PART 3

The Federal Budget

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

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Reforming CPI: Not a "Grand Bargain" but a Prudent Reform

This article was originally published at E21 on July 12, 2011.

The consumer price index, used not only to calculate Social Security COLAs but also to index many other federal operations, is one of several federal policy issues that inevitably engender widespread confusion. Press coverage around the time this article was published depicted a recent presidential proposal to employ a reformed CPI in a variety of ways: as a policy concession by President Obama to congressional Republicans, as a first move on major entitlement reform, and as a cruel cut in seniors' Social Security benefits.

As this piece explains, the proposals under consideration were none of those things: CPI reform favors neither Democrats nor Republicans because it has roughly equal effects on spending and revenues. It is also not a major entitlement program reform but simply a technical correction to reflect wide expert agreement that the inflation indices currently in use tend to overstate national price inflation. As the title of this article states, reforming CPI would be a prudent move, but has little to do with any grand fiscal bargain between the political parties.

RECENT REPORTS INDICATE THAT THE BUDGET/DEBT NEGOTIATIONS will not produce a "grand bargain."[1] At best, they will produce a smaller set of targeted reforms slightly improving but not correcting the unsustainable trajectory of federal finances. But whether the budget discussions produce a big deal or a small one, both sides would do well to implement a more accurate measure of economy-wide inflation, namely the "chained" C-CPI-U.

Basic Background

Many aspects of federal law, from income tax brackets to Social Security payments, are indexed to grow each year with price inflation—more specifically with the consumer price index (CPI). There are different versions of CPI now in use, including CPI-U (measuring inflation facing all urban

1. Scott Wilson and Lori Montgomery, "Debt Reduction Talks in Limbo as Clock Ticks toward Aug. 2 Deadline," *Washington Post*, July 10, 2011.

consumers) and CPI-W (measuring inflation facing urban workers). Some programs use one of these and some the other, but generally the two are close in value anyway.

Over the years, many economists have noted that these measures tend to overstate actual price inflation as felt by consumers. Simplifying considerably, this is because the rising price of one item often causes consumers to buy a different item instead—one whose price hasn't risen as much. The mix of items that consumers buy thus changes over time, meaning the increase in the total cost of living is less than if no purchase substitutions had occurred.

Over the years the Bureau of Labor Statistics, which calculates these various inflation measures, has implemented improvements to correct for these changes in buying patterns. The current CPI-U and CPI-W, however, do not adequately account for changes across purchasing categories. That is to say, consumers don't limit their purchasing substitutions merely to other items within the same spending category; they also shift their purchasing preferences between categories according to inflation trends within each. To address this, the Bureau of Labor Statistics developed another index known as the superlative or chained CPI (C-CPI-U), which accounts for cross-category substitutions.

This C-CPI-U has averaged something close to 0.3 percentage points per year less than CPI-U or CPI-W in the years since 2000.[2] Advocates of its adoption across federal programs argue that not only would C-CPI-U more faithfully reflect inflation than measures now in use, but it would substantially reduce federal deficits as well due to its effects on outcomes ranging from income tax bracket growth to Social Security COLAs.

Press articles recently reported that the Obama administration suggested the adoption of chained CPI in the ongoing budget discussions. Unfortunately, the reform was described in the worst possible way—as the administration having proposed "Social Security cuts" rather than merely the next technical improvement in the implementation of current policies.[3] This led to an immediate denunciation of the idea by congressional Democrats, considerably lessening its chances of being adopted.[4]

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2. Adam Rosenberg and Marc Goldwein, "Measuring Up: The Case for the Chained CPI," Moment of Truth Project, May 11, 2011.

3. Lori Montgomery, "In Debt Talks, Obama Offers Social Security Cuts," *Washington Post*, July 6, 2011.

4. Robert Pear, "Democrats Oppose Talk of Cuts to Social Security," *New York Times*, July 7, 2011.

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This is highly unfortunate, as CPI’s refinement is a reform whose time ought to have come. It would improve the accuracy of federal processes, improve the budget outlook, and serve the interests of negotiators on both sides of the table. It is strongly to be hoped that the option can be kept alive. The following are some reasons why.

C-CPI-U Is the Most Accurate Available Estimate of Economy-Wide Inflation

Some federal policies (like the fixed income thresholds for the recently enacted 0.9% Medicare surtax) aren’t indexed at all. Others (like Social Security’s benefit formula) are indexed to wage growth. But currently expressed policy in many other areas of the federal budget is to index for general price inflation, no more and no less. To use the best available measure of such inflation is therefore not a “benefit cut” or a “tax increase” as much as it is the most faithful available method of complying with the policy basis of various statutes.

CPI-U and CPI-W weren’t originally inserted into existing laws because their sponsors thought that they overstated inflation; they were inserted because the sponsors were attempting to capture inflation, and those metrics were the best available at the time. To now use the more recently developed C-CPI-U is, in effect, to better conform these various aspects of federal law to congressional policy intent.

The Purpose of CPI-Indexation Is Not to Attain Targeted Benefit or Tax Levels

Many on the Left oppose using C-CPI-U because the continued use of CPI-W would lead to higher Social Security benefits, especially among the oldest seniors. Many on the Right are similarly concerned about C-CPI-U because continuing to use current CPI-U would constrain the growth of federal revenue collections, relatively speaking. I share the policy goals of keeping tax burdens manageable and of ensuring adequate benefits for the most vulnerable seniors. But continuing to overstate inflation is not the appropriate means of achieving these goals—even with respect to these respective policy advocates’ interests.

The policy goal of increasing benefits for the oldest seniors is more efficiently pursued by changing Social Security’s benefit formula to do so, rather than by overstating inflation in the COLAs provided to all beneficiaries.

Income taxes are also better contained by lowering marginal rates than by faulty indexing. Moreover, pressure for higher taxes is driven predominantly by growth in federal spending, and federal spending would grow faster under current CPI indexing than under an accurate CPI. Both sides of the aisle will also find it easier to argue for their respective policy priorities in an improved fiscal environment.

A case could be made that income tax levels should rise with average income, rather than prices, to prevent bracket creep from steadily increasing individual tax burdens. But as long as the current policy is to index for inflation, the most accurate available measure should be used. No particular policy rationale is served by indexing for inflation inaccurately.

The Federal Balance Sheet Would Improve, Especially over the Long Term

Deficit reduction alone is not a dispositive reason to embrace C-CPI-U. The fact that its adoption would improve the fiscal outlook is, however, a substantial benefit. To more fully appreciate this, imagine the opposite scenario: imagine that federal laws were currently indexed to C-CPI-U. A proposal to switch to CPI-U or CPI-W would then rightly be criticized both for resulting in less accurate indexing and for adding recklessly to projected long-term deficits. If C-CPI-U were the measure already on the books, there would be hardly any question that it should be the operative method going forward.

Proposals to Adopt an Alternative Measure of Inflation Would Produce Absurd Results

Some have argued that an experimental index of inflation developed specially for seniors (CPI-E) should be used to index Social Security COLAs, even though doing so would increase costs and worsen Social Security's projected shortfall. Methodologically, however, the experimental CPI-E suffers from the same problems as CPI-U and CPI-W in that it fails to account for upper-level product substitutions.

Even if the CPI-E didn't suffer from significant methodological shortcomings, however, it could not sensibly be applied to Social Security benefits. Social Security beneficiaries come in various forms, from retirees to the disabled to child survivors. It would make no methodological sense to use a purchasing index for the elderly to adjust benefits for child survivors, nor would it make sense for the young disabled. It would also create a nightmare of complexity to have different beneficiary populations using different measures of CPI, shifting between them as they move from one category to the other (e.g., from disabled to old-age benefits). The purpose of inflation indexation is not to model the purchasing patterns of every individual or subgroup but to model general price inflation, which C-CPI-U does better (even for Social Security's beneficiary population, on average) than CPI-E.

C-CPI-U Has Distributional Advantages Also

Although the method of indexation should not be chosen based on distributional considerations, it should be said in response to some concerns raised that C-CPI-U does carry distributional benefits. Lowering deficits, debt, and long-term spending levels would all reduce tax burdens on younger generations. And on the Social Security side, the biggest existing distributional inequity is the net income loss faced by younger generations as a result of the excess of benefits over taxes contributed for earlier generations. Under current benefit formulas, people who have already entered the Social Security system will receive $18.8 trillion ($2011 present value) more than the amount of taxes contributed over their lifetime, creating a deficit that would subtract roughly 4% from the lifetime wage income of younger generations, even if those generations receive all benefits now being promised.[5] We needn't "cut" the benefits for people now on Social Security, but formulaically exaggerating inflation will grossly exacerbate the program's intergenerational inequities.

CPI reform is not Social Security reform, and for both tactical and substantive reasons should never have been presented as such. By itself, it won't fix the long-term budget outlook—that task requires serious further reforms of Social Security and the healthcare entitlements. It would, however, improve the long-term outlook for the federal budget as well as for Social Security.

Not every distributional consequence of CPI reform will be to everyone's liking, but that is true of any technical refinement of the federal government's indexing methods. Altogether, CPI reform is a long-overdue correction that would serve the interests of negotiators on both sides of the aisle, of taxpayers, and of the nation as a whole.

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5. OASDI Board of Trustees, *The 2011 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, May 13, 2011, § IV.B.5.

Should Congress Change CBO's Scorekeeping Rules?

This article was originally published at E21 on May 29, 2012.

This article has proved to be one of the more evergreen pieces in this collection. The impetus for it was my earlier study of the fiscal consequences of the ACA, which showed that the ACA only appeared to reduce federal budget deficits because Congress's scorekeeping methods compared it to a somewhat contrived budget baseline rather than to the actual stipulations of prior Medicare law. I had intended that study to be explanatory rather than to advocate for a process change. However, as events unfolded, the problems with the existing scorekeeping methods and the need to change them became clearer. Several of these problems are detailed in this piece.

Since its publication, this material has taken on an interesting role, at least among budget nerds. Although some ACA advocates took umbrage at my original findings about the ACA's fiscal effects, an increasing number of people gradually accepted them. As I noted earlier (in the preface to "The Fiscal Consequences of the Affordable Care Act"), the Committee for a Responsible Federal Budget later called for the aforementioned scorekeeping loophole to be closed, and Tom Price, then chairman of the House Budget Committee, subsequently introduced legislation to do so. Others who have written in this area have also acknowledged the problematic inconsistencies in existing scorekeeping methods.

The point of this article, that Congress's scorekeeping methods distort budget policy choices and do not accurately reflect existing law, has continued to arise in other contexts. In 2017, congressional Republicans unleashed a vigorous debate among budget watchdogs about what scorekeeping baseline should be used for tax policy changes. During that debate this piece was circulated anew, to remind participants of the inconsistencies between the current scoring treatments of the revenue and spending sides, respectively, of the budget equation.

ON MAY 21, 2012, I PARTICIPATED IN A CONSTRUCTIVE DEBATE WITH JARED Bernstein,[1] sponsored by E21, about my paper, "The Fiscal Consequences

1. Jared Bernstein and Charles Blahous, "Medicare Numbers Examined: Blahous and Bernstein Discuss the Fiscal Consequences of the Health Care Law," debate sponsored by E21 (Manhattan Institute for Policy Research), May 21, 2012.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

of the Affordable Care Act."[2] For those unfamiliar with my paper, it shows that the enactment of the 2010 healthcare law will add more than $340 billion to federal deficits over the next 10 years, an adverse fiscal consequence disguised by Congress's current scorekeeping conventions.

Without getting too far into the weeds, the main scorekeeping issue involves the treatment of Medicare. Social Security and Medicare are financed under law from special trust funds and are only permitted to pay benefits to the extent that they have resources in those trust funds. The scorekeeping conventions currently in use ignore these constraints. They instead implicitly assume that all financing discipline imposed by the trust funds under current law will be overridden by future Congresses.

Relative to this hypothetical scenario, the 2010 healthcare law would indeed produce lower deficits. That scenario, however, does not represent prior law, nor does it reflect prior historical practice. Relative to actual law and to how lawmakers have operated these programs to date, the healthcare law will substantially worsen federal deficits.

During the question-and-answer period after the debate, American Enterprise Institute economist Alan Viard challenged me as to whether and how I thought these scorekeeping rules should change. I gave essentially the same answer I'd given in my paper, which is that I thought the scoring rules made sense for most policy evaluation purposes, but they simply had a drawback in the particular case of the ACA. I wasn't seeking to change them, only to inform the public of fiscal effects that they miss.

Here's how I put it in the paper:

> There are many reasons the CBO's and trustees' scoring convention is appropriate in many circumstances. Among these reasons is that without it, policymakers would not receive appropriate credit for tough choices made to correct the fiscal imbalances of Social Security and Medicare and would thus be less likely to make them. . . . Without the usual scoring convention, both CBO and the trustees would effectively assume that the program's imbalance vanishes by itself as a result of benefit cuts upon Trust Fund depletion.[3]

2. Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

3. Blahous, "Fiscal Consequences," 16.

I am now, however, reconsidering this position. The position I outlined in the ACA paper reflects my primary objective of explaining scorekeeping rules rather than criticizing them. But I am now coming around to the view that Congress should give serious consideration to changing the scorekeeping rules under which CBO operates, to reflect literal law for Social Security and Medicare in the same way literal law is reflected elsewhere in the federal budget. Here's why.

1. The Current Rules Are Internally Inconsistent

The current rules oblige CBO to take a literal view of current law in some areas but not in others. These inconsistencies are not justifiable based on past practice—quite the opposite.

Take, for example, the alternative minimum tax. Under current law, the income thresholds for this tax would capture huge numbers of new taxpayers starting at the end of this year. The current scoring rules assume this will happen, even though lawmakers have repeatedly overridden it.[4] Similarly, the current scoring rules assume that physician payments under Medicare's sustainable growth rate formula will be cut dramatically starting next year, as they would be under literal current law—even though, again, this has been repeatedly overridden.

On the other hand, the scoring rules assume that Social Security and Medicare will be allowed to spend far in excess of their trust fund resources, though this is not current law and in the past Congress has generally not overridden these constraints.[5]

In sum, the rules assume that many aspects of current law will be observed even though they have been overridden in the past, while other aspects of current law will be overridden even though they have been upheld in the past. That's a problem.

2. The Current Rules Distort Policy Decisions

Under current rules, if you want to extend current income tax rates, your proposal is scored as adding to the federal deficit. The same is true for further patches of the alternative minimum tax income thresholds or if you

4. Congressional Budget Office, "CBO's 2011 Long-Term Budget Outlook," June 2011.
5. Congressional Budget Office, "CBO's 2011 Long-Term Budget Outlook."

want to override an impending cut to Medicare physician payments. This is all defensible.

But the same rules assign no penalty to other similar actions, like overriding impending cuts in Social Security or Medicare Hospital Insurance benefits. Such overrides are selectively treated as not adding to the deficit. This inconsistent treatment distorts policy decision-making. It makes it easier to increase spending in some parts of the budget than in others, and also easier to do so than to maintain current tax policies.

3. The Current Rules Incent Irresponsible Fiscal Practices

The current rules incent lawmakers to enact the most irresponsible resolutions of Social Security and Medicare shortfalls—namely, to completely abandon all spending discipline imposed by their trust funds and to bail out the programs with debt-financed general revenue commitments. This incentive is created by the scorekeeping rules that essentially assume this outcome and thus assign no scoring penalty to it.

The rules also incent other fiscal equivalents of these irresponsible outcomes—for example, extending the spending authority of Social Security and Medicare with genuine cost-saving measures, but simultaneously spending the proceeds of those savings on other programs. This has exactly the same adverse effect on the overall budget as would the hypothetical debt-financed bailout of Social Security and Medicare described in the previous paragraph. A version of this tactic was employed, unfortunately, in the 2010 healthcare law.

4. The Current Rules Dampen the Urgency That Should Appropriately Be Associated with Impending Insolvency of Social Security and Medicare

There is a lot of discussion right now about the impending fiscal "cliff" if certain tax and spending provisions are allowed to expire at the year's end. But there are other cliffs looming in the years to come—among them sudden reductions in Medicare HI spending in 2024 and sudden cuts in Social Security disability benefits in 2016. Awareness of these "cliffs" is dimmed because our so-called current-law baseline doesn't show the cuts happening, even though under law they would.

Nor do current methods reflect the additional spending authority granted whenever Medicare or Social Security are permitted to pay additional benefits for more years into the future, as the healthcare law did by extending Medicare HI solvency from 2016 to 2024. With other programs, we generally show the consequences of impending cuts and the budgetary costs of postponing them; we don't with Social Security and Medicare.

5. The Current Rules Allow for Misleading, Demagogic Politics

To take but one example: proponents of Social Security reform are often attacked for proposing to cut future benefits by huge amounts, when they would do no such thing. There have been claims this year, for example, that certain political candidates' proposals would cut Social Security benefits by 40%.

These claims are nonsensical. They are produced by comparing benefits under a proposed, solvent Social Security system with benefits currently "scheduled" for some long-distant year like 2085 but that would not be paid under existing law. Scorekeeping rules ought not to legitimize the demagoguery of claims that benefits would otherwise be paid where there is no legal authority to do so.

One argument against changing the rules to reflect literal current law that incorporates impending benefit cuts in Social Security and Medicare is that this scenario is both politically unrealistic and paints an overly rosy fiscal picture. As some critics pointed out in response to my study, much of our projected fiscal problem disappears if one assumes that current law plays out exactly as written.[6]

This isn't, however, a good reason to keep using a current-law baseline that reflects current law only in certain selective ways. First, realistic or not, lawmakers should know what current law requires. Second, CBO can elsewhere inform lawmakers of the costs of unfunded Social Security and Medicare benefit promises in its alternative fiscal scenario, just as it does with other reasonably probable overrides of existing law. Third, we already know that the current-law scenario is politically unrealistic: it still ought to

6. Committee for a Responsible Federal Budget, "The Affordable Care Act and the HI Trust Fund," April 10, 2012.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

be applied consistently across federal programs. Surely it ought to include financing constraints that have historically been respected if it also includes many that have not been.

In sum, our current scorekeeping rules are internally inconsistent, they create an unlevel playing field between policy choices, they incent irresponsible fiscal practices, and they can too easily be used to support misleading political demagoguery. By employing a baseline that more accurately reflects current law, the fiscal picture would indeed look unrealistically rosy—but the fiscal consequences of costly budget gimmicks would be far more transparent. For these reasons—and certainly before the next round of possible changes to Social Security and/or Medicare—Congress should carefully consider changing its scorekeeping rules.

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How Did Federal Surpluses Become Huge Deficits? (Hint: It Wasn't Because of Tax Cuts for the Rich)

This article was originally published at E21 on August 20, 2012.

Among the best subjects for a writer to address are those about which the writer believes that the conventional wisdom is wrong. I'm not suggesting that writers should take pleasure in being contrarian. Rather, I mean that when a writer already agrees with the conventional wisdom, there is simply less value he or she can add by writing about that topic. It's best to engage a subject when the ongoing national dialogue is missing something important.

This piece was written to address such a subject. During the administration of George W. Bush, a significant amount of press coverage bought into opposition spin that a benign federal fiscal outlook had been recklessly destroyed by President Bush's irresponsible tax cuts for the rich. The truth was much more complicated, and bore scant resemblance to that story.

The article walks through, in rather picayune detail, the various factors that changed the fiscal outlook from one of permanent surpluses to large permanent deficits. The bottom line: yes, tax relief played a role, but it was less than one-quarter of the story, and the Bush administration wasn't even responsible for all of that portion. The vast majority of the deterioration in the fiscal outlook was attributable to subsequently enacted spending increases and simple CBO projection error.

NONPARTISAN ANALYSTS AGREE THAT THE FEDERAL GOVERNMENT faces an enormous budget shortfall.[1] This shortfall cannot be resolved unless we accurately diagnose its causes and devise solutions that address them.

Discussions about federal deficits too often feature partisan blame-laying when what is needed is problem-solving analysis. To prevent a future fiscal meltdown, we must address the causes of unsustainable future deficits. On this question there is little disagreement among nonpartisan scorekeepers. The Congressional Budget Office projections show that future fiscal strains

1. Congressional Budget Office, "CBO's 2012 Long-Term Budget Outlook," June 2012.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

will be driven almost entirely by growth in federal entitlement spending, driven in turn by population aging and by the growth of federal health benefits per capita. Under current law, the projected problem is not one of insufficient taxes (which would grow to far exceed historical norms) or appropriated spending (which would shrink relative to the economy). Seriously addressing the long-term fiscal problem means restraining entitlement spending growth, plain and simple.

We spend a great deal of time, however, debating not the future of the budget but past policy choices. How is it that we have such large deficits already? The two parties debate this in part to establish their own relative credibility as future stewards of the nation's finances. This debate also affects perceptions of which policies are thus far "at fault," and thus of who can fairly be asked to sacrifice going forward.

This discussion often intensifies when the time comes to decide whether to continue a current policy, repeal it, or allow it to expire. Two prominent examples are current income tax rates (which many Democrats argue should rise via expiration) and the 2010 healthcare reform law (which many Republicans argue should be repealed). Even in this context, however, there's a limit to how useful a debate about the past can be. Most of the 2010 healthcare reform law's costs, for example, haven't yet begun to show up on the federal ledger and thus are missed in any discussion of past or current deficits. But the debate over the past will always continue. As long as it does, we all have a stake in having an accurate picture of how things have played out so far.

One of the most common narratives about the federal budget is as follows: back in the halcyon days of early 2001, we were facing large surpluses lasting as far as the eye could see; by a series of policy blunders, these were transformed into the gargantuan deficits we see today. The two parties naturally blame one another for the fiscal deterioration. But objectively, what happened to turn those projected surpluses into huge deficits?

Thanks to a recent report from CBO, we now have a comprehensive, nonpartisan answer to that question. I will walk through it step by step, using graphs to illustrate the CBO findings.[2]

The order in which one does this can affect one's impressions of the analysis. So first I will do it one way, then at the end of this piece I'll show

2. Congressional Budget Office, "Changes in CBO's Baseline Projections since January 2001," June 7, 2012.

the reverse view. On the first run-through, I'll hold the 2001–2003 tax reductions (the so-called Bush tax cuts) for last, to isolate their effects. I do this in deference to the rhetorical attention that this tax relief has received as a possible contributor to our current fiscal problem.

First, let's compare the 2001 projections as a whole to what actually happened. As shown in figure 1, in 2001 CBO was anticipating a total of $5.6 trillion in surpluses from 2001 to 2011, including a surplus of nearly $900 billion in 2011 alone. Instead, we ran $6.1 trillion in deficits, including deficits exceeding $1 trillion in each of the years from 2009 to 2011. This was a dramatic worsening of our fiscal outlook.

The first thing to understand is that, like most projections, the 2001 projections were simply wrong. CBO now identifies over $3.2 trillion in "economic and technical changes" in the subsequent projections, a polite way of saying "correcting for prior projection inaccuracy." So, even if there had been no tax relief or additional spending, a good portion of 2001's projected surpluses would never have materialized. Had this then been known, the 2001 outlook would have looked like the solid gray line in figure 2. (In all of these graphs, for consistency, the bottom "actual" line will be a dashed gray line.)

Forecasters in early 2001 failed to anticipate the bursting of the 1990s' dot-com stock bubble, which by itself eliminated the surpluses projected for

Figure 1. Federal Surpluses and Deficits, 2001–2011

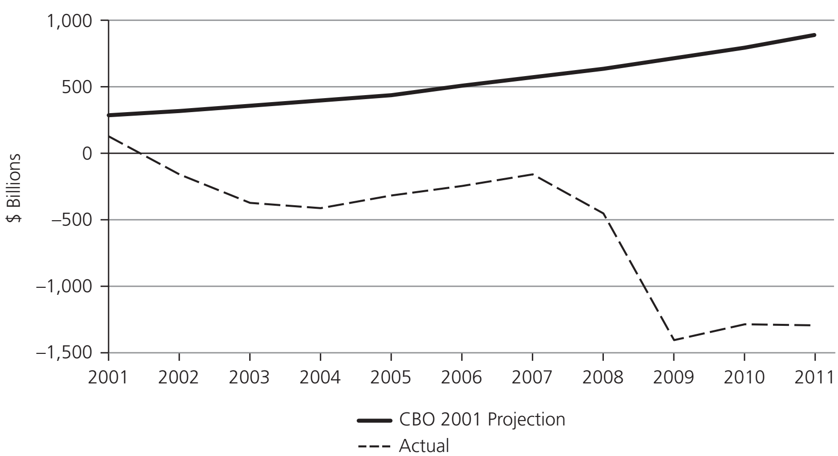
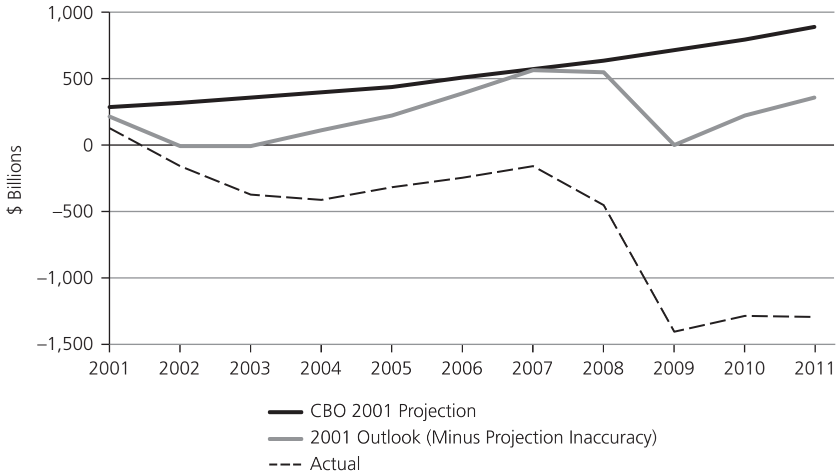


Figure 2. Federal Surpluses and Deficits, 2001–2011



2002 and 2003. The 2001 projections also contained other inaccuracies, and (understandably) failed to anticipate our most recent recession.

One major factor that worsened the fiscal outlook was a large increase in federal discretionary spending. Much of this, of course, happened after the United States was attacked on September 11, 2001. The United States thereafter conducted major military operations in Afghanistan and Iraq, and also increased expenditures on homeland security. These policies were enacted with bipartisan support, including bipartisan decisions to add their costs to the federal deficit. Discretionary spending increases further accelerated in 2009–2011. (See figure 3.)

There were other spending increases as well, in mandatory spending. Three significant increases involved the Medicare prescription drug benefit, the Troubled Asset Relief Program (TARP) financial sector bailout, and the 2009 stimulus. First I'll add the effects of all mandatory spending increases other than these three big-ticket items: see figure 4. Then I'll add in TARP (the financial sector bailout), which mostly just moves the 2009 number: see figure 5. Next I'll include President Obama's 2009 stimulus package, which added to the 2009–2011 deficits: see figure 6. (See how the thin black line is below the heavy dashed black line in 2009–2011.)

Figure 3. Federal Surpluses and Deficits, 2001–2011

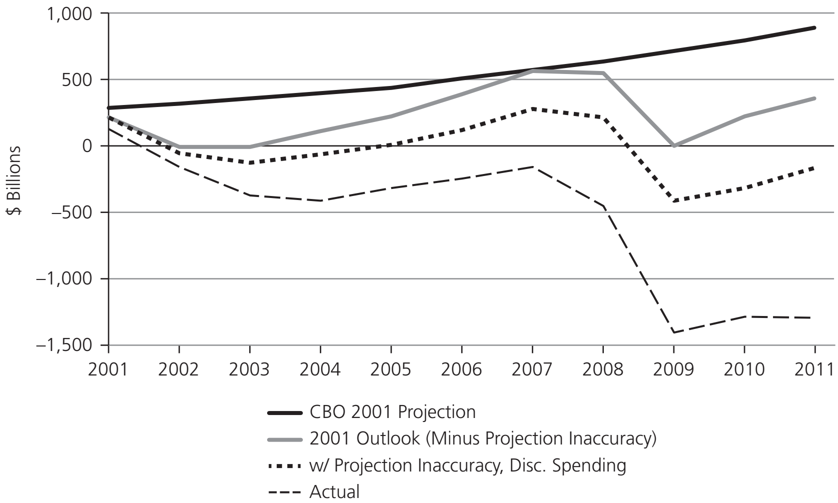


Figure 4. Federal Surpluses and Deficits, 2001–2011

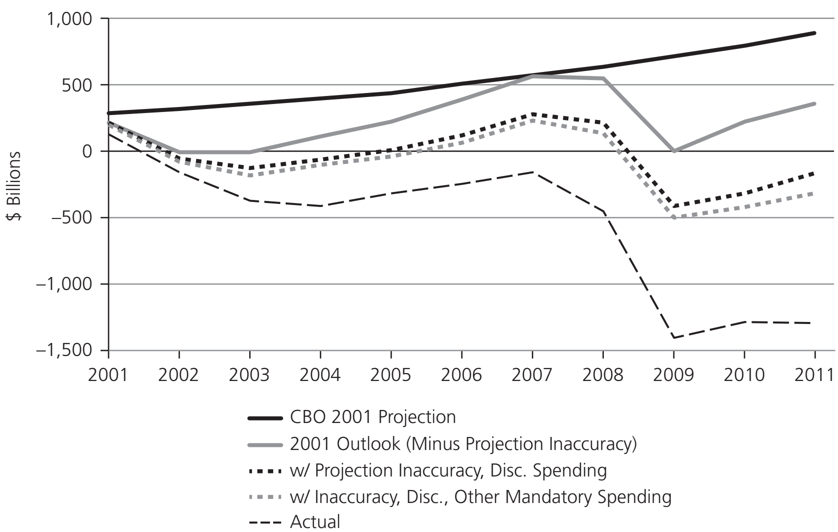


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Figure 5. Federal Surpluses and Deficits, 2001–2011

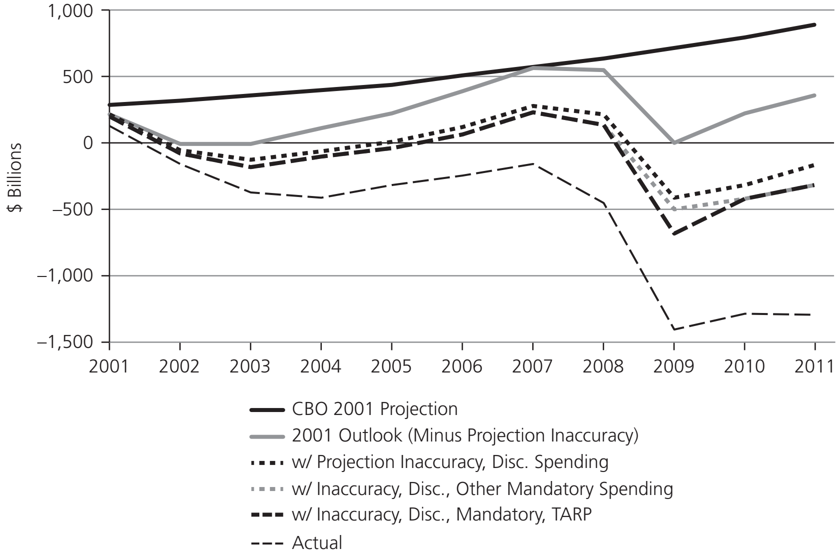
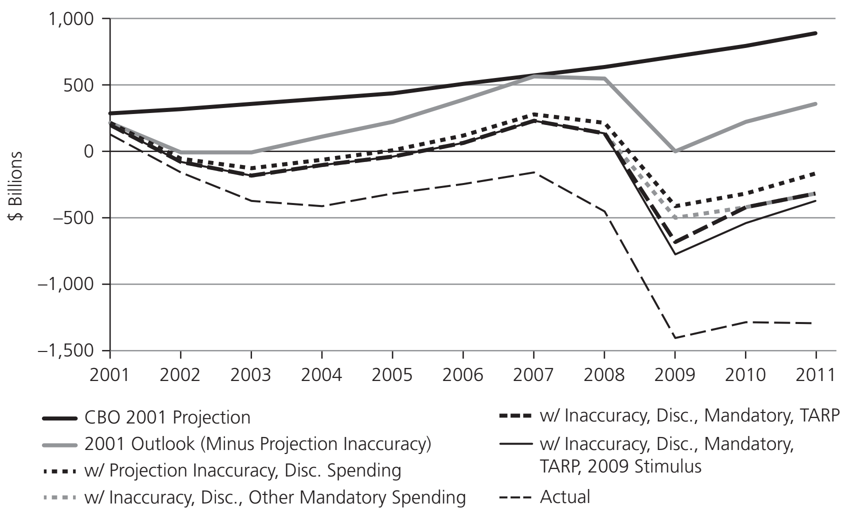


Figure 6. Federal Surpluses and Deficits, 2001–2011



I've held the Medicare prescription drug benefit for last among the spending items because of the attention it has received as a contributor to deficits. Including it completes the changes in the outlook due to noninterest spending: see figure 7.

We have another spending component to add: interest on the debt. Though both spending and revenues affect the size of the debt, interest payments are classified as mandatory spending. Adding in the effects of interest payments, we have incorporated all the subsequent worsening of the 2001 outlook arising from projection errors and additional federal spending: see figure 8.

That's a lot of lines for one graph, so I'll clean it up. Figure 9 summarizes all changes to the 2001 fiscal outlook arising from increased federal spending and corrections of projection inaccuracy. Again, the heavier dashed line at the bottom is what actually occurred, while the lighter dashed line just above it is where we would have been based on spending increases and projection corrections alone.

Let's look a bit closer at figure 9 before moving on. A few critical points are clear. One is that the two dashed lines are qualitatively similar: that is, the vast majority of the deterioration in the fiscal outlook would have occurred

Figure 7. Federal Surpluses and Deficits, 2001–2011

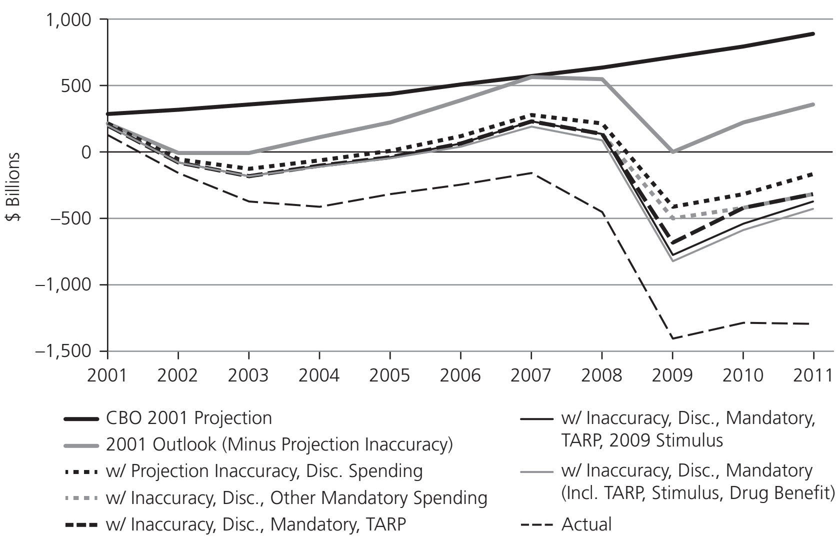


Figure 8. Federal Surpluses and Deficits, 2001–2011

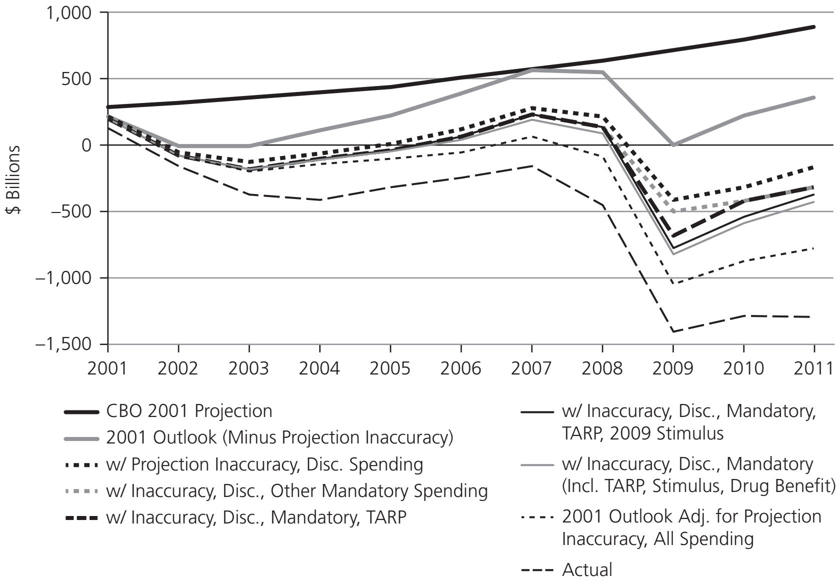
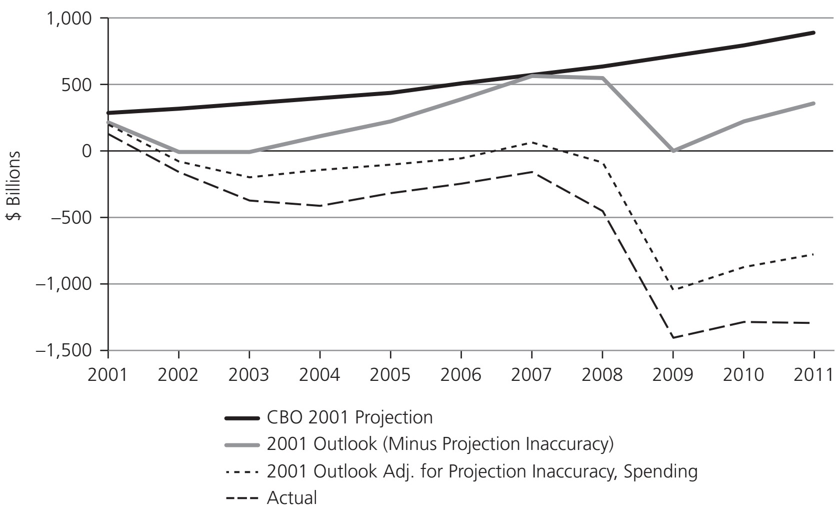


Figure 9. Federal Surpluses and Deficits, 2001–2011



even if there had been no tax relief in 2001 or 2003. This is first because the 2001 projections were quite wrong and second because federal spending increases were more than sufficient to eliminate projected surpluses.

Let's now look at the often-discussed effect on the deficit of the 2001–2003 tax relief laws, and of their extension in 2010. I'll isolate the effect of the 2001, 2003, and 2010 laws by first incorporating the effects of all other tax legislation enacted since 2001—including the 2004 Working Families Tax Relief Act, the 2008 stimulus, and the tax portion of the 2009 stimulus. The result is shown in figure 10.

So, how much did the 2001–2003 tax cuts contribute to our current budget predicament? The difference between the bottom two lines in figure 10 represents the maximum possible answer. The bottom darker dashed line shows the deficits we've had. The lighter dashed line just above it shows the deficits we would have had without the 2001, 2003, and 2010 tax relief laws. Clearly, the post-2001 fiscal deterioration had comparatively little to do with the 2001–2003 tax cuts.

A few words of clarification are in order on the difference between the bottom two lines in figure 10. The tax rates created in 2001 and 2003 were extended by another law in 2010. That law also contained other unrelated tax reductions, including a significant Social Security payroll tax cut. Thus, even if one counts the 2010 extension as part of the "cost" of the 2001–2003 tax cuts, the narrow difference between the bottom two lines in figure 10 is actually somewhat larger than the 2001–2003 tax relief's total fiscal effect.

The CBO report allows us to sum the reasons that the surpluses projected in 2001 never transpired.[3] Figure 11 summarizes CBO's findings. Roughly half of the reason the surpluses never materialized is that federal spending was subsequently increased. (Over half of this total increase was concentrated in the three years of 2009–2011.) A little over one-quarter of the projected surpluses disappeared because of subsequent corrections to the 2001 projections. Less than one-quarter of the fiscal deterioration was due to tax relief of any kind—and only a little more than half of that small fraction is directly attributable to the 2001 and 2003 tax relief packages (see figure 12).

My goal in this analysis has been to isolate the effects of the 2001–2003 tax cuts by showing where we would have been without them. Now I'll take

3. Congressional Budget Office, "Changes in CBO's Baseline Projections since January 2001."

Figure 10. Federal Surpluses and Deficits, 2001–2011

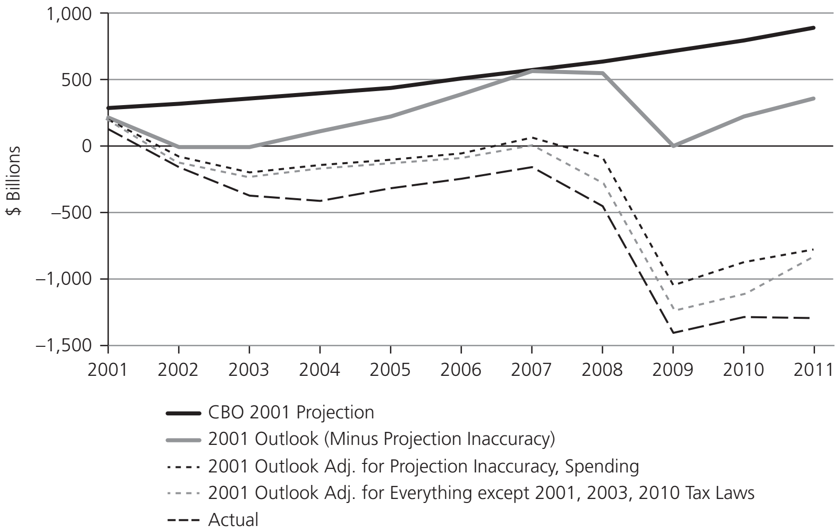


Figure 11. Federal Surpluses and Deficits, 2001–2011

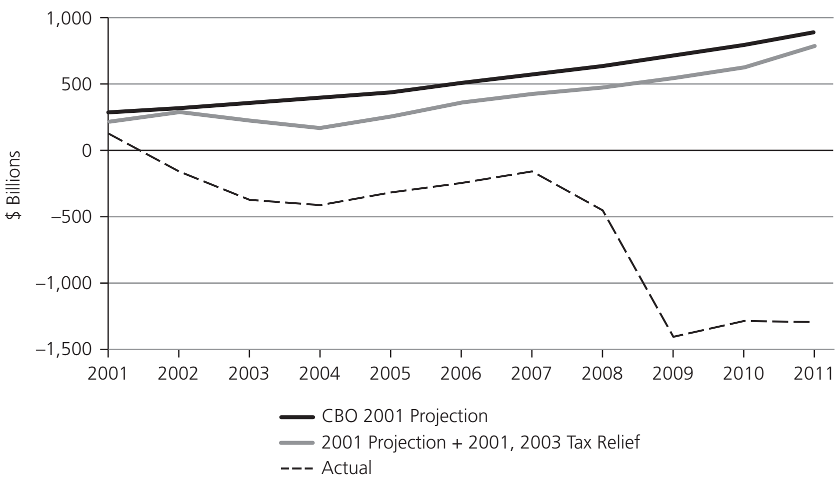
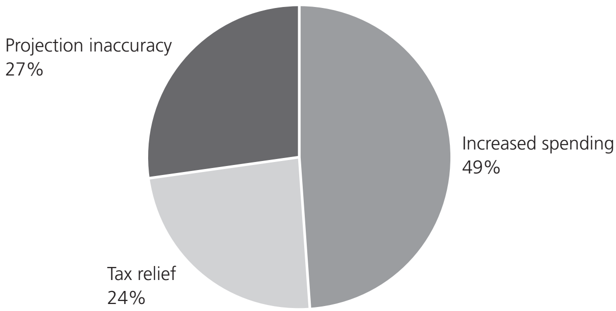


Figure 12. Reasons for Deterioration of Surpluses Projected in 2001



exactly the opposite perspective. Let's assume that only the 2001–2003 tax cuts had been enacted, with no other changes in spending or in the underlying projections. Had that been the case, our budgetary situation would have looked like figure 11.

As before, the bottom line shows what actually happened. The middle line, rising nearly as rapidly as the top one, shows the rising surpluses that would have occurred if tax relief had been the only change to the 2001 outlook.

There are thus two opposite ways we can look at the effect of the 2001–2003 tax relief on our current fiscal situation:

- Had the tax relief never been enacted but had everything else happened as it has, we still would face enormous deficits today.
- Had only the tax relief been enacted, we would still have enjoyed large and growing surpluses.

Various advocates have their own reasons for wanting the tax rates established in 2001 and 2003 to either be extended or expire. But the CBO analysis should finally put to rest any misperception that tax cuts were the leading driver of our currently enormous budget deficits.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

The Federal Fiscal Predicament: What Seems Better Is Actually Worse

This article was originally published at E21 on June 27, 2013.

In recent years behavioral economists have been especially prolific and interesting, explaining to us why what we believe to be true so often isn't. One of the more peculiar manifestations of this phenomenon occurred during the second term of the Obama administration, when many press reports—influenced by aggressive political messaging—adopted the viewpoint that the federal fiscal outlook was becoming benign and federal finances no longer needed to be a subject of national concern.

This was, of course, untrue. Federal finances were on an unsustainable, troubling trajectory even before the Great Recession of 2007–2009 began, and the recession (along with the federal policy response to it) made the fiscal outlook far worse. After the recession, federal finances recovered somewhat, as they always do—but still remained far worse than what most everyone had agreed was a dire outlook before the recession hit. In other words, the recession had made a bad situation far worse on balance, but because it had made things temporarily even worse than that, much of the nation irrationally (but naturally) perceived the situation as improving. This piece walks through what exactly had happened and why the US fiscal situation isn't actually "better" simply because things had temporarily looked even worse.

OF LATE THERE HAS BEEN A GREAT AMOUNT OF DISCUSSION ABOUT whether federal deficit reduction should remain a national policy priority. While bipartisan fiscal watchdog groups like the Committee for a Responsible Federal Budget continue to argue that it should be, there have been plenty to argue that it should not.[1] Some of the latter have even suggested that the deficit problem is now essentially under control, and that arguments to

1. Committee for a Responsible Federal Budget, "The Debt Won't Magically Solve Itself," June 18, 2013; Paul Krugman, "Fight the Future," *New York Times*, June 16, 2013; Michael Linden, "It's Time to Hit the Reset Button on the Fiscal Debate," Center for American Progress, June 6, 2013.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

contain further federal debt accumulation serve a "political calculus" rather than a substantive need.[2]

The debate is intriguing because of what it reveals about the complex relationship between perceptions and reality. To gain some perspective on this, consider the projection of federal debt as a percentage of GDP shown in figure 1.

Virtually any economic policymaker would look at this projection and see cause for deep concern. It shows federal debt rising uncontrollably in relation to our total economic output, a trend that can only result in a crowding out of national savings, slower economic growth, lower standards of living, and an ultimate inability to sustain our debt payments.

This projection was in fact made. And when it was, there was wide agreement that it represented an unsustainable fiscal situation that threatened our economic well-being and warranted legislated corrections. Peter Orszag, then director of the Congressional Budget Office, testified about this projection that "a substantial reduction in the growth of spending, a significant increase in tax revenues relative to the size of the economy, or some combination of the two will be necessary to maintain the nation's long-term fiscal stability."[3] The Brookings Institution's Tax Policy Center also declared flatly of this projection, "current budget policy is not sustainable."[4] They, and many others who made similar statements, were right.

The projection displayed in figure 1 and referenced in the aforementioned quotes is actually from CBO's *The Long Term Budget Outlook*, published in December 2007—specifically from its fiscal scenario that assumed the continuation of then-current tax and spending policies.[5] (That fiscal scenario was widely held to be more realistic than CBO's other "extended baseline" scenario in which, among other unlikely outcomes, then-current tax rates would all have been allowed to expire at the end of 2010.[6] Throughout this

2. Ezra Klein, "How Republicans Stopped Worrying and Learned to Love Big Government," *Washington Post*, June 21, 2013.

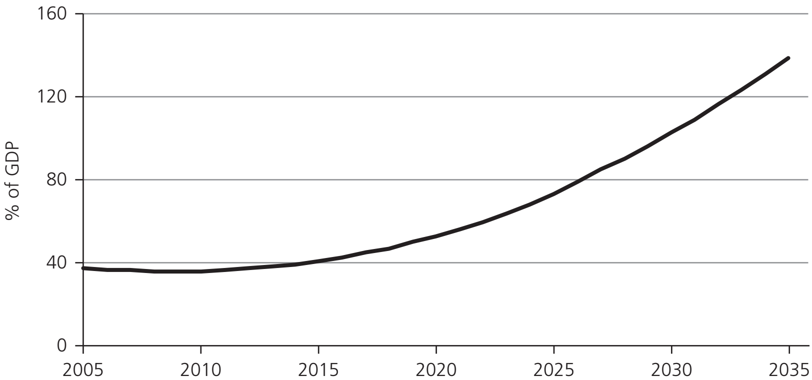
3. Quoted in Abisalom Omolo and Andrew Taylor, "Congressional Budget Office Predicts Deficit Will Rise to $250 Billion for This Budget Year," *Indiana Daily Student*, January 23, 2008.

4. Tax Policy Center, "The Tax Policy Briefing Book: A Citizens' Guide for the 2008 Election and Beyond," Urban Institute and Brookings Institution, December 31, 2007.

5. Congressional Budget Office, "The Long Term Budget Outlook," December 2007.

6. Richard Kogan and Gillian Brunet, "How Projected Surpluses Became Deficits," *Center on Budget and Policy Priorities*, September 12, 2008; Tax Policy Center, "The Tax Policy Briefing Book."

Figure 1. Federal Debt as a Percentage of GDP, December 2007 Projection



article I will refer to various updates of CBO's projections; to maintain consistency I will always refer to this particular projection scenario.)

What has happened since these dire projections were released? The fiscal picture has become worse—much worse. The worsening was due to the severity of the Great Recession, the tepid recovery that followed it, and aggressive federal deficit spending in response to it. The fiscal picture deteriorated markedly from December 2007 to June 2009, as shown in figure 2's updated projections for federal debt.[7]

This worsening happened because, between these two CBO reports, the federal government engaged in a burst of deficit spending partially caused by, and partially a deliberate policy response to, the recession. Though some argued that the long-term fiscal picture might actually be improved by increased federal "stimulus" spending in the near term, the spending binge greatly accelerated the approach of the previously projected debt crisis.

One additional year later—as of June 2010—nothing had happened to improve the fiscal outlook.[8] Instead, projections of federal debt accumulation had grown slightly worse. (See figure 3.)

7. Congressional Budget Office, "The Long-Term Budget Outlook," June 2009.
8. Congressional Budget Office, "The Long-Term Budget Outlook," June 2010.

Figure 2. Federal Debt as a Percentage of GDP

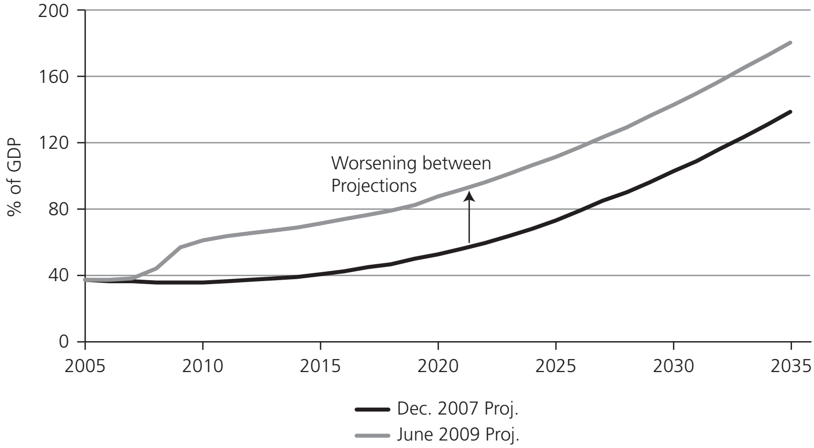
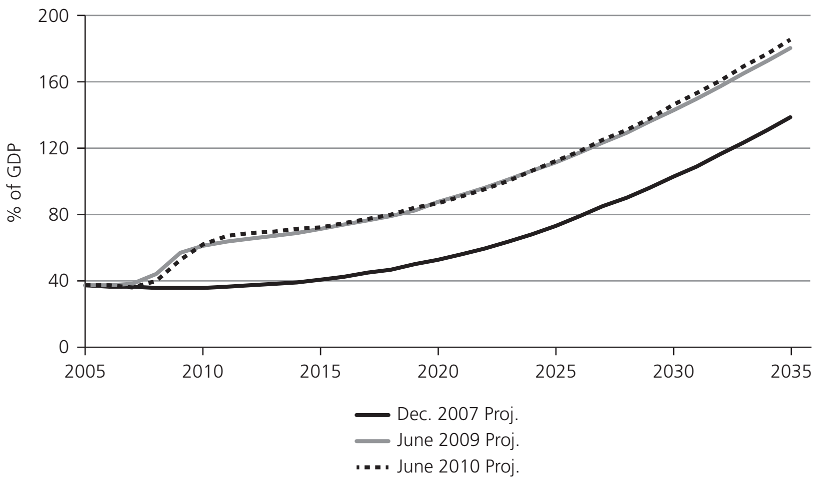


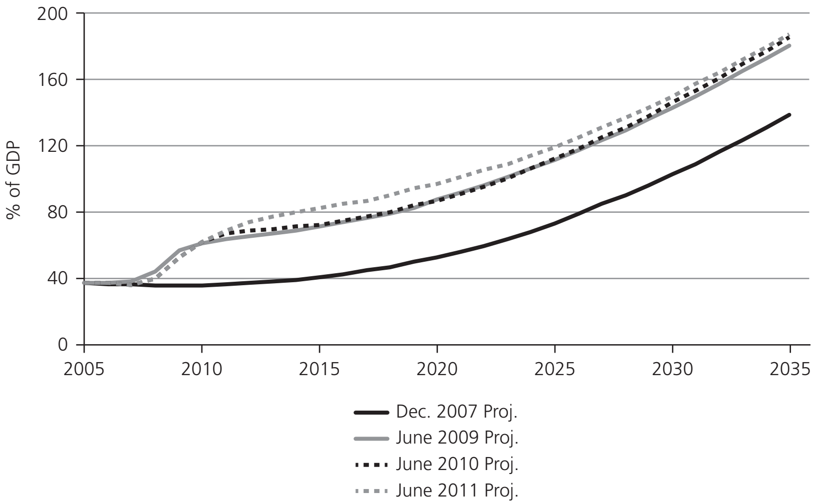
Figure 3. Federal Debt as a Percentage of GDP



CBO next updated these long-term projections in June 2011.[9] Doing so showed that the long-term fiscal picture had grown still worse, with the near-term debt picture looking substantially worse. (See figure 4.)

9. Congressional Budget Office, "CBO's 2011 Long-Term Budget Outlook," June 2011.

Figure 4. Federal Debt as a Percentage of GDP



In June 2012, CBO updated its long-term projections again.[10] The worsening of the near-term outlook shown in its 2011 report remained on the books. The long-term picture remained extremely bleak: slightly better than in the 2011 and 2010 reports (due in part to some fiscal discipline enacted as part of the 2011 Budget Control Act), but a little bit worse than the 2009 projections and still much worse than the late 2007 projections that had been understood to represent a dire fiscal threat. (See figure 5.)

CBO has not yet updated its long-term budget outlook published in 2012.[11] Its latest projections show the projected fiscal outlook over just the next 10 years (through 2023).[12] Figure 6 cuts off at year 2023 for that reason. That's a lot of clutter for one graph, so let's reduce it to two lines—the earliest projection and the latest one—to see how things have evolved since we were warned of an unsustainable fiscal outlook in December 2007: see figure 7.

Figure 7 shows that we are in much worse fiscal shape now than we thought we would be before the Great Recession hit, though even back then

10. Congressional Budget Office, "The 2012 Long-Term Budget Outlook," June 2012.

11. Douglas W. Elmendorf, Congressional Budget Office Director, to Paul Ryan, Speaker of the House, June 13, 2013.

12. Congressional Budget Office, "Updated Budget Projections: Fiscal Years 2013–2023," May 2013.

Figure 5. Federal Debt as a Percentage of GDP

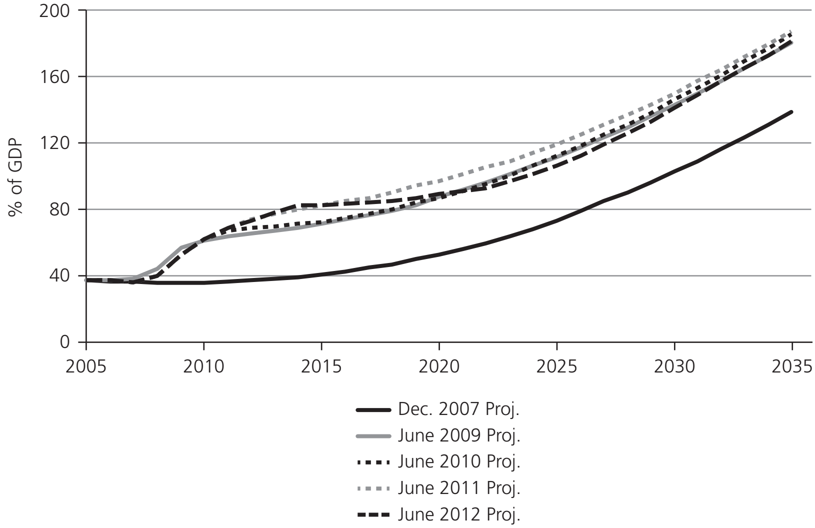


Figure 6. Federal Debt as a Percentage of GDP

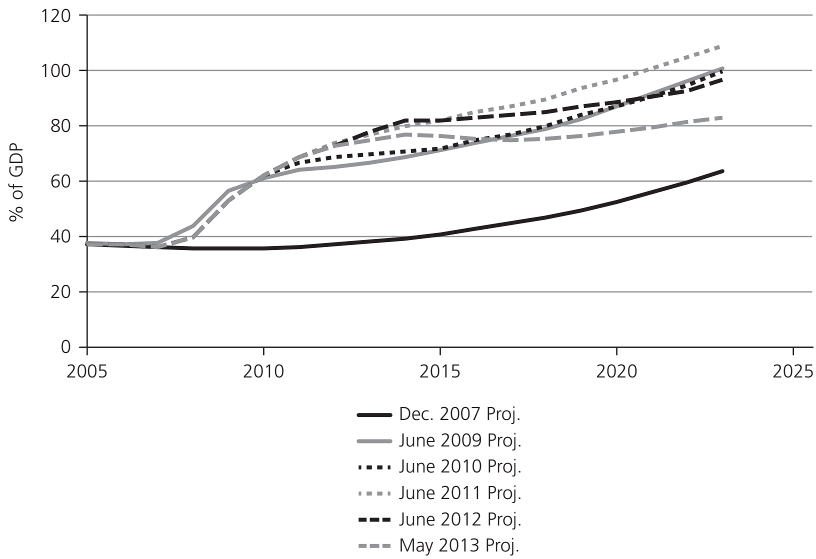
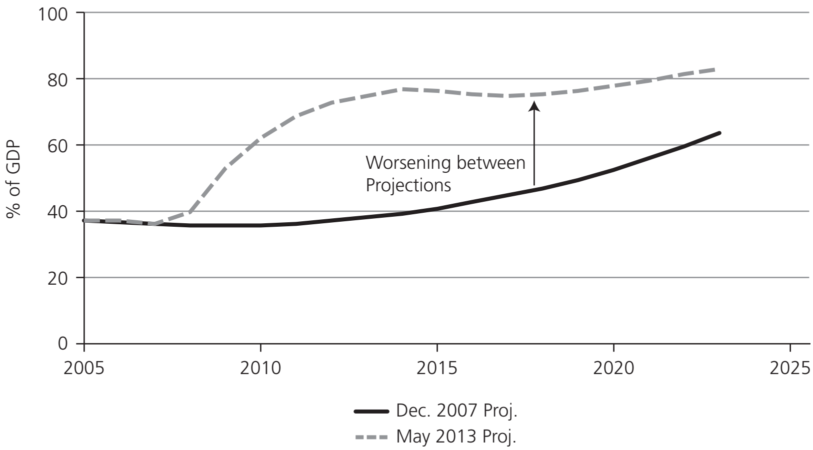


Figure 7. Federal Debt as a Percentage of GDP



it was understood that our fiscal path was unsustainable. Following are some of the salient details of the comparison:

- Our near-term debt situation is now much worse than was foreseen at that time.
- Our long-term debt outlook is also worse than was foreseen at that time.
- The fiscal picture has grown so much worse that federal debt as a percentage of GDP has already far surpassed levels that the dire projections of late 2007 didn't foresee happening until more than a decade from now.
- By any objective measure, if the fiscal picture was serious in late 2007 and warranted substantial deficit-reduction measures, it is far more serious now and requires more aggressive corrections.

Despite all this, as mentioned above, there are some today who are arguing that the fiscal challenge is now so well under control that policymakers should put it aside for now and concentrate on other concerns.[13] Given the data, how can this be?

13. Michael Linden, "It's Time to Hit the Reset Button on the Fiscal Debate," Center for American Progress, June 6, 2013.

The answer may be rooted in the cognitive phenomenon of "anchoring," well-known in behavioral economics. Anchoring is basically a cognitive illusion in which an initial perception distorts our evaluation of subsequent data.[14] An individual who believes he will end a transaction with $10 but comes away with $50 is happy. The same individual, if he previously believed he would end the transaction with $100, will come away unhappy with the same $50. The actual welfare of the individual is the same in both cases, but his subsequent attitude about the transaction is heavily influenced by his prior expectations.

Since December 2007 we've had several CBO reports in which the fiscal outlook has grown much darker, but also some recent ones in which it briefly appeared a little bit worse than it now is. This phenomenon can create skewed perceptions of federal finances. The last few years of massive deficit spending have objectively made our fiscal situation much more problematic. But at the same time, they have caused the large deficits we now continue to run to be misperceived by some as a return to reasonable fiscal health.

Rationally, it cannot be the case that our fiscal situation was made better by being made worse. But that is exactly the misperception that our last few years of massive deficit spending have apparently created in some quarters. As policymakers look at our fiscal situation, they need to remain on guard against illusion, recognize an untenable fiscal outlook for what it is, and take responsible action to deal with it.

14. David McRaney, "Anchoring Effect," *You Are Not So Smart*, July 27, 2010.

Why We Have Federal Deficits

This article was originally published at E21 on November 14, 2013.

The study on which this article was based might be my personal favorite among all the studies I have conducted—perhaps largely because it involved such extensive, arduous labor. I also found the results genuinely fascinating, insofar as they simultaneously illuminated (at least for me) many interesting aspects of our political history as well as of current federal policy.

My objective was to study and quantify nothing less than all the federal fiscal policy decisions over the years leading to our current problematic fiscal outlook, while also cataloguing who was responsible for those decisions. To perform this analysis, I studied every Office of Management and Budget and CBO annual budget report stretching back over more than four decades, along with many other sources. It was exhaustive and exhausting, and had I anticipated the amount of work I was taking on, I probably never would have begun the project.

The fascinating finding was that, while today's Republicans and Democrats exchange impassioned charges of culpability for our current fiscal problems, the vast majority of the decisions causing them were made in the seven years spanning from 1965 to 1972. This period covered the latter part of the Johnson administration and the first term of the Nixon administration, each administration working with a Democratic Congress. Since then, other elected officials have certainly contributed to our fiscal challenges, but they have also taken many actions to clean up the damage caused by legislation enacted during that 1965–1972 period.

This article describes the study's major findings—to get the full picture, see the full study, published by the Mercatus Center.

TODAY (NOVEMBER 14, 2013) THE MERCATUS CENTER IS RELEASING A study I completed earlier this year that comprehensively analyzes the policy decisions underlying federal deficits.[1] Too often partisan advocates focus on a limited time period to purposely throw blame on a targeted political figure.

1. Charles Blahous, "Why We Have Federal Deficits: The Policy Decisions That Created Them" (Mercatus Research, Mercatus Center at George Mason University, Arlington VA, November 14, 2013).

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

Instead I dissected the entire budget, identifying deficit-driving policies regardless of when they were enacted. The study was a mammoth undertaking; it required the digestion of practically every Congressional Budget Office and Office of Management and Budget budget report published over the past 40 years.

The striking finding is that more than three-quarters of our long-term fiscal problem derives from a set of policy decisions made over a period of just seven years, 1965 to 1972. The year 1965 saw the establishment of Medicare and Medicaid, advocated for and signed by President Lyndon B. Johnson. Both of these programs were later expanded in 1972 during the Nixon administration, as was Social Security. Nothing done by any recent president or Congress carries long-term fiscal consequences as daunting as those arising from these 1965–1972 decisions.

The study examined deficits from three different vantage points. The first was to analyze the specific policy decisions that moved us from budgeting norms practiced over the last 40 years to current projections of untenable long-term deficits. The second was to analyze the policy decisions that led to the current 2013 deficit. The third was to analyze which officeholders ran the largest deficits when they were responsible for federal budget policy. These methodological details are accessible in the full study.[2]

The Long-Term Deficit

Our long-term deficit problem turns out to be pretty simple. It consists entirely of spending growth in Medicare, Medicaid, Social Security, and the new health insurance exchanges established in the 2010 Affordable Care Act. If it were not for spending growth in these four programs, we would not have a long-term budget problem. Under current law, tax revenues will well exceed historical averages going forward, and spending in all other areas will be far less, as a percentage of GDP. (See figure 1.)

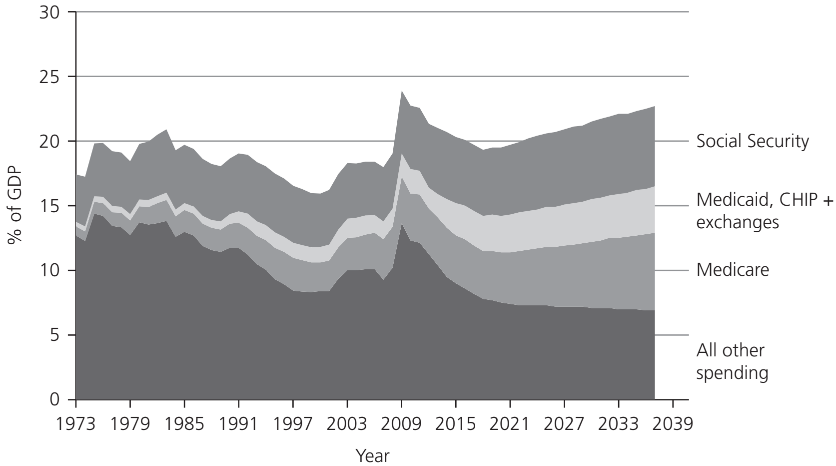
Let us review these contributors one by one:

- *Medicare.* Medicare is the single biggest contributor to our long-term deficit problem. The vast majority of currently projected Medicare costs derive from the program's original enactment in 1965. There was a significant Medicare expansion in 1972, and

2. Blahous, "Why We Have Federal Deficits."

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

Figure 1. Components of Federal Noninterest Spending, Historical and Projected (as a Percentage of GDP)



Source: Figure 4 in Charles Blahous, "Why We Have Federal Deficits: The Policy Decisions That Created Them" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, November 14, 2013), 34. The data are from Congressional Budget Office, "The 2012 Long-Term Budget Outlook," June 2012; Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2013 to 2023," February 2013.

its Part D prescription drug benefit was added in 2003. Most Medicare legislation in recent decades has reined in projected cost growth rather than added to it.

- *Medicaid and the ACA health insurance exchanges.* Around 30% of the projected excess spending growth in this combined category is due to the ACA, which dramatically expanded Medicaid and established new health insurance exchanges. Most of the other costs here derive from Medicaid's original enactment in 1965. Medicaid also underwent an expansion in 1972, and a series of smaller-scale expansions from 1985 through 1990.
- *Social Security.* If its pre-1972 benefit formula were still on the books, projected Social Security spending would be well within affordable historical norms. Legislation in 1972 increased benefits by 20% across the board, in addition to introducing annual COLAs and indexing the growth of benefits paid to new claimants.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

The Current-Year Deficit

The causes of the current-year deficit are more diffuse. As with the long-term deficit, growth in Medicare, Medicaid, and Social Security is a big part of the problem. In addition, growth in income security programs as well as lower-than-typical tax revenue collections have played a role. Legislation enacted by the last outgoing Congress and signed by President Obama is primarily responsible for the tax side. Some of the recent growth in income security spending is attributable to expansions of the earned income tax credit (EITC) and child tax credit and extensions of unemployment insurance during the Obama administration. Another significant portion traces back to an expansion of the EITC enacted in 1993 under President Clinton. Notably, even with ongoing military operations abroad, all current appropriations spending remains within levels affordable within a balanced budget, assuming current interest rates and historical spending prioritization.

Allocating Responsibility

The study assumes that 50% of the responsibility for fiscal policy decisions resides with the president, 25% with the House majority party, 20% with the Senate majority party, and 5% with the Senate minority party. Those assumptions produce an allocation of responsibility for our deficit predicament that is accessible in the full study. For example, the study finds that the individual who bears the greatest responsibility for our long-term imbalance (28.6%) is President Johnson.

Fiscal Stewardship Track Records

Due to the last five years of record deficits, deficit responsibility shares have been much higher on an annual basis during the Obama administration than during any other administration studied, by a wide margin.

In sum, the fiscal problems now bedeviling policymakers are largely those created during the seven-year span of 1965–1972. We will not solve our deficit problem until we scale back the spending commitments originally made to Medicare, Medicaid, and Social Security during those years, in addition to scaling back the ACA's health insurance exchanges. From a budgetary perspective, everything else is mere distraction.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

To Understand the Federal Budget, Get Past the Baseline Game

This article was originally published at E21 on April 9, 2014, as "The Secret Assumptions behind Federal Budgets."

The details of federal budget baselining are probably of interest only to the wonkiest of wonks. Nevertheless, they drive the directions of public debate and therefore of policy itself. Whenever one reads in the paper, "Party X offered $3 of spending cuts for every $1 in tax increases," there are lot of assumptions implicit in those numbers, some of which will violate the reader's instincts about common sense.

This piece attempts to flesh out these assumptions, to better inform newsreaders, and to equip them to make sense of what they read and hear about federal budgeting.

OUR NATIONAL DIALOGUE OVER FEDERAL POLICY SUFFERS FROM A huge information gap when it comes to understanding the federal budget. This information gap afflicts not only the general public and the press but also much of Washington's policy-insider community. At the very start of my 11 years on the Senate staff, I quickly learned that if one can master Congress's arcane budget rules, one will command knowledge that even many legislators lack. To put it bluntly, far too few people understand how the federal budget works, how budget-related legislative procedures work, and how scorekeeping works. This article represents an effort to fill in some of that information gap.

Often one will read sentences such as the following in published commentary, reflecting both (a) incomplete understanding of the budget and (b) ongoing political spin: "We have enacted about $2.5 trillion in deficit reduction with about three-quarters coming from spending cuts."[1] Or, "In

1. Michael Linden, "It's Time to Hit the Reset Button on the Fiscal Debate," Center for American Progress, June 6, 2013.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

February, the President released the Fiscal Year 2013 Budget, which does the following: . . . Cuts $2.50 for every $1 of additional revenue."[2]

Such statements are usually misleading because they do not illuminate the absolute levels of spending and revenues implicitly being referenced. They only describe spending, revenues, and deficits relative to an alternative scenario known in wonk parlance as a "baseline." This is a problem for a number of reasons:

- The baseline is a purely hypothetical, counterfactual scenario.
- It has limited utility and meaning.
- It doesn't represent current law or the continuation of current policy or what would happen in the absence of further legislation.
- It is constructed in ways that exaggerate the fiscal prudence of lawmakers and, specifically, the amount of deficit reduction achieved under proposed changes in law.

What we ought to do whenever public officials put forth budget proposals is to discuss the total amount of spending and taxation involved, and whether that represents a sensible policy. Instead we often compare those budget proposals to spending and taxes assumed in the so-called baseline. Why is this done? Ideally, it is so that policymakers have a sense of the course we are on now, and of how a specific proposal would redirect that course.

Importantly, however, this scorekeeping baseline deviates from current law as well as from a "no action" scenario in several key ways. For example, under law, appropriations spending must be renewed annually (via either new appropriations bills or a continuing resolution)—or else it terminates, precipitating a so-called government shutdown. But the Congressional Budget Office does not assume that appropriations spending will actually stop upon the expiration of current appropriations authority. Instead, CBO projects what are deemed to be realistic spending levels going forward. These spending levels may indeed be plausible, but they are not current law, nor are they what would happen under a "no action" scenario. These assumptions have very influential effects in that they are the levels to which legislative proposals are compared.

2. White House Archives, "Obama Administration Record on Fiscal Responsibility," accessed April 2014, https://obamawhitehouse.archives.gov/sites/default/files/docs/fiscal_record.pdf.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

Similar issues are even more significant with respect to the largest federal entitlement programs, Social Security and Medicare. Congress's scorekeeping rules require CBO to assume a high rate of growth for spending in these areas—and specifically, that certain cost-constraint mechanisms in both programs will be overridden in future legislation.[3] These assumed changes in law to increase future Social Security and Medicare spending have no historical precedent. Accordingly, when one hears of proposed "cuts" in these programs, these are not being quantified in comparison with actual law but with a hypothetical baseline at considerable variance with law and historical practice.

CBO is always diligent about disclosing that its baseline projections for Social Security and Medicare do not reflect the dictates of actual law. For example, in its recent Budget and Economic Outlook, CBO notes,

> In keeping with the rules in section 257 of the Deficit Control Act of 1985, CBO's baseline incorporates the assumption that payments will continue to be made after the trust fund has been exhausted, although there is no legal authority to make such payments.[4]

This is more than a minor footnote. It means that CBO is directed to assume in its baseline that Social Security and Medicare payments will be trillions of dollars higher than they would be under existing law. The assumption that legislators will enact legislative changes allowing for trillions in additional spending has a huge effect on the evaluation of any legislation affecting Social Security and Medicare.

Misunderstanding of these conventions is at the root of common misperceptions, among those unfamiliar with congressional scorekeeping practices, that CBO found that the Affordable Care Act would reduce federal deficits.[5] CBO actually found that the ACA would reduce federal deficits only relative to other Medicare spending increases assumed in its baseline. Relative to previous law, the ACA unambiguously increases deficits because it authorizes

3. Charles Blahous, "Should Congress Change CBO's Scorekeeping Rules?," E21 (Manhattan Institute for Policy Research), May 29, 2012 (republished in this collection).
4. Congressional Budget Office, "The Budget and Economic Outlook: 2014 to 2024," February 2014.
5. Brad DeLong, "Pro Tip for Charles Blahous: You Have Just Made One of the Misrepresentations That Makes Me Stop Reading . . . ," *Brad DeLong's Grasping Reality*, October 9, 2013.

more additional spending than it would generate in additional taxes.[6] The illusion that the ACA would reduce deficits arises solely because of the scorekeeping convention according to which CBO is directed to assume that some of those spending increases would have happened anyway.

Similar misperceptions are at the root of occasional representations that the federal government has been practicing "austerity" in recent years.[7] By any objective standard, federal spending and deficits have been at historic highs. It is only in comparison with baseline projections made on the basis of even higher recent deficits that it appears that lawmakers have been practicing fiscal prudence.

Accordingly, readers who wish to understand competing budget presentations would do well to discount any claims made in relation to these baselines, be they claims about ratios of proposed spending cuts to tax revenues or claims about net amounts of deficit reduction. The only way to really understand the federal budget is to look at absolute spending and revenue levels.

Figures 1 and 2 are depictions of spending and revenues under President Obama's and House Budget Committee Chairman Paul Ryan's proposed budgets.[8] Ryan's budget estimates are based on CBO projections; CBO has not yet scored the president's budget, so here I will use Office of Management and Budget projections (which employ different economic assumptions). This is thus not a strictly apples-to-apples comparison, but it is the one we have readily available.

President Obama proposes to continue to spend more than historical averages as a share of the economy, Chairman Ryan somewhat less.

The projected tax picture is interesting. Under either budget, Americans will carry higher tax burdens going forward than they have historically. The

6. Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012); Charles Blahous, "The Fiscal Consequences of the Affordable Care Act," E21 (Manhattan Institute for Policy Research), April 10, 2012 (republished in this collection); Charles Blahous, "Yes, the Health Law Worsens the Deficit," E21 (Manhattan Institute for Policy Research), April 18, 2012.

7. Charles Blahous, "Record-High Deficits Are Not 'Austerity,'" E21 (Manhattan Institute for Policy Research), February 21, 2014.

8. Office of Management and Budget, *Fiscal Year 2015 Budget of the U.S. Government*, 2014; US House of Representatives, *FY2015 House Budget*, accessed April 2014.

Figure 1. Past/Projected Federal Spending as a Percentage of GDP

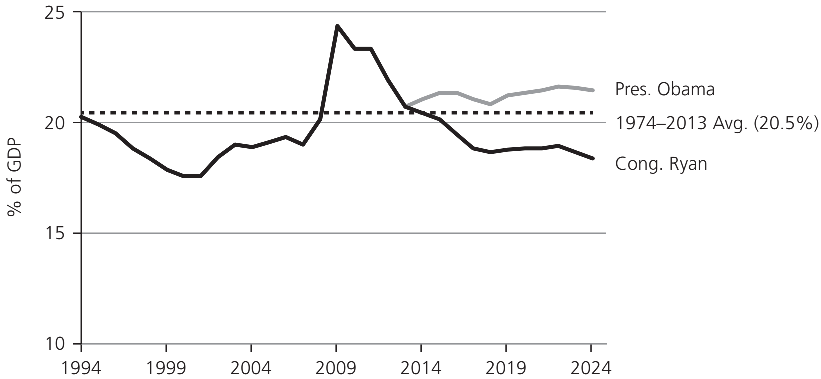
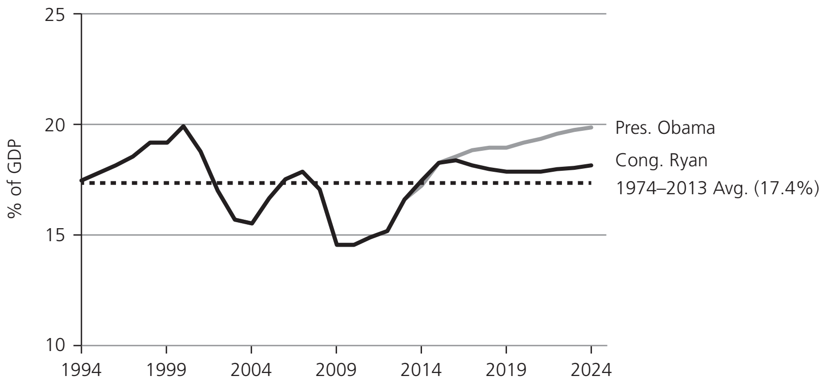


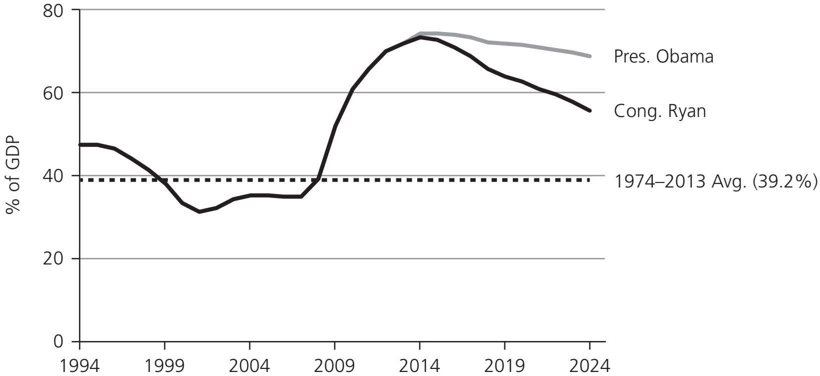
Figure 2. Past/Projected Federal Revenues as a Percentage of GDP



main difference is that under President Obama's proposal, the tax burden would be a lot higher.

The two approaches differ with respect to deficit spending. Chairman Ryan's proposal to balance the budget by 2024 would put public debt on a path back toward historical norms. President Obama's would keep it at permanently elevated levels. (See figure 3.)

Figure 3. Past/Projected Public Debt as a Percentage of GDP



The next time you hear political advocates making claims about how much deficits and spending are being cut, remember that these claims are being made in comparison to fictitious, somewhat arbitrary baselines. Ask them how much total spending and taxation would occur under their plans, and compare their answers. That is the only way to really understand the budget debate.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

Mindless Yes, Austerity No: The Real Budget Problem

This article was originally published at E21 on February 19, 2015.

The late Senator Daniel Patrick Moynihan used to speak of what he termed "semantic infiltration." Basically, this meant the adoption of terminology inherently favorable to one side in a contentious debate. Once that was accomplished, Moynihan used to observe, the favored side was well on its way to winning the argument.

Shortly after 2010 there was tremendous consternation among some policy advocates about the fiscal "austerity" allegedly being practiced by Western governments, including the United States. News reports adopted the term as though it represented agreed-upon fact. In truth, there was nothing austere about the US federal budget. In the wake of the Great Recession, federal policy had pushed deficits and debt to unprecedented levels.

Now, it certainly was true that federal appropriated spending has been squeezed more and more over the years—not because of austerity but because it has been crowded out by rising spending on programs such as Medicare, Medicaid, Social Security, and the ACA. This article walks through the data to demonstrate why recent federal practices are the furthest thing from austerity.

WHEN HIS BUDGET PROPOSALS WERE RELEASED IN FEBRUARY 2015, President Obama stated, "I want to work with Congress to replace mindless austerity with smart investments that strengthen America."[1] That quotation neatly summarizes how the White House is framing the basic tradeoff faced in federal budgeting: between "austerity" (i.e., severe cuts in spending and deficits) and "investments" (i.e., spending on things needed to support future prosperity). The real tradeoff we face, however, is fundamentally different.

It should be recognized up front that the president makes an important point. To see this, let's put aside for a moment the semantic battle between Right and Left over whether to call government outlays "spending" (with

1. David Nakamura, "Obama's Shift from 'Mindless Austerity' Derided by GOP as 'Envy Economics,'" *Washington Post*, February 2, 2015.

its negative connotations) or "investments" (with its positive ones). Let's also put aside important policy questions such as the relative efficiency of public versus private investments in areas ranging from transportation infrastructure to education. The president is correct to suggest there has been a protracted decline in the share of our economic output going toward this type of federal expenditure.

Figure 1 shows total federal domestic appropriations as a percentage of GDP. This budget category essentially includes (among others) the categories of spending described in the president's budget as "investing in America's future"—among them education, manufacturing research, and transportation infrastructure.[2] This category does not include mandatory autopilot spending such as Social Security, Medicare, and interest payments on the debt. The long-term trend for appropriated nondefense spending has indeed been down, at least as a share of our economic output, despite surging after President Obama took office. Under current Congressional Budget Office projections, this downward trend will continue: less of our output will be going toward such federal expenditures than was formerly the case.

This is not because we have been shifting our resources from domestic needs to fight wars. Spending on defense did increase after the 9/11 attacks, but overall the relative decline in defense spending has been even steeper than the decline in domestic appropriations. In other words, there has not been a shift of butter to guns; quite the opposite, as figure 2 shows.

Is it correct, then, to say that our ability to spend/invest in the areas favored by the White House has been constrained by the practice of fiscal austerity? Decidedly not. Federal deficit spending has instead risen persistently, soaring to a post–World War II high in the first years of the Obama administration. It has abated in the past few years but CBO finds that it will resume rising in the years ahead. (See figure 3.)

These historically large deficits have produced historically large debt. Federal indebtedness to the public is now 74% of GDP, over twice the share of our economy that it was just seven years ago. CBO projects it will rise to roughly 79% of GDP by 2025, a level not seen this side of a world war. (See figure 4.)

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2. Office of Management and Budget, *Fiscal Year 2016 Budget of the U.S. Government*, 2015, 15.

Figure 1. Past/Projected Federal Nondefense Appropriations

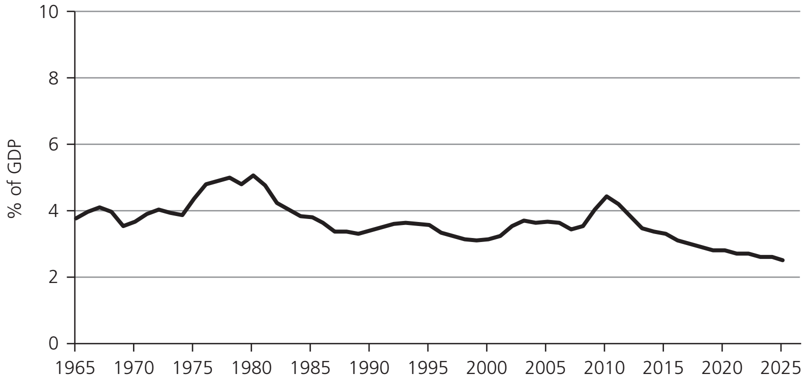
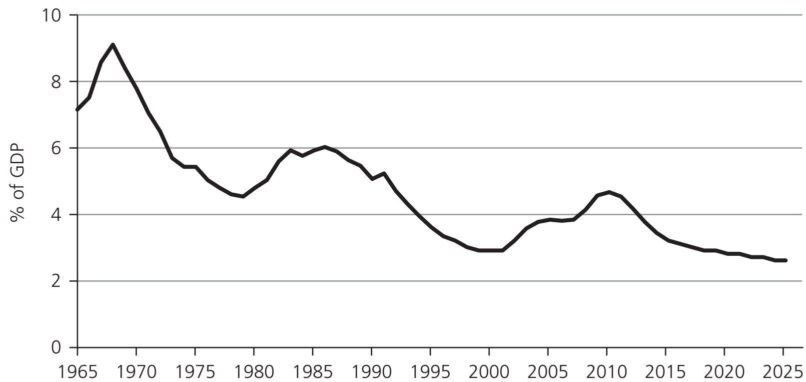


Figure 2. Past/Projected Federal Defense Appropriations



Taken together, figures 1–4 reveal that the fundamental tradeoff we face is not between spending on education, innovation, and infrastructure on the one hand and "mindless austerity" on the other. To the contrary, prioritization of such federal spending has declined during the same period that federal indebtedness has soared to historic highs.

Is this happening because Americans, specifically rich Americans, aren't being taxed enough? No. In 2014 federal revenues equaled 17.5% of GDP,

Figure 3. Past/Projected Federal Budget Deficits

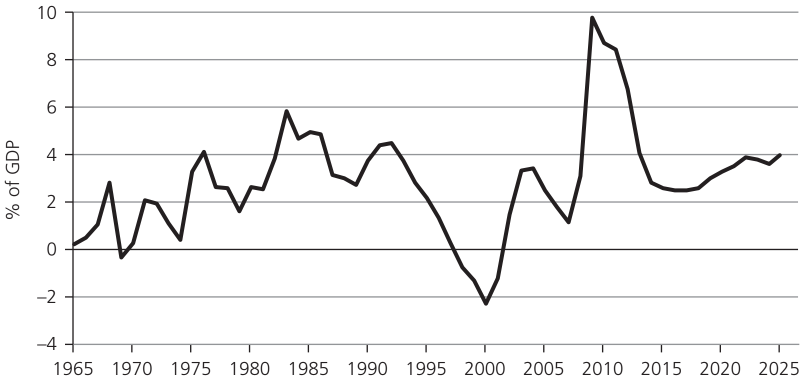
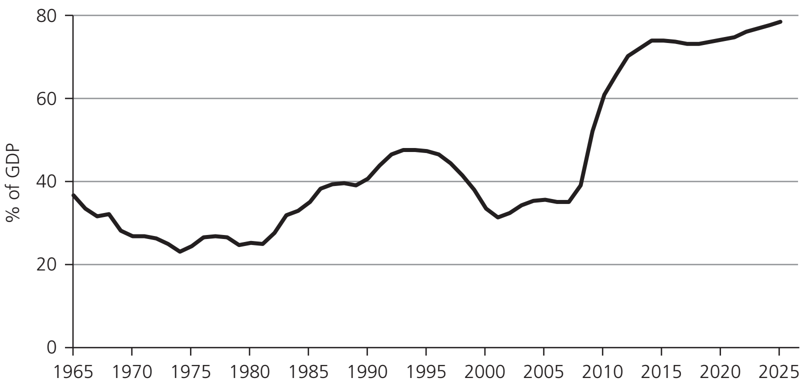


Figure 4. Past/Projected Federal Debt Held by the Public



a little above the average (17.4%) over the last 50 years. Looking forward to when various current-law tax increases fully kick in, CBO projects revenue collections will reach 18.3% of GDP, well above historical norms. In other words, federal debt will be at historic highs while appropriated spending is lower than historically normal and taxation is higher than historically normal. Clearly these variables alone don't explain what is going on. (See figure 5.)

Our debt has exploded because total federal spending, beyond those areas many define as "investments," is rising faster than our economic output or our revenue base can sustain. (See figure 6.)

This unsustainable spending growth occurs because we continue to increase spending on Social Security, on Medicare, on Medicaid, and now on the massive expansion of federal health spending embodied in the Affordable Care Act. Growth in these four categories of federal entitlement spending accounts for our whole fiscal imbalance.

Figure 5. Past/Projected Federal (Tax) Revenues

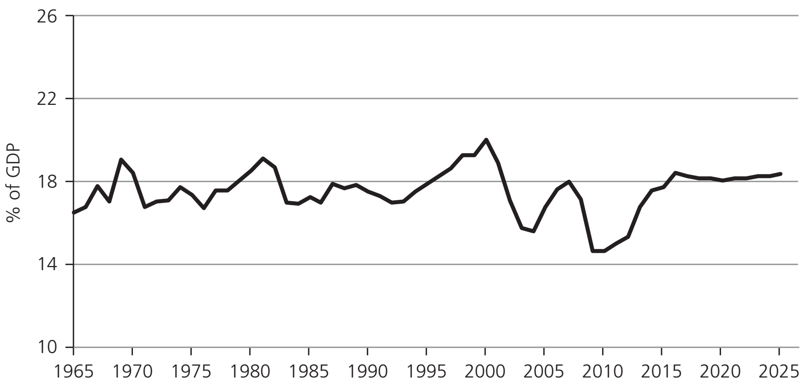
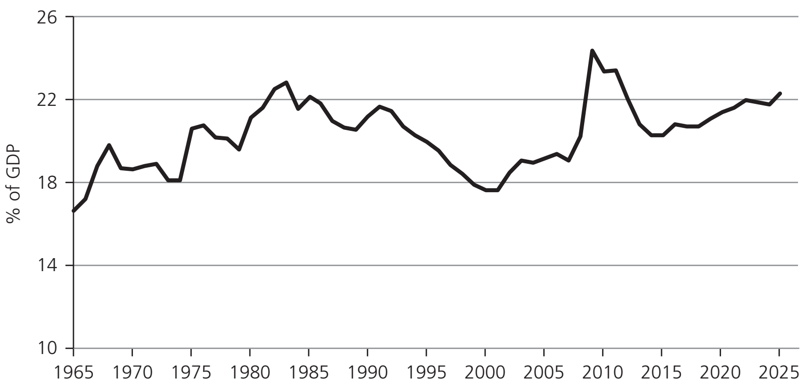


Figure 6. Past/Projected Total Federal Spending



Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

Figure 7. Past/Projected Social Security, Medicare, and Medicaid, ACA Net Spending

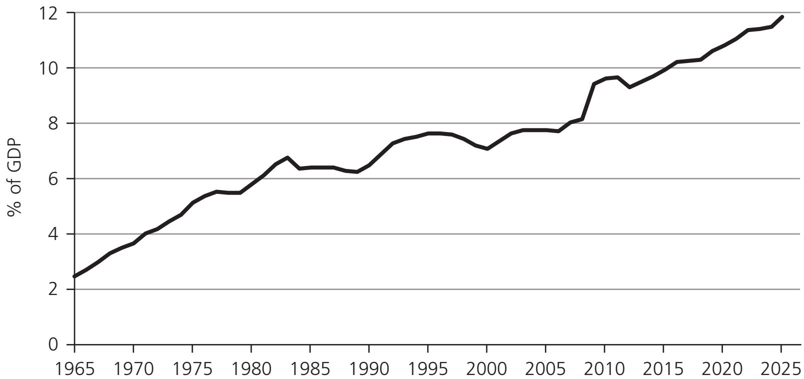


Figure 7 shows the essence of our budget problem. It reveals that the barriers confronting those who want to see more federal spending on education and infrastructure have little to do either with austerity or with insufficient taxes paid by rich people. Both taxation and debt are heading to historic highs despite the relative declines in the aforementioned spending. The reason we are spending relatively less on defense, education, and highways is purely that we are continually spending more on Medicare, Medicaid, Social Security, and the ACA.

A dialogue between Left and Right will not change this dynamic because the areas of strongest disagreement between Left and Right—taxation and alleged austerity—are not at the root of the problem. The dynamic will only change if the conversation within the political left changes; specifically, when left-of-center thinkers decide that rising entitlement spending is a problem because it steadily degrades our capacity to spend on other priorities. This would not require those on the Left to abandon their philosophical commitment to Social Security, Medicare, Medicaid, or the ACA—it would only require that they recognize that these programs cannot perpetually grow faster than our ability to finance them, without undesirable consequences for the rest of the budget.

To date this conversation has yet to be seriously engaged in. Certain narrative fictions persist, for example that the only thing preventing us from having enough money to spend on highways and community colleges is that the rich aren't paying enough taxes. Though this fiction may suit certain political interests, it does not serve the interests of those serious about addressing other societal needs. Even if one believed this narrative, the fact remains that our abilities to tax and to issue debt are not unlimited. Plus, there are practical limitations that the political center will impose that the political left, left to its own devices, would not. It is not realistic to believe that our untenable entitlement spending growth path can remain in place and that we will also find more money to invest in roads and bridges.

The evidence of these dynamics is clearly visible. In 2011, Democrat and Republican negotiators both well understood that entitlement spending growth was driving our fiscal imbalance. Still they could not agree on even modest corrections. Raising taxes on the rich, as President Obama succeeded in doing in early 2013, has not meaningfully changed the long-term trend. Even with these tax increases in hand, the burden of meeting fiscal targets under the Budget Control Act is falling primarily on the discretionary spending accounts, especially defense. This has meant across-the-board spending cuts (sequestration), mostly in appropriated spending, while entitlement spending continues to rise unchecked.

As long as spending growth in Social Security, Medicare, Medicaid, and the ACA continues unabated, we can expect the share of national resources devoted to other federal government priorities to continue to decline. As former President Clinton might say, "It's arithmetic."

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

The One Budget Reform That Matters

This article was originally published at E21 on October 10, 2016.

If you hang around Washington long enough, you see certain policy initiatives rear their heads so many times, only to collapse in failure or inefficacy, that you risk becoming jaded about them.

One of those recurring initiatives is budget process reform. Granted, we absolutely do need a better federal budget process, and many earnest experts on both sides of the aisle have poured gallons of sweat into efforts to create one. But at the same time, we must be clear-sighted about the fact that our current fiscal predicament hasn't arisen primarily because our budget process is broken. It has arisen primarily because the people's representatives, for better or for worse, have chosen to engage in large amounts of deficit spending. The process we have is reflective of the policy approach legislators have adopted.

While budget process reform can be important, it is equally important not to mistake advocacy of process reform for fiscal responsibility. It's much easier to propose changes to the process than it is to make the tough calls to restrain the spending growth at the heart of federal deficits—in Medicare, Medicaid, Social Security, and the ACA. As this article points out, the only budget process reforms that will ultimately help, from a fiscal perspective, will be those that provide more effective checks on the uncontrolled growth of entitlement spending.

PROPOSALS TO REFORM THE FEDERAL BUDGET PROCESS ARE MUCH IN the air these days.[1] While there is a widespread belief that the process is broken, definitions of that breakage vary widely. Complaints include arguments that the process is overly complex, cumbersome, and outdated; that it promotes short-term thinking over long-range planning, that it lacks transparency and accountability; that it fails to uphold Congress's constitutional powers; that it fails to advance national priorities; and that it promotes bad

1. James C. Capretta, "Reforming the Budget Process," *National Affairs*, 2014; House Budget Committee, "Budget Process Reform," https://republicans-budget.house.gov/initiatives/budget-process-reform/; Center for a Responsible Federal Budget, "Chairman Enzi Proposes Budget Process Reforms," July 14, 2016.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

fiscal outcomes.[2] Because budget reform proposals reflect such a wide range of motivations, they take a wide variety of forms. Yet if a central goal is to meaningfully improve federal financial management, only one reform is likely to matter: in the words of Rudy Penner and Gene Steuerle, restoring "more discretion to the federal budget."[3] More on that later.

Though many budget process reforms might be desirable for various reasons, this does not mean they will necessarily result in better budgeting. For example, it may be good government practice to publicly disclose the texts of budget resolutions and amendments before they are considered; there is no guarantee that doing so will result in more public pressure for fiscal responsibility rather than in more interest-group pressure to relax fiscal constraints. Similarly, biennial budgeting may free lawmakers' time to consider legislation more thoroughly. Whether this would result in more or less deficit spending remains to be seen.

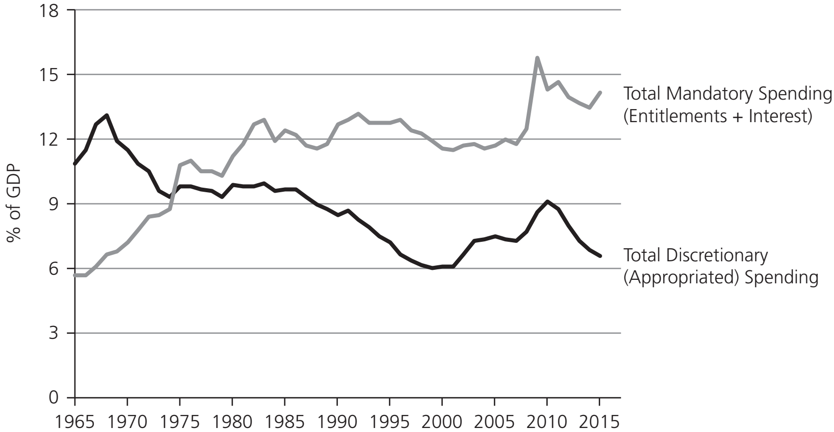
Even well-considered legislation to improve Congress's appropriations process may have minimal impact on federal finances. This is because appropriations—basically the spending Congress determines anew each year—already represent a deteriorating percentage of total federal spending. Even if the appropriating process were perfected, we could still end up with uncontrolled federal spending and deficits due to the automatic growth of entitlements under existing law.

Entitlement programs are those automatically authorized to continue to spend funds, often in increasing amounts, without further legislative action. Some of the biggest examples include Social Security, Medicare, and Medicaid. Figure 1 shows how, over time, automatic growth in such programs has precipitated a corresponding relative decline in discretionary/appropriated spending. (Interest costs are grouped with entitlements here because they are also mandatory spending; their inclusion does not affect the qualitative trend.) Figure 2 shows that, under current projections, mandatory spending will continue to absorb an ever-greater share of budget resources. In sum, unless and until the laws governing mandatory entitlement programs are changed, lawmakers will only exert annual control over a shrinking fraction of the budget.

2. Peter G. Peterson Foundation, "Budget Processes Solutions," https://www.pgpf.org/finding-solutions/budget-process-reforms.

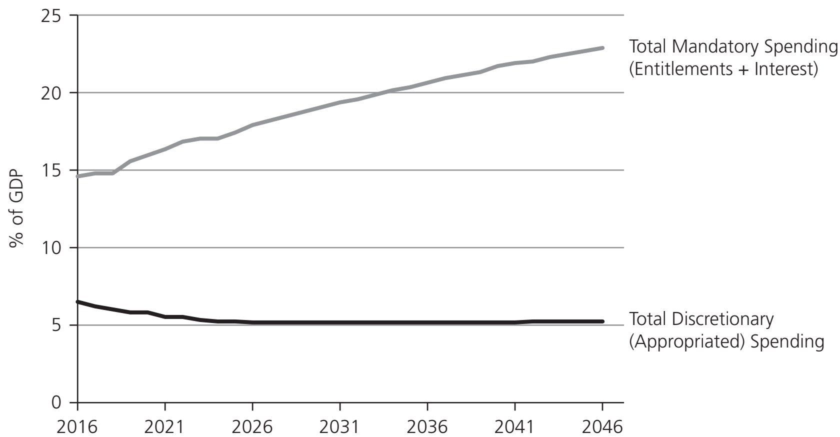
3. Rudolph G. Penner and C. Eugene Steuerle, "Options to Restore More Discretion to the Federal Budget" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2016).

Figure 1. Historical Federal Spending as a Percentage of GDP



Source: White House Office of Management and Budget.

Figure 2. Projected Federal Spending as a Percentage of GDP



Source: Congressional Budget Office.

Reasonable people can and do differ over what constitutes responsible fiscal policy. Because of these differences, budget reforms designed to advantage one side's fiscal views will be resisted by the other. The current process, however, is an equal-opportunity offender: it does not readily allow any legislative coalition's fiscal policy views to be implemented. This is because the vast majority of the budget does not reflect the decisions or even the consent of current lawmakers; rather, it reflects decisions made many years ago by legislators possessing information since rendered obsolete. Unless a new legislative coalition can be formed to change those laws, that problem automatically worsens.

Members of Congress on both sides of the aisle share a stake in fixing this. Believers in a more activist government, for example, would like to see consistently greater spending on transportation infrastructure.[4] But because of the automatic growth of entitlement spending, this has not happened, and won't without a process change. Believers in a more restrained government would like to reduce the drag of taxes on economic growth. Again, because of automatic entitlement spending increases, this has not happened and will not happen without precipitating larger deficits. Under current practices neither side gets what it wants, nor do the two sides get a compromise between what each respectively wants.

Because of this dynamic, lawmakers would do well to shed a zero-sum view of fiscal policy, in which one side's gain is perceived as the other's loss. It might well have once been true that the mandatory spending system advantaged the perspectives of those on the political left. Now that such spending has grown to where it paralyzes progressives' attempts to spend on their chosen priorities, that is no longer the case. Both sides lose under the current system, and both sides would gain by reforming it.

Previous lawmakers attempted to impose fiscal discipline on mandatory spending by establishing trust funds for such items as Social Security, Medicare, and highway spending. The idea was that these programs would be forbidden to spend in excess of the revenues raised for their respective trust funds. Unfortunately, this attempt at fiscal discipline has largely failed. Many trust funds, such as those for Medicare Parts B and D, impose no constraints at all because the federal government's general fund automatically gives them whatever money they lack to meet expenses. Lawmakers have also supplemented Social Security's trust funds with hundreds of billions of general fund dollars.[5] At this point, whether a program has a trust fund provides no meaningful information about whether it strains the general federal budget.

The recent Penner-Steuerle paper, "Options to Restore More Discretion to the Federal Budget," offers several proposed reforms to address these

4. Derek Thompson, "One Issue Trump and Clinton Agree On," *The Atlantic*, August 16, 2016.

5. Committee for a Responsible Federal Budget, "General Revenue & the Social Security Trust Funds," August 19, 2014.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

Table 1. Sources and Uses of Changes in Budgetary Resources, 2016–2026

Sources	Real dollar increases (billions)	Uses	Real dollar increases (billions)	Percentage of increase
Revenues	781	Social Security	421	31.1
Deficits	571	Major healthcare programs	462	34.2
		Other mandatory spending	53	3.9
		Defense discretionary	3	0.3
		Domestic discretionary	–24	–1.8
		Net interest	437	32.3
Total	1,352	Total	1,352	100.0

Source: Rudolph G. Penner and C. Eugene Steuerle, "Options to Restore More Discretion to the Federal Budget" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2016).

challenges.[6] These include, among others, automatic triggers to slow the growth of federal mandatory spending and of tax-code entitlements and requiring periodic congressional votes on whether to allow full scheduled increases in program spending. Of particular interest are the authors' presentational recommendations. Penner and Steuerle would have Congress supplement the current confusing "budget baseline" methodology with other presentations disclosing the budget's areas of real growth. Having the Congressional Budget Office routinely release such reports could potentially further essential public and media awareness of the drivers of fiscal pressures.[7] (See table 1.)

6. Penner and Steuerle, "Options to Restore More Discretion."
7. Penner and Steuerle.

Penner and Steuerle summarize the table aptly as showing that, over the next 10 years,

> almost one-third of the increase in budgetary resources will be devoted to Social Security, one-third to major healthcare programs, and one-third to interest on the debt. Close to nothing is left for everything else, including most programs for education, infrastructure, the environment, and energy. Social Security and healthcare entitlements may be good and popular programs, but should the federal government really be spending almost all new resources on them and on interest?[8]

Different people will have different answers to those questions. But at the very least, they should be discussed and deliberately decided. Our failure to address such questions has resulted in a budget process that has spiraled ever more wildly out of control. Unless and until we address the mandatory spending framework that undercuts lawmakers' ability to manage the federal budget, no other process reforms are likely to matter.

8. Penner and Steuerle.

Rising Entitlement Spending Is Straining the Budget

This article was originally published at E21 on April 18, 2018.

It has proved necessary from time to time to publish articles reminding policymakers, press, and public that the structural federal fiscal imbalance is driven by cost growth in mandatory spending programs (e.g., Social Security, Medicare, and Medicaid) exceeding growth in our economic capacity. It is very easy to lose sight of this in the midst of ongoing policy debates in other areas, such as tax policy and appropriated spending.

The two major political parties have significant differences over optimal tax policy and appropriations levels. Moreover, it is true that both higher appropriations spending and lower tax collections cause deficits to be higher than they otherwise would be. But trends in both of these areas of contention are small potatoes from a fiscal perspective, relative to entitlement spending growth. The press tends to focus more on recent battles over taxes and appropriations, where each party is eager to distinguish its position from the other's. But it's important not to let these less significant fiscal policy arguments distract us from the far larger fiscal strains caused by entitlement spending, which only the bravest politicians are willing to tackle.

The two parties frequently hurl charges at each other of irresponsibility and hypocrisy on fiscal issues. There is certainly plenty of irresponsibility and hypocrisy to go around, but there is also room for honest differences over optimal tax collection and appropriations levels. Legislators who reach differing conclusions on these questions are not necessarily irresponsible hypocrites. As this piece details, the acid test for whether someone is truly serious and committed to fiscal consolidation is whether he or she is willing to address the entitlement spending growth that is the root cause of the fiscal imbalance.

AN IMPASSIONED ARGUMENT BROKE OUT IN EARLY SPRING 2018 OVER THE federal budget. It was precipitated by an op-ed in the *Washington Post* by five prominent economists from the Hoover Institution, warning of a coming debt crisis and pointing the finger of blame at runaway federal entitlement spending.[1] A riposte appeared in the *Washington Post* soon after, by several

1. Michael J. Boskin et al., "A Debt Crisis Is on the Horizon," *Washington Post*, March 27, 2018.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

prominent left-of-center economists, headlined "Don't Blame Entitlements" and highlighting the role of tax cuts in worsening federal deficits.[2] Since then, several others have weighed in on the controversy, including my E21 colleague Brian Riedl, my Mercatus colleague Veronique de Rugy, James Capretta, and Ryan Ellis. John Cochrane, a member of the original Hoover group, also published a further rejoinder.[3]

The bottom line after all the back-and-forth: the Hoover economists and those who have written in support of them are correct. (Disclosure: I am a visiting fellow with the Hoover Institution but have not communicated with the Hoover authors about their op-ed.) The budget problem we face is almost entirely an entitlement spending problem, and it is critically important to understand this reality if we are to devise effective repairs. For clarity, one must distinguish between three concepts:

1. whether we face a nascent fiscal crisis,
2. what is causing that fiscal crisis, and
3. what we should do about it.

Fortunately for the purposes of our understanding, both sides in this argument agree, when addressing issue 1, that federal finances are in dire shape. The Hoover group finds that "unchecked, such a debt spiral raises the specter of a crisis,"[4] while their critics agree that "growing debt will take an increasing toll on the ability of government to provide for its citizens."[5]

Naturally, there are strong disagreements over issue 3: what we should do about it. Those on the Right generally prefer to restrain spending growth, whereas those on the Left prefer to lean more heavily on tax increases. We need to hash out those policy differences, but it's important not to let them confuse us about issue 2, the underlying causes of the problem.

2. Martin Neil Baily et al., "A Debt Crisis Is Coming. But Don't Blame Entitlements," *Washington Post*, April 8, 2018.

3. Brian Riedl, "Yes, Entitlements Are Driving the Long-Term Debt," E21 (Manhattan Institute for Policy Research), April 9, 2018; Veronique de Rugy, "To Infinity and Beyond: Are Trillion-Dollar Deficits the New Norm?," *Townhall*, April 12, 2018; James C. Capretta, "CBO Forecast Leaves No Room for Wishful Thinking," *RealClearPolicy*, April 13, 2018; Ryan Ellis, "CBO Confirms That Mandatory Spending Drives the Budget Deficit," *Forbes*, April 10, 2018; John H. Cochrane, "Why Not Taxes?," *Grumpy Economist*, April 11, 2018.

4. Boskin et al., "Debt Crisis Is on the Horizon."

5. Baily et al., "Debt Crisis Is Coming."

Of course, there is a certain tautological sense in which one can always trivially define the budget problem as being equally one of taxes and spending, thereby implying that equal attention must be given to each when crafting solutions. After all, by definition the deficit is the difference between spending and revenues, so a $1 change on either side will affect the deficit by $1.

It does not follow from this, however, that both sides of the budget are equally or even comparably to blame for the problem. To understand why, simply imagine that each year you get a nice healthy raise, but that you nevertheless go more deeply into debt because your spending rises even faster. You might try to manage this problem by taking a second job or seeking a higher-paying one. This wouldn't change the root cause of your problem—your failure to moderate the growth of your spending. And, unless you have a magic way of making more money every year forever, you can't avoid the need to eventually restrain the growth of your spending habits.

With the federal budget, too, the problem is spending growth—specifically, entitlement spending growth. Entitlement programs are those in which ongoing spending is automatically authorized by law, without lawmakers needing to appropriate funds each year.[6] The Congressional Budget Office and other nonpartisan budget analysts have been documenting this runaway spending growth for some time. The federal fiscal imbalance is driven by that growth, especially in Social Security and the "major health care programs," to use CBO's parlance.[7]

One need not look for long at the contours of federal budget operations to see this. Consider tax collection patterns first. Figure 1 shows that nothing historically aberrant is happening on the tax side to bring about our huge deficits.

As figure 1 shows, federal tax policy has been largely consistent throughout modern history—collecting between 16% and 19% of GDP in the vast majority of years. Even with the recent tax cut, this pattern is projected to continue going forward. Indeed, tax burdens will remain generally on the rise as a share of national economic output. In 2017 they were almost exactly at the historical average; now they are projected to dip somewhat lower in the next few years, then rise faster than GDP to climb above historical norms in

6. Congressional Budget Office, "Glossary," January 2012.
7. Congressional Budget Office, "The 2017 Long-Term Budget Outlook," March 2017.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

2024 and beyond. If we are facing a debt explosion, it is not because we're eschewing taxation in any historically significant way.

Nor, as figure 2 shows, is appropriated/discretionary spending the problem. Aside from a onetime surge in such spending early in the Obama administration, federal discretionary spending—including both defense and domestic spending—has steadily shrunk as a share of the budget and relative to our economic output.

Figure 1. Federal Tax Collections: Historical/Projected Federal Revenues as a Percentage of GDP

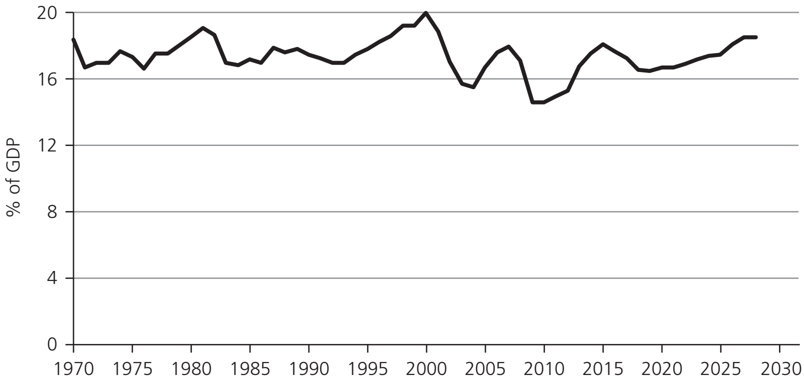
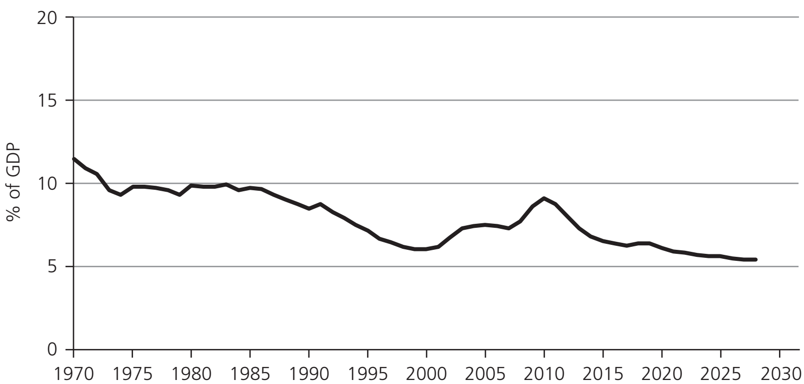


Figure 2. Federal Discretionary Spending: Historical/Projected Federal Discretionary Spending as a Percentage of GDP



Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).

If national tax burdens have remained roughly consistent, and discretionary spending has become relatively more affordable, why have deficits climbed into the stratosphere? The answer is straightforward and is evident in figure 3.

Figure 3 shows the source of our budget problems in a nutshell. They exist because year after year we are spending more on entitlements—not only as a share of the federal budget but as a share of our overall economy.

Some numbers from the latest CBO report amplify the point. There is wide bipartisan consternation over the latest CBO projections, which show annual federal deficits climbing from 3.5% of GDP last year to 5.4% of GDP by 2022.[8] Yet entitlement spending alone in 2022 is projected to be 13.8% of GDP, and just the *growth* in such spending relative to GDP over the past few decades is larger than the entire projected 2022 deficit.

It is worth emphasizing that this way of measuring actually understates the point. All of these graphs and numbers are expressed as a percentage of GDP, which means they erase from the picture any growth in revenues and spending in step with national economic growth. If we instead showed the growth in real (inflation-adjusted) revenues and spending, entitlement spending would appear the culprit even more strongly.

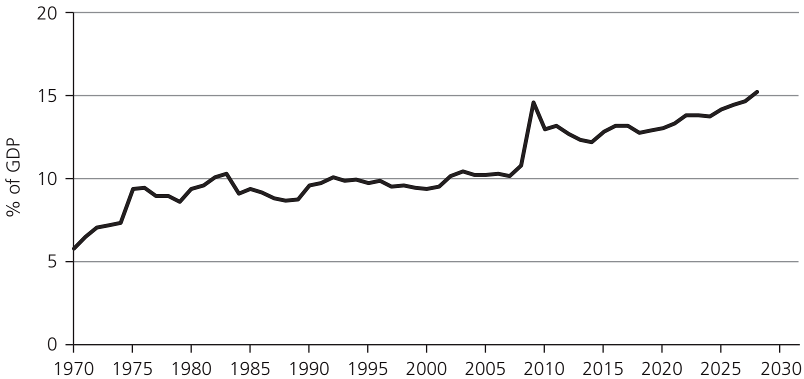
Given the widespread evidence of the dominant role played by spending growth, why do some argue that tax policy is a comparable contributor to the budget problem? There are many reasons, but a couple that stand out are probably best described as analytical mistakes.

One mistake is to frame the question not in terms of the overall drivers of budget deficits but in terms of policy decisions made only within a certain time frame. Tax cuts and appropriations increases do raise the deficit whenever they are enacted—as they were last year—even if they are not of a magnitude comparable to entitlement spending. So if instead of asking "What is driving the budget deficit?" we ask only "What caused the deficit picture to worsen over the past year?" we are going to get a different answer: a distorted picture that reveals only a small fraction of the legislative decisions fueling our growing deficits, while ignoring all the others.

Excluding all policy decisions made outside a chosen time frame grossly exaggerates the relative effects of any decisions made within that time frame.

8. Congressional Budget Office, "The Budget and Economic Outlook: 2018 to 2028," April 2018, 4.

Figure 3. Federal Entitlement Spending: Historical/Projected Federal Mandatory (Entitlement) Spending as a Percentage of GDP



While some might prefer revisiting policy decisions made during the past year to revisiting those made at other times, that subjective preference should not distort our understanding. To see the whole picture, one must look at all policies affecting the budget, not just those one is inclined to change.

The other mistake is to dismiss the primary drivers of the problem by treating them as unchangeable, while treating only some other policies as open to renegotiation. Hoover's critics commit this mistake when they suggest that Social Security, Medicare, and Medicaid benefits must inevitably grow more expensive because of "the aging of the population and the increase in economywide health costs."[9] They are mostly right in their analysis of the causes of program cost growth (though these programs are also delivering rising per capita benefits), but their analysis is only an explanation; it doesn't undo the reality of the situation—nor does it mean these trends cannot be moderated.

Current law implicitly makes various questionable policy choices: that virtually all of our improved national health and longevity should translate into greater fractions of our lives spent in government-subsidized retirement, and that government should fuel excess healthcare inflation by perpetually ratcheting up the amount of health services purchased through government-subsidized insurance. Some might see less political resistance to raising taxes

9. Baily et al., "Debt Crisis Is Coming."

than to moderating these spending policies, or might simply prefer to leave them unrestrained. Either way, these programs are still driving the budget problem.

We need an open national discussion about whether to address the fiscal gap mostly by slowing the growth of government spending or by raising taxes. It is legitimate for anyone to argue that a certain amount of additional government spending growth is desirable and that we should raise taxes to meet it. This doesn't mean, however, that spending increases are not driving our budget strains. Nor does it mean that we can continue perpetually to allow entitlement spending growth to outrun our capacity to finance it.

Excerpt from Charles Blahous, Decoding the Debates
(Arlington, VA: Mercatus Center at George Mason University, 2020).