal democracy and a budget that increasingly threatens a declining nation. However, failure to act will only make matters worse—not just for the public but for both political parties. The frustration and anger faced by political parties here and around the developed world derives, at least in part, from a budget process that has shifted the debate from what we can do to what we can't—that is, from letting dead men rule.