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#2
Lessons from the Anglosphere

The Bleak Long-Run Outlook

for US fiscal policy and how to improve it

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True North in Canadian public policy

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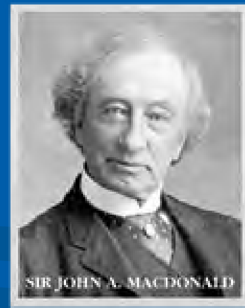

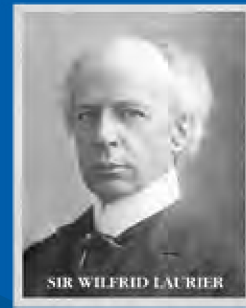

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Introduction

The United States is slowly but surely headed toward a federal debt crisis certain to inflict serious economic hardship on future generations. Today, the amount of federal debt held by the public stands at $14.8 trillion (all figures in this paper are in US $). While the US economy is expected to grow 76 percent in the next 30 years, that debt burden will, in inflation-adjusted terms, increase by over 240 percent during that time. Returning to a sustainable fiscal outlook will require hard choices and a clear understanding of both what led us to this point and the economic consequences of inaction.

Not all strategies to address the fiscal imbalance are equivalent. Both *when* reform occurs – ideally soon, before the burden becomes unmanageable – and *what* specific actions are undertaken will have meaningful effects on the long-run course of the US economy. For example, unanticipated and large tax increases may induce a recession, while gradual reductions in entitlement spending for future generations may encourage workers to increase their savings rate and foster long-run growth.

The objective of this essay is to explain the fiscal challenge and weigh the options to rectify it.

Defining the Problem

The publicly held federal debt today is the accumulation of past federal deficits, where the deficit (or surplus) is the difference between revenues and outlays in a given year. For example, in fiscal year (FY) 2016, the federal government collected roughly $3.3 trillion in revenues and spent approximately $3.9 trillion, making the FY 2016 federal deficit nearly $600 billion and increasing the federal debt from $14.2 trillion to $14.8 trillion.

While this framework is simple and logical, it obscures key nuances in the significance of the federal debt burden. In short, not all debt is the same. There is an important difference between debt accrued to acquire an asset and debt accrued to make a transfer payment. For example, the USS *Gerald R. Ford* – the first of the newest generation of aircraft carriers – was commissioned in early 2017 and cost approximately $13 billion to build. All else equal, the federal debt is $13 billion (or 0.088 percent) higher as a result. However, the federal government now owns an asset worth $13 billion with an expected useful life of 50 years. This is not the case when federal outlays are transfer payments, which they often are. For example, federal spending in response to hurricanes has averaged $14 billion annually in recent years just to restore affected areas (CBO 2016a). All else constant, the federal debt is $14 billion higher *per year* as a result. The point is not that one type of expenditure is good and the other bad, but that, despite the similar amounts, the transfer from the federal government is not economically equivalent to the purchase of a long-lived asset. Similarly, from a capital

> *"Federal entitlement spending on Medicare and Social Security has a distinct effect on the budget compared to investments in infrastructure."*

accounting perspective, federal entitlement spending on Medicare and Social Security has a distinct effect on the budget compared to investments in infrastructure.

It is also worth noting that some revenues collected today accrue a dedicated obligation for an outlay in the future. If today's deficit is lower because of these current revenues, the fiscal outlook may, in fact, be worse than it appears. For example, before the Great Recession, Social Security tax receipts were larger than outlays, but workers paying these taxes were accruing future retirement benefits.

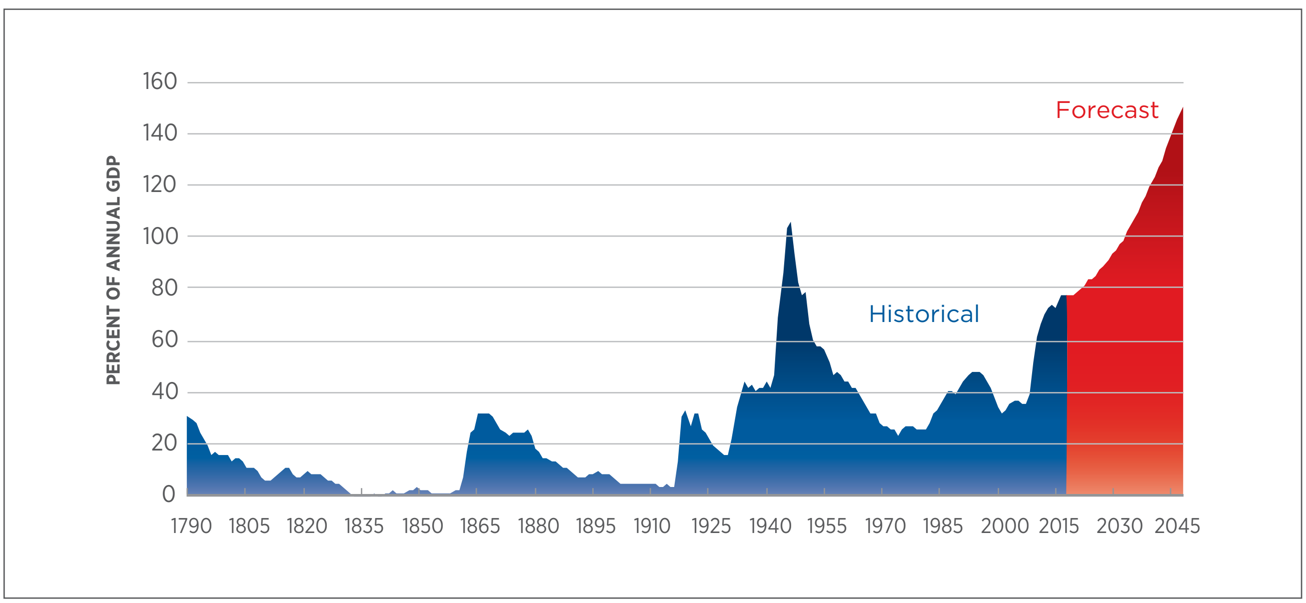
Understanding these distinctions is particularly important because the largest categories of federal spending are Social Security ($910 billion in FY 2016) and Medicare ($692 billion in FY 2016). As discussed in greater detail below, the growth of those programs has dire implications for our fiscal future.

The debt and interest burden the United States faces today

The magnitude of the US fiscal imbalance can be understood both from a current perspective and a forward-looking perspective. The amount of federal debt held by the public – $14.8 trillion – is unfathomable in many respects. It is equivalent to $119,499 in debt per household or $44,964 per person. It is equal to 48 percent of the value of all residential housing in the United States. It is slightly larger than total outstanding mortgage debt and is an order of magnitude larger than total outstanding student debt ($1.5 trillion).

But it is not particularly meaningful to assess debt by the amount alone. The ability of a nation to shoulder debt depends on the size of its economy; taxpayers in a large economy such as the United States, which produces $19 trillion in goods and services annually, have more resources to finance debt. As our economy grows in real terms, the consequence of a fixed level of debt is diminished. As such, a common way of describing a government's debt burden is to express the debt relative to annual GDP. In the United States, that share was 77 percent in 2016. Figure 1 illustrates the US debt-to-GDP ratio historically.

FIGURE 1: Federal debt held by the public

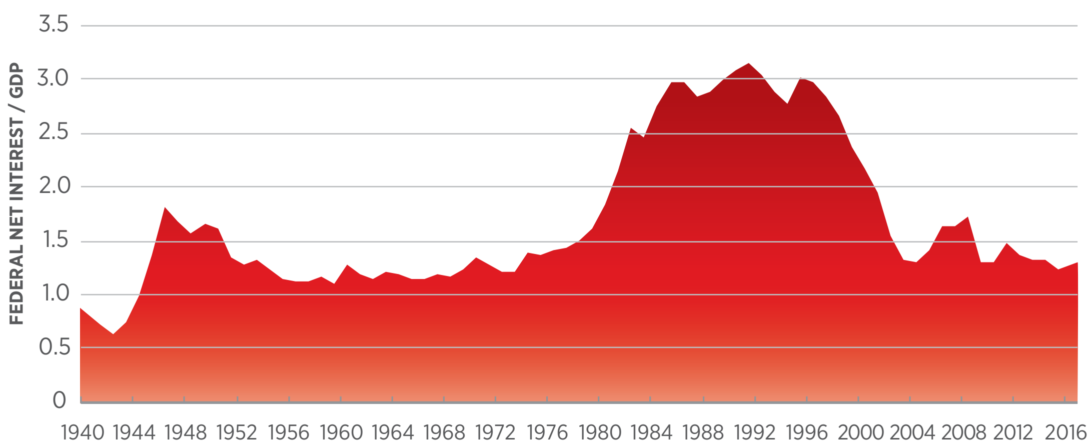


Source: Congressional Budget Office, Historical Budget Data (January 2017) and Long-Term Budget Projections (March 2017).

In addition to this federal borrowing, which has grown and is projected to continue to grow faster than the overall economy, state and local governments borrow as well. State budgets are generally constructed very differently than the federal budget and consist of an operating budget and a separate capital budget. Nearly every state is constrained to balance their operating budget, which covers state employee salaries, transfers to localities, and health programs. Generally, only capital budgets, which include investments in various types of infrastructure, are debt-financed, and the level of that debt has held relatively constant over the last decade. Beyond the operating and capital budgets of state and local governments is a third fiscal obligation, the pension liabilities for state and local government employees. In aggregate, these pension obligations are woefully underfunded. Estimates range from $1.4 trillion to $3.8 trillion depending on the methodology for valuing these liabilities (Rauh 2017). However, given the relative stability of state and local capital budgeting and the unique and complex nature of state and local pension funding, this essay will focus entirely on federal budget challenges and the options facing policymakers in Washington, DC.

In 2016, the cost to service the federal debt – that is, the interest paid on this obligation – totalled $241 billion, or 1.3 percent of GDP. Low interest rates in recent years have lowered the debt service cost considerably because both new borrowing and refinancing old debt are cheaper than in most previous decades. Thus, while the federal debt has increased significantly, low interest rates have caused interest payments on the debt to decline by more than 50 percent over the last 20 years, putting them back near the historical average. Figure 2 illustrates the cost of federal borrowing as a share of GDP since 1940.

FIGURE 2: Interest payments on federal debt

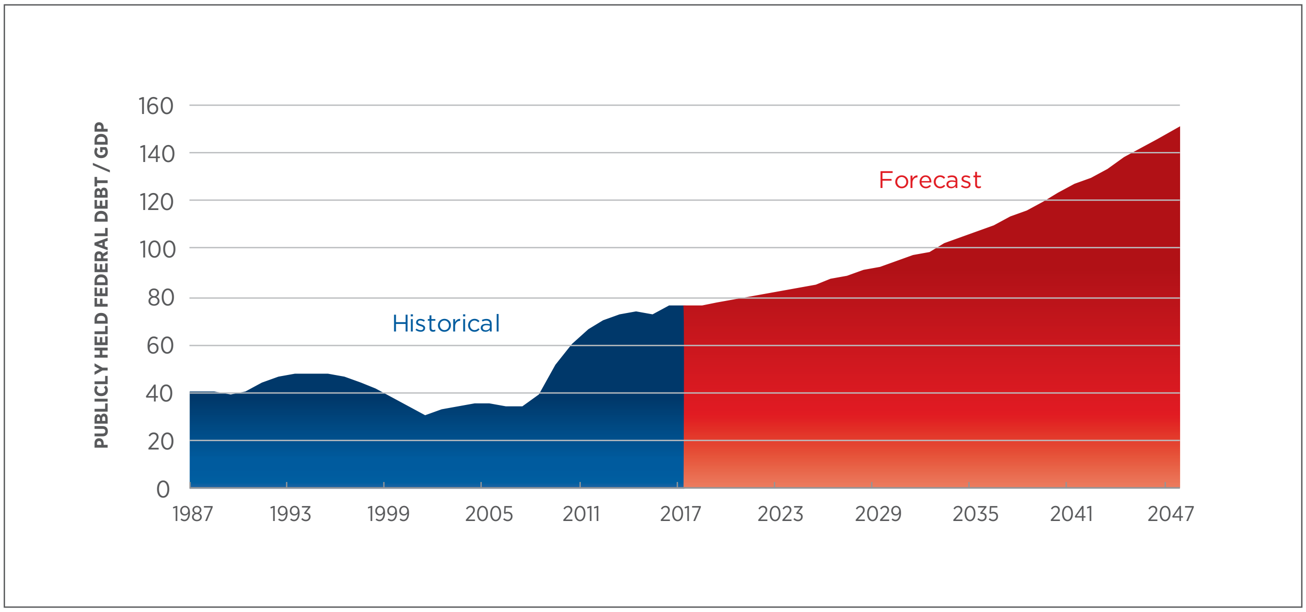


Source: Federal Reserve Bank of St. Louis and U.S. Office of Management and Budget, Federal Outlays: Interest as Percent of Gross Domestic Product [FYOIGDA188S], retrieved from FRED, Federal Reserve Bank of St. Louis.

The US debt and interest burden in the future

The outlook for federal borrowing is disturbing. According to the Congressional Budget Office (CBO), assuming no change in fiscal policies, federal outlays as a share of GDP are scheduled to increase from 20.7 percent to 29.4 percent over the next 30 years, while federal revenues are forecast to rise from 17.8 percent to 19.6 percent (CBO 2017). Due to this widening gap between outlays and revenues, the debt as a share of annual GDP is forecast to rise from 77 percent to 150 percent (see Figure 3). In real terms, the debt will increase from $14.8 trillion to $51.3 trillion. Should this forecast hold true, interest payments as a share of GDP will increase from 1.3 percent of GDP in 2016 to 6.2 percent of GDP in 2047, as debt rises and the 10-year Treasury rate more than doubles to 4.7 percent (CBO 2017).

FIGURE 3: Federal debt-to-GDP ratio



Source: Congressional Budget Office, Historical Budget Data (January 2017) and Long-Term Budget Projections (March 2017).

Long-run projections by the White House Office of Management and Budget (OMB) are similar (United States, Office of the President, Undated a). In the President's recent budget proposal, OMB estimated a baseline budget forecast that sees debt as a share of annual GDP rise to 85 percent in 2027 and 111 percent in 2042.

The CBO and OMB long-run forecasts are subject to significant uncertainty. As OMB notes, an increase or decrease in the annual productivity growth rate (and commensurate increase in interest rates) of one-quarter of a percent will raise or lower the debt-to-GDP ratio by roughly 15 percentage points after 25 years. The 2042 debt-to-GDP ratio will be 10 percentage points larger if health care costs grow 1.5 percentage points per year faster than GDP (rather than the baseline assumption of 0.8 percentage points); the ratio will be 10 percentage points smaller if health care costs grow at the same rate as GDP. The CBO also notes the effects of alternative policy assumptions on its long-run forecast. For example, limiting Social Security benefits to the amounts payable from dedicated funding would limit the debt-to-GDP ratio to only 111 percent in 2047.

The Evolution of the US Debt Burden

While the current US fiscal outlook is bleak, that was not always the case, even recently. In the late 1990s, the US government ran a small budget surplus. In 2000, the CBO projected a sustained budget surplus each year of the subsequent decade, reaching 3.3 percent of GDP in 2010 (CBO 2000). In actuality, debt held by the public was 40 percent of GDP in 2000. That same year, CBO forecast a decline in the debt-to-GDP ratio to a mere 6 percent of GDP in 2010. In reality, the debt-to-GDP ratio rose to 61 percent in 2010.

A review of historical budget forecasts reveals a turning point in the late 2000s when the CBO switched from forecasting an improving 10-year debt outlook to a deteriorating outlook. In the early 2000s

(2000–2003), the debt-to-GDP ratio hovered near 33 percent and CBO consistently projected a decline in the subsequent decade of 20 to 27 percentage points. The 10-year forecast was less optimistic during 2004–2006 (when CBO projected a 10-year change in the debt-to-GDP ratio of 0 to 7 percentage points) but again was noticeably positive in 2007 and 2008 when the debt-to-GDP ratio was 20.1 and 22.6 percent, respectively, and projected to drop to 15.1 and 16.7 percent over the course of 10 years.

In other words, optimism about the future reduction in the debt-to-GDP ratio was commonplace until recently – at least under the official 10-year "current law" budget scenario. In reality, the pressures of future entitlement obligations have threatened our long-run fiscal situation for decades, but because those pressures were forecast to materialize outside the 10-year budget window they were partially masked from lawmakers.

The 2008 inflection point

During the 1967–2007 period, the US debt-to-GDP ratio averaged 34 percent. It rose in the 1980s and fell in the 1990s but never exceeded 48 percent. A recession in 2001, unanticipated wars in Iraq and Afghanistan, and changes in fiscal policy (including tax cuts in the early 2000s and the establishment of a prescription drug benefit for retirees known as Medicare Part D) led to a very different fiscal reality from the baseline forecast in 2001.

> *"Optimism about the future reduction in the debt-to-GDP ratio was commonplace until recently."*

But the most dramatic changes started in 2008 as a result of the Great Recession. In 2008, the deficit was 3.1 percent of GDP. In 2009, the deficit surged to 9.8 percent of GDP as revenues dropped 2.5 percentage points (from 17.1 percent of GDP to 14.6 percent) and outlays surged 4.2 percentage points (from 20.2 percent of GDP to 24.4 percent, the highest level since 1945). In 2008, the debt-to-GDP ratio was 39 percent. After 5 years, it had climbed 33 percentage points to 73 percent, and it reached 77 percent at the end of 2016. In addition, the 10-year outlook was changing rapidly too. In 2010, the debt-to-GDP ratio was 60.9 percent and projected to increase to 66.7 percent in 2020. The next year, the debt-to-GDP ratio jumped to 65.9 percent, and the 2021 forecast soared to 76.7 percent.

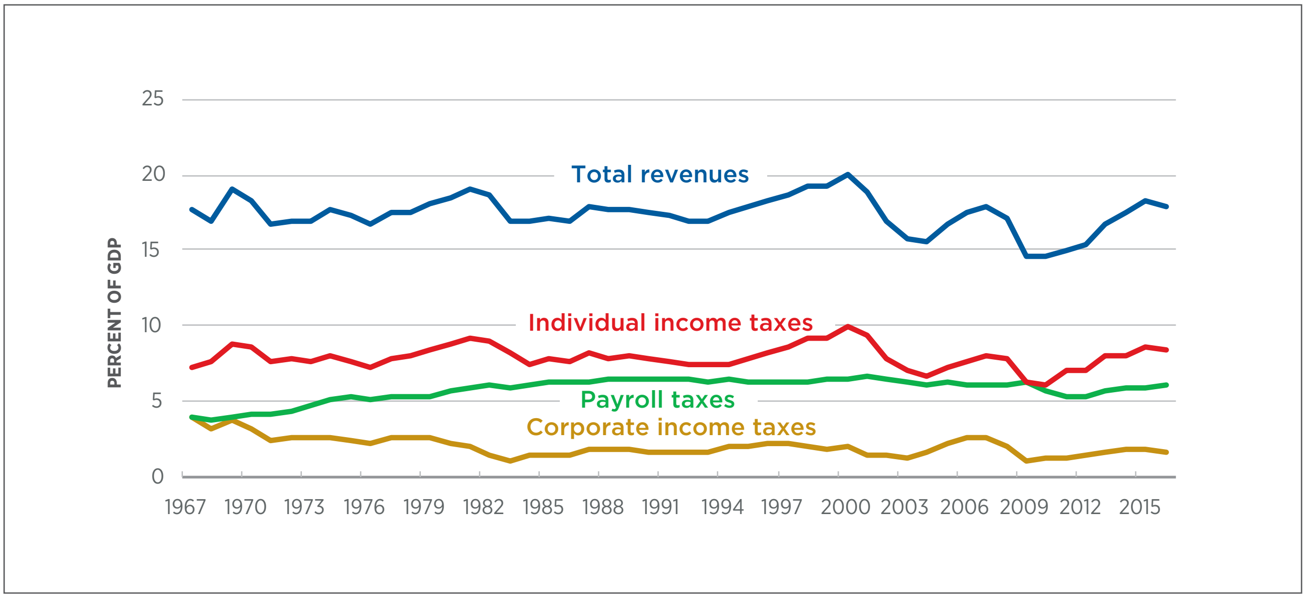
There has been only limited deterioration in the outlook in the last few years. Outlays have, for the time being, leveled off near 21 percent of GDP, and revenues have returned to near the post-1967 average as well. In the most recent CBO budget forecast, the debt-to-GDP ratio for 2016 was reported at 77.0 percent and likely headed to 86.1 percent by 2026. It may seem that the debt crisis is merely the result of this recent fiscal devastation, but in reality it has been long in the making.

Understanding the long-term drivers of the federal debt

Deconstructing the federal debt allows us to identify its primary drivers. This can be accomplished by examining tax receipts and outlays separately, as Figures 4 and 5 do.

In Figure 4, revenues are broken down into individual income taxes, payroll taxes, corporate income taxes, and other taxes. Over the last 50 years, total revenue has fluctuated from 15 percent of GDP to 20 percent and at present is 17.8 percent, near the 50-year average of 17.4 percent. Most of the aggregate volatility comes from the largest source, individual income tax receipts.

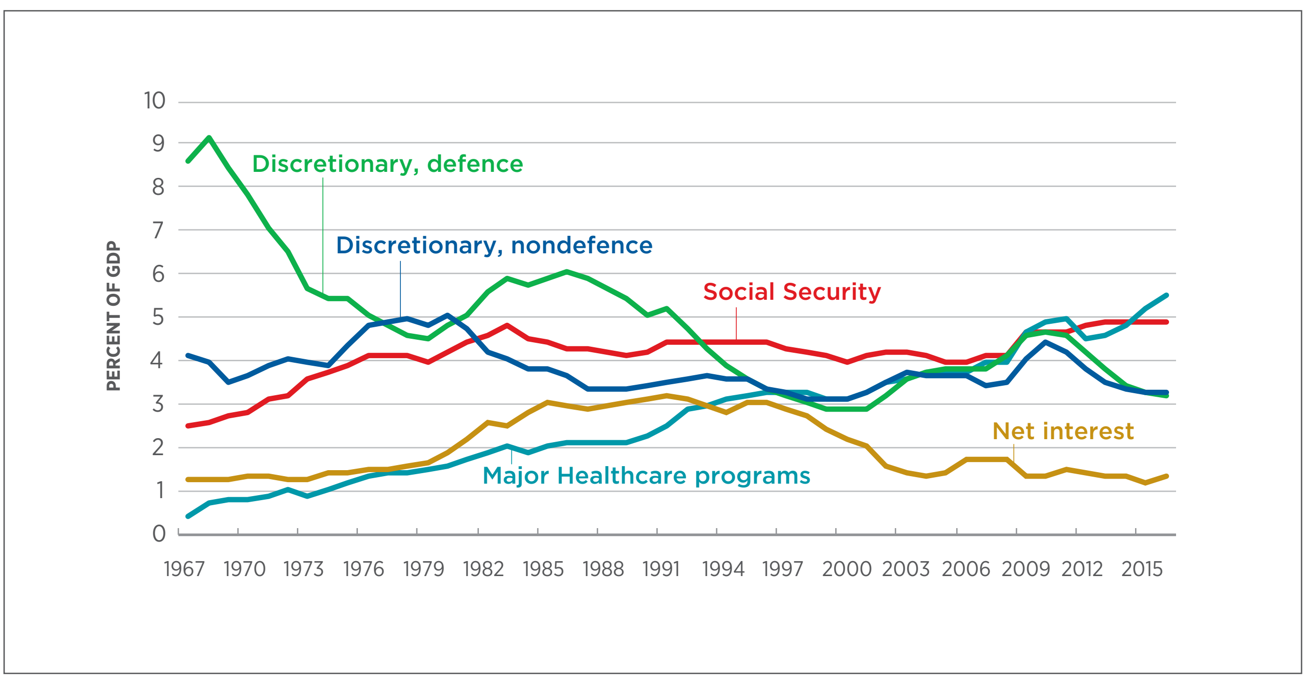
Figure 4: Tax revenue as a share of GDP



Source: Congressional Budget Office, Historical Budget Data (January 2017).

In Figure 5, outlays are broken down into several categories of discretionary and nondiscretionary spending. Discretionary spending refers to programs subject to the annual Congressional appropriations process. Congress must explicitly authorize and appropriate these funds in order for them to be available to federal agencies to spend. Nondiscretionary spending refers to programs that are on autopilot – that is, statutory provisions set this spending to occur without an annual Congressional appropriation. Social Security and Medicare are the largest of these programs, but many smaller programs, including food stamps and veterans' health benefits, also operate this way.

Figure 5: Federal outlays as a share of GDP



Source: Congressional Budget Office, Historical Budget Data (January 2017).

As is evident from Figure 5, mandatory outlays – primarily Medicare, Medicaid, and Social Security – have been rising as a share of the overall economy. In 1967, these two categories combined totaled 2.9 percent of GDP and grew to 10.4 percent by 2016. Defence spending is far lower than in the 1960s but has risen and fallen over the decades as US foreign and defence policy has reacted to changes around the world. Nondefence discretionary spending has been relatively stable. And, as discussed above, due to low interest rates, the cost to service the existing federal debt has remained relatively flat – and less than half as large as a share of GDP as in the early 1990s – over the last 15 years even as the debt burden has increased.

These data make clear that the historical drivers of the debt are rising federal outlays on entitlement programs, the largest of which are Social Security and Medicare. These two programs mostly service an increasingly aged population, which means that they will continue to grow as a share of the overall economy and will, over time, exert even more fiscal pressure on the federal budget.

In 2016, the Social Security program comprised 61 million people – 44 million retirees and dependents, 6 million survivors, and 11 million disabled workers and dependents. In 2016, the Social Security Administration spent $922 billion, 17 percent more than four years earlier. Due primarily to demographic changes, Social Security outlays are projected to grow from 4.9 percent of GDP in 2017 to about 6.0 percent of GDP in 2033. In 2034, Social Security Trust Fund reserves are projected to be depleted, and the fund's ongoing revenue will be insufficient to pay scheduled benefits. Absent a policy reform, payable benefits in 2034 will be only 77 percent of the amount that beneficiaries were promised. Over the long run, the unfunded obligation of the Social Security program is estimated to be 1.4 percent of GDP (Social Security Administration 2017).

In general terms, Social Security and Medicare are roughly similar in size at present. In 2016, 56.9 million people received benefits from Medicare, and total expenditures were $679 billion. Like Social Security, Medicare is expected to grow faster than the overall economy and eventually reach almost 6 percent of GDP, up from 3.6 percent of GDP in 2016. However, many independent analysts, as well as the Medicare trustees, strongly suspect that provisions of current law intended to constrain federal Medicare spending will prove to be politically untenable and operationally unsustainable. In other words, health care providers will be unwilling or unable to provide services at the lower reimbursement rates specified by current law. Under more plausible assumptions about the rate of growth of physician reimbursement and other provider reimbursements, the Medicare program will grow much faster than otherwise implied and much faster than Social Security. The 2017 Trustees report estimates that Medicare will balloon to 9 percent of GDP by 2091 under a more realistic alternative scenario that keeps physician payment rates growing with overall medical inflation, among other similar assumptions. Thus, while the near-term pressure on Medicare is modestly less than Social Security, the longer-run challenge is likely significantly greater.

Consequences of Inaction

Though the drivers of the bleak budget outlook are primarily Medicare and Social Security, the consequences of failing to address the debt crisis are broader-ranging. One consequence not fully appreciated in this time of extremely low interest rates is the cost of servicing our massive debt. As the CBO noted in a report on this topic last year:

> The government's net interest costs are projected to more than double as a share of the economy over the next decade—from 1.4 percent of GDP in 2016 to 3.0 percent by 2026. By 2046, if current laws governing taxes and spending generally did not change, those

> costs would reach 5.8 percent of GDP—increasing from 6 percent of federal spending to 21 percent over the next 30 years. (Barello and Simpson 2016)

While the likely long-run interest on US Treasuries is a matter of some debate, the CBO currently projects 10-year Treasury notes to yield 3.7 percent when they return to normal, a level roughly 50 percent higher than current interest rates. As a result, the cost of financing the debt, even if the amount of debt were to remain fixed, is scheduled to rise significantly in the next few years.

A second consequence of inaction is that the plausible policy choices become more limited as the pending fiscal challenges progress from medium-term challenges to near-term challenges. Policy changes that take effect a decade after enactment give affected parties time to adjust. This is critically important if the adjustments are large or potentially difficult. Fiscal reforms that are expected to lead taxpayers to increase their personal savings to offset adjustments to Social Security, for example, must give households many years to accumulate additional savings. If structural reforms are implemented gradually (as they were in 1983, when Social Security was last reformed), near-term adverse impacts can be mitigated or even eliminated. Conversely, if changes take effect immediately and adversely affect current beneficiaries, both the political cost and the economic cost will likely be large. The longer policymakers wait to enact the needed changes, the less latitude they will have to provide lead time before the changes take effect.

> *"Policy changes that take effect a decade after enactment give affected parties time to adjust."*

Due to the higher debt-to-GDP ratio and larger entitlement spending, the stakes are higher than they were in the 1983 Social Security reform or in 2005 when President George W. Bush unsuccessfully tried to reform Social Security.[1]

And finally, there are significant macroeconomic consequences of inaction. Large and sustained projected federal deficits would cause interest rates to rise, private investment to fall, and the economy to falter. As a result, the deficit outlook would worsen further. The CBO, in a discussion of high and rising federal debt, identifies a number of large-scale consequences. First:

> The large amount of federal borrowing would draw money away from private investment in productive capital in the long term, because the portion of people's savings used to buy government securities would not be available to finance private investment. The result would be a smaller stock of capital and lower output and income than would otherwise be the case, all else being equal. (Topoleski 2014)

Among other adverse consequences, if the debt burden rises significantly it will also impede lawmakers' ability to address unexpected challenges. The CBO warns:

> The large amount of debt would restrict policymakers' ability to use tax and spending policies to respond to unexpected challenges, such as economic downturns or financial crises. As a result, those challenges would tend to have larger negative effects on the economy and on people's well-being than they would otherwise. The large amount of debt could also compromise national security by constraining defense spending in times of international crisis or by limiting the country's ability to prepare for such a crisis. (Topoleski 2014)

1 The 1983 legislation resulted from the "Greenspan Commission" that developed the reforms including a phased-in increase in the Social Security retirement age. The Bush administration focused on establishing personal retirement accounts and investing a portion of trust fund assets in private assets.

Solutions

Comprehensive reform proposals

A recurring but misguided solution to the debt crisis is a balanced budget amendment (BBA) to the US Constitution, requiring that the federal government spend no more than its revenue in each fiscal year. In January 2017, Senators Chuck Grassley (R-Iowa) and Mike Lee (R-Utah) became the latest lawmakers to introduce a BBA.

The allure of this idea lies in the belief that policymakers have proven themselves inadequate to the task of matching government spending to revenues, and only a strict requirement to balance the budget will ensure fiscal responsibility. But this is an ill-advised approach because it imposes an artificial rigidity on the annual budget. Moreover, a strict BBA would limit the federal government's ability to respond to temporary emergencies that require deficit funding. For example, there can positive effects of deficits as "automatic stabilizers" that can reduce the duration and/or severity of a recession, and deficits can be necessary to quickly and significantly increase spending at times of war. To address this concern, most recent BBA proposals include a "release valve" of sorts by permitting a super-majority vote in both the House and Senate to override the balanced budget requirement. This political hurdle may prove unreachable in a politically charged environment or, conversely, may be too easily reached and thereby prove the rule ineffective.

In recent years, several proposals have offered real solutions to the debt crisis. For example, a plan that I coauthored with colleagues at the American Enterprise Institute would reduce the debt to 63 percent of annual GDP by 2040. Key elements of that plan include converting Medicare to a premium support plan, moving to block grants for Medicaid, replacing the Social Security benefit formula with a flat-dollar benefit, and reforming the tax code in a manner likely to promote growth and modestly increase revenues (Antos, Biggs, Brill, and Viard 2015). The report we wrote was one in a series of reform proposals submitted by think tanks to a project organized by the Peter G. Peterson Foundation. Needless to say, those proposals received scant serious attention by lawmakers.

> *"Deficits can be necessary to quickly and significantly increase spending at times of war."*

The National Commission on Fiscal Responsibility and Reform, a bipartisan commission formed by President Barack Obama in 2010, put forward an even more aggressive proposal that would reduce the debt to 40 percent of annual GDP by 2035 (National Commission on Fiscal Responsibility and Reform 2010). Commonly known as Simpson-Bowles after its co-chairs, former senator Alan Simpson and former White House chief of staff Erskine Bowles, the commission's December 2010 report proposed discretionary spending caps; tax reform structured to lower statutory rates, broaden the tax base, and increase revenues; and Medicare, Social Security, and mandatory spending reforms to curb the growth of these programs.

The Simpson-Bowles plan went nowhere. Similarly, large-scale fundamental reform negotiations contemplated by then-Speaker of the House John Boehner and then-President Obama faltered and later collapsed. A process established in the Budget Control Act of 2011 (BCA) known as the Joint Select Committee on Deficit Reduction (commonly referred to as the Super Committee) was an effort by lawmakers to facilitate major deficit reduction in the coming decade. The Super Committee, consisting of six Democrats and six Republicans equally divided between the House and Senate, was charged with proposing legislative changes to reduce the deficit by at least $1.5 trillion in the coming decade. Any proposal that garnered support from a simple majority of committee members could then receive expedited consideration in the House and Senate and would not be subject to amendments on either the House or Senate floor. On November 11, 2011, the Committee announced it was unable to reach an agreement and no deficit reduction bill was considered in that Congress. Instead, a backstop provision in the BCA, automatic sequestration, reduced spending across the board. Specifically, discretionary spending reductions were imposed equally between defence and nondefence budget categories, and some mandatory spending was reduced, though Social Security, Medicaid, interest on the debt, and veterans' programs were exempt from cuts. Medicare cuts did occur but were limited. Amendments to the BCA in 2012, 2013, and 2015 mitigated these cuts relative to the amounts projected in the BCA.

Entitlement spending and the national debt continue on an unsustainable course. On the campaign trail, now-President Donald Trump went so far as to promise that Social Security, Medicare, and Medicaid would not be touched should he be elected; he recently reiterated his commitment not to cut the first two programs (Wocjik, 2017, March 16).

Incremental options for reducing the debt

While many experts and policymakers have focused on comprehensive plans like those described above, the debt crisis does not have to be solved all at once. Although prompt and large-scale reform would be desirable, it may well be politically infeasible. Moreover, due to the uncertainty associated with the long-run fiscal baseline as well as the uncertainty associated with the exact impact of reform, incremental reforms may be more appropriate, and properly chosen incremental changes can go far in addressing long-term budget challenges.

For example, the CBO periodically presents options for reducing the deficit, complete with estimates of what each option would save over the 10-year budget window (CBO 2016b). Among the deficit-reduction ideas for Social Security, the most substantial (saving $190 billion over 10 years) is reducing benefits for new Social Security beneficiaries by 15 percent. The next largest (saving $182 billion over 10 years) involves indexing Social Security cost-of-living adjustments to a more accurate measure of inflation known as the chained consumer price index. However, while the 10-year savings of both of these options is very similar, the inflation-adjustment option has somewhat less long-term impact. Reducing benefits for all new beneficiaries saves $58 billion in 2026 while correcting the inflation adjustment saves just $39 billion in 2026.

> *"Entitlement spending and the national debt continue on an unsustainable course."*

For Medicare, the CBO option representing the greatest opportunity for savings is increasing premiums in Medicare Parts B and D, which would save $331 billion over 10 years. Other incremental health care reforms include tax policy changes. For example, limiting (but not eliminating) the tax subsidy for employer-provided health insurance could raise $429 billion over 10 years, including $92 billion in 2026.

Even in combination, let alone individually, these kinds of reforms would be entirely insufficient to adequately address the projected growth in the debt-to-GDP ratio in the coming decades. However, regularly accumulating reforms of this magnitude, whether they be within Medicare, Medicaid, Social Security, or any of the myriad other federal entitlement programs, could lead to a measurable improvement in the long-term fiscal outlook.

Federal policies, other than on taxes and spending, can also improve the fiscal outlook by increasing the economy's long-run growth rate. Minimizing the burden of necessary regulations while repealing unnecessary restrictions on businesses and workers – and thus on innovation – can improve the flexibility of the US economy and ultimately enhance growth. Moreover, without altering the aggregate level of federal taxes, restructuring the tax code in a revenue-neutral manner to reduce distortions and promote growth could improve the fiscal outlook over the long run.

The fiscal challenges facing the United States cannot be addressed solely through faster real economic growth, but accelerated growth can be a meaningful contributor. An increased growth rate will generate additional tax revenues while modestly reducing the need for safety net programs. Critical to understanding this channel for fiscal relief is a reasonable expectation about the magnitude of potential change. For example, if real GDP growth is 0.1 percentage points faster than otherwise expected, the budgetary impact over a decade is estimated to be $313 billion (United States, Office of the President, Undated b).

Conclusion

The US federal government's choice to debt-finance a portion of its spending has saddled future taxpayers with an undeniable burden: higher taxes and/or fewer government services. The appropriateness of these decisions depends on an evaluation of the consequences of alternative choices – higher taxes or lower spending – either of which would have mitigated the current federal debt burden. While increased deficits during periods of military conflict and economic recessions are reasonable and commonplace in the history of the US and many other developed nations, the US has experienced large deficits during other periods as well. As a result, it has accumulated significant debt, which will impose high debt service costs when interest rates rise.

Importantly, the feasibility of achieving fiscal sustainability without significant tax increases declines with time because dramatic cuts in benefits to current beneficiaries will be political untenable. Incremental reform options can help curb the growth of entitlements and, if necessary, collect new revenues in a manner less economically distortionary than the current tax code. But absent serious fiscal reform, the debt outlook is scheduled to deteriorate significantly in the coming decades. Social Security benefits are projected to increase as a share of GDP while payroll taxes remain relatively constant. Rising health care costs and an aging population will likely cause Medicare and Medicaid spending to increase even faster than Social Security.

In other words, the one option that will not exist much longer is doing nothing.

About the Author

Alex Brill is a resident fellow at the American Enterprise Institute (AEI), where he studies the impact of tax policy on the US economy as well as the fiscal, economic, and political consequences of tax, budget, health care, retirement security, and trade policies. Brill is the author of a pro-growth proposal to reduce the corporate tax rate to 25 percent, and *The Real Tax Burden: More Than Dollars and Cents* (2011), coauthored with Alan D. Viard. He has testified numerous times before Congress on issues including tax policy, labor markets and unemployment insurance, Social Security reform, and fiscal stimulus.

Before joining AEI, Brill served as the policy director and chief economist of the House Ways and Means Committee. Previously, he served on the staff of the White House Council of Economic Advisers. He has also served on the staff of the President's Fiscal Commission (Simpson-Bowles) and the Republican Platform Committee (2008).

Brill has an M.A. in mathematical finance from Boston University and a B.A. in economics from Tufts University.

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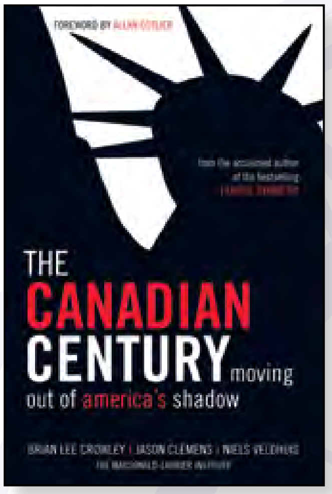

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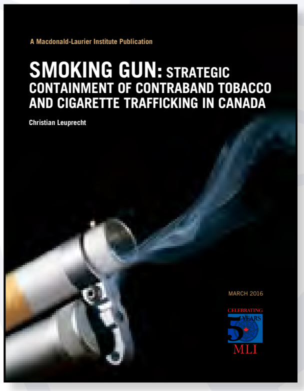

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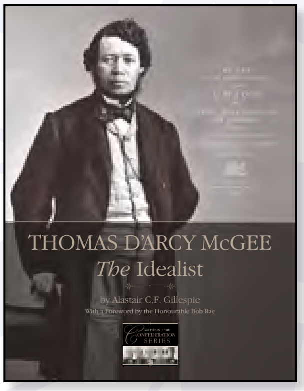

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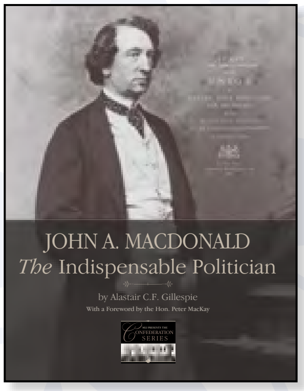

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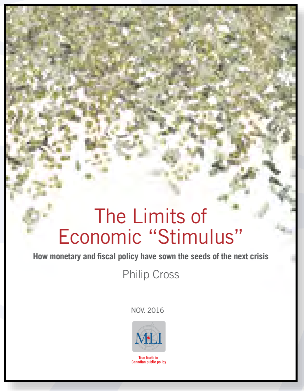

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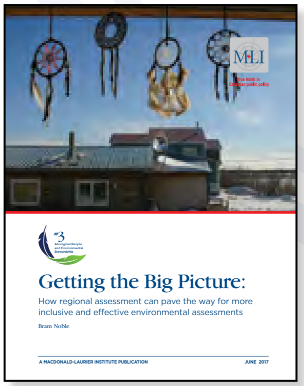

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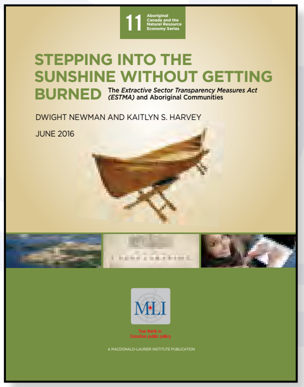

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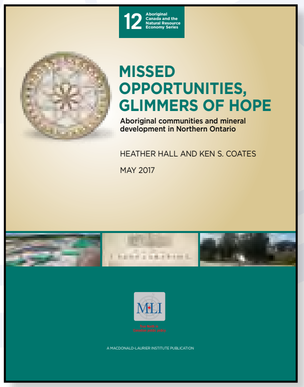

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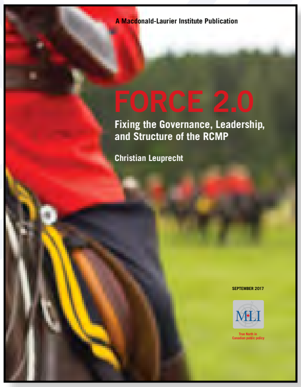

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