



THE FY 2014 BUDGET PROPOSALS: CREDIBLE REFORM OR FISCAL SLEIGHT OF HAND?

Despite years without a federal budget, trillion-dollar deficits, and ad hoc, crisis-driven fiscal and economic policies that failed to deal with the looming entitlement crisis, leaders on both sides in Washington are now touting seemingly miraculous progress toward a “fix” to our budgetary woes.

True, some minor cuts in discretionary spending, the expiration of the Social Security payroll tax cut, and a tax increase on wealthy Americans have improved the nation’s short-term fiscal outlook and temporarily stabilized the nation’s debt-to-GDP level—at least on paper. But relying on this brief uptick in the fiscal forecast to put off critical reform is dangerously shortsighted. The outlook for the nation’s fiscal and economic future remains dire, and will grow increasingly so unless Washington meaningfully addresses the greatest drivers of unsustainable government spending and debt—the largest entitlement programs.

Should Washington continue to rely on token reforms, accounting gimmicks, and other shortsighted policies, the situation will inevitably continue to deteriorate and generations of Americans will suffer the consequences.

If, however, Washington can agree to—and actually implement—a credible budget deal, it will bolster market credibility by reducing the threat of increasing taxes, inflation, the squeezing out of all discretionary programs by entitlement spending, and the collapse of the nation’s safety net programs under their own weight. A serious, credible budget deal is the only path to ensure the nation’s debt burden doesn’t crowd out sustainable economic and job growth.

THE GOAL AND THE MEANS

A credible budget should include fundamental reform in the areas of spending, taxes, and the budget process (or accounting), based on the ultimate goal of restraining government spending and public debt to levels consistent with a healthy economy and a vibrant private sector that will create the jobs needed to return us to full employment. Below, scholars from the [Mercatus Center at George Mason University](#) identify key tests in each of these categories to help assess whether a budget is a serious plan for growth.

What’s the Real Goal?

Credible Reform

Restrains federal spending as a share of GDP so as to constrain public debt from acting as a drag on economic growth.

- “The key question we should ask about any budget is this: does it reduce federal spending and indebtedness from their current elevated levels and return them to sustainable historical norms?”—Charles Blahous, Mercatus Center senior research fellow and public trustee for Medicare and Social Security
- “We need to stop taking the shortest-term view of economic policy. Credible nonpartisan analyses agree that even if deficit spending improves the GDP numbers in the short run, it makes us—and our kids—poorer in

the long run. Balancing the budget isn't merely an end in itself; it also means a more prosperous future for our children and grandchildren."—Charles Blahous

- Spending growth should not exceed the rate of economic growth.
 - Even with the sequester—and assuming very optimistic economic growth—CBO estimates that federal spending will grow at least 5 percent faster than the economy over the next decade (spending growth is estimated at 67 percent, economic growth at 62 percent).
 - Using [more realistic estimates](#), spending growth will likely outpace the revenues generated by economic activity by an even larger margin, creating even larger deficits and debt.

Sleight of Hand

Uses old markers and changes to the budget baselines to pretend we're "almost there." Neither the minor sequestration spending cuts nor the tax increase that was part of the "fiscal cliff" deal addresses the real problem of the growing size of government. Perpetuating this myth diverts attention from the urgent need to limit the growth of government spending so that it stays in line with private sector growth.

- CBO's baseline projections of improvements in near-term deficits to under \$1 trillion annually are based on unrealistically optimistic assumptions of both economic growth and tax revenues. Yet even under these assumptions, deficits will still total \$7 trillion over the next decade.
- A mere reduction in the rate of growth of spending that fails to reduce the size of government as a share of the economy merely slows the nation's progress to fiscal crisis.

How Do We Get There?

A "balanced approach" that relies heavily on tax increases rather than controlling spending is less likely to succeed than fiscal reform that focuses on controlling spending. Limiting tax and debt burdens requires that government spending growth be slower than the growth of the private sector.

- Data from 21 OECD countries from 1970 to 2010 [show](#) that fiscal adjustments based mostly on spending cuts were far more likely to be successful at reducing debt and increasing economic growth than those that relied more on tax increases. This was particularly true when spending cuts were combined with policies that increased competitiveness.

REQUIREMENTS OF A SERIOUS BUDGET

Entitlements

Credible Reform

Proposes meaningful reforms beginning in the coming fiscal year to make the largest entitlement programs more effective and sustainable and ease their future burden on the nation's economy.

- "Credible reform requires correcting the growth rates of federal entitlement programs so they do not exceed what the underlying economy can sustain. Specifically, this means slowing the cost growth of Medicare, Medicaid, Social Security, and the new health entitlement created in the 2010 health care law."—Charles Blahous
- "Scaling back or eliminating the new health law's exchange subsidies—now scheduled to begin in 2014—would serve several of these objectives at once. First, it would directly address one of the most problematic sources of untenable future spending growth. Second, it would mean that recently enacted Medicare savings are used solely to shore up Medicare, not spent on a new program. And third, it would address [problematic incentives](#) now facing states—specifically, to shift their Medicaid population with incomes above the poverty line to the exchanges, thereby swelling the federal cost of this new entitlement program."—Charles Blahous
- "This may be our last opportunity to responsibly constrain the cost of this new entitlement before it takes effect in 2014. History proves that it is very difficult to control entitlement spending growth once individuals become dependent on these programs."—Charles Blahous
- "We need a bipartisan willingness to take on Social Security reform; neither party can do it alone. We do need to cut current Social Security benefits, but we do need to slow their growth. This is [vital](#) not only to

correct system finances but to improve the fairness of the treatment of participants—first as workers, and later as beneficiaries.”—Charles Blahous

Sleight of Hand

Proposes token reforms, reforms that begin “later,” or maintains the status quo.

- “We cannot simply ‘leave these programs alone.’ They will grow themselves into [insolvency](#), leaving the most vulnerable Americans without a reliable safety net and bankrupting the economy in the process.”
—Jason Fichtner, Mercatus Center senior research fellow; former deputy commissioner, Social Security Administration
- “We need to all be clear that CPI reform, while meritorious, does not constitute Social Security reform; it would save less money over the next 75 years than Social Security’s financial outlook has deteriorated over just the last two.”—Charles Blahous

Discretionary Spending

Credible Reform

Keeps sequestration in place; puts everything on the table for review and for cuts; reduces size of government—spending declines each year in real terms, not compared to projected spending increases.

Sleight of Hand

Claims cuts in one program to increase spending in another; adds more “temporary” spending increases; calls for the largest cuts in the “out” years; makes vague reductions in “waste, fraud and abuse.”

- “American public works need improving, but federal spending on [infrastructure](#) doesn’t work as ‘stimulus,’ and we’ve got to stop pretending for the umpteenth time that it will.”—Veronique de Rugy, Mercatus Center senior research fellow
- “Washington doesn’t exactly have a good track record for correctly guessing tomorrow’s jobs. Federal job-training programs that help accumulate expertise for jobs that may not exist today—and may even be less likely to exist tomorrow—are not a solid plan to reduce unemployment in any meaningful or [sustainable](#) way.”—Matthew Mitchell, Mercatus Center senior research fellow

Taxes

Credible Reform

Proposes reforms to make the tax code simpler, more predictable, more competitive, more equitable, and more efficient.

- “If Washington is serious about improving American competitiveness, there are several things both sides should be able to agree on: [reduce the corporate tax rate](#) at or below the OECD average of 25 percent, end the ridiculously anti-competitive practice of double-taxing exports, and clean up the hundreds of special-interest temporary provisions currently [mucking up the tax code](#). Lowering the corporate tax rate across the board would be infinitely better for growth.”—Jason Fichtner
- Credible reform would simultaneously [lower rates and eliminate the tax loopholes](#) that reduce federal revenue by more than \$1 trillion each year. These loopholes seldom accomplish their stated legislative intent and encourage “gaming” the system by those in a position to take advantage, often resulting in cronyism and the capture of the tax code for private gain.

Sleight of Hand

Proposes further complicating and increasing uncertainty in the tax code by adding more special-interest, temporary tax breaks; tax increases to “fix” the economy, deficits, or both; tax increases to chase additional spending; and tax increases to achieve social policy aims.

- “It’s [non-millionaires who will likely pay](#) for tax hikes on the rich in the form of lower wages, higher prices, and fewer jobs. And it’s fantasy to suggest taxing the rich is a solution to the looming explosion of spending and debt. No set of numbers can make that calculation add up.”—Veronique de Rugy

- Sleight of hand presumes to collect revenues above 19 percent of GDP. Over the past 60 years, government revenue has historically averaged about 18 percent—*regardless* of tax levels. Pretending the federal government can not only increase taxes to any level it wishes but actually collect these purported levels of revenue ignores [decades of evidence to the contrary](#).

Budget Process/Sound Accounting

Credible Reform

Includes credible enforcement mechanisms for near- and long-term spending reforms. Gives credibility to the BCA's spending caps by tightening the [definition and enforcement of "emergency" spending](#)—two of the biggest loopholes through which Congress spends beyond the budget limits on items that are often neither an 'emergency' nor related to any unforeseeable disaster. Also includes a realistic fund for these categories based on average prior-year spending levels.

- Of particular concern in the coming years will be attempts to backfill reduced discretionary spending by declaring such spending in response to an emergency.

Sleight of Hand

Characterizes spending below the increases anticipated prior to the BCA and sequester as "cuts"; counts as "new" cuts from the BCA and sequester; pretends "war savings" are actual savings and "doc fix" savings will materialize; employs phony savings to get around budget caps.

- "It's a huge stretch to count as 'savings' future war spending that was never going to happen. And Congress will likely blow through even these pretend savings by continuing to stuff every 'emergency war funding' bill with spending that has nothing to do with either emergencies or war. These 'war savings' will never materialize."—Veronique de Rugy
- "No one should count on the '[savings](#)' that would require a 25 percent cut to doctors' reimbursement fees for Medicare. Lawmakers have 'fixed' this cut every year for the past decade. They need to stop pretending it's real, or they need to push for the cut and then explain to Medicare patients why it will be so hard to get a doctor's appointment."—Veronique de Rugy
- Relies on "changes in mandatory programs" (CHiMPs) to increase discretionary spending beyond budget limits.
 - This accounting gimmick takes one-time savings from mandatory programs—which are fully restored the next year—then transfers those "savings" to the discretionary side of the ledger to offset spending above budget limits. Worse, these phony CHiMPs savings get included in the next year's discretionary spending baseline, resulting in permanent increases in discretionary spending.

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