Process Before Policy
How Washington Can Avert Financial Ruin After the Election

By R. Glenn Hubbard

With Republicans set to control both houses of Congress, pundits are busy asking what will come next, particularly on questions of taxes and spending. Ordinary Americans, meanwhile, are wondering what will even be possible. According to a Washington Post-ABC poll conducted in September, the number-two issue on voters’ minds during the election was “the way things are working in Washington.” They were onto something: Changing the rules of the policy game, not just the leaders who play it, may be the key to solving the country’s fiscal problems.

The challenge is clear. Absent changes in policy, continual increases in federal spending, particularly in spending on retirees, will bury Washington in dangerous levels of debt. But the changes needed to avert that outcome are significant. According to the economists Alan Auerbach, of the University of California, and William Gale, of the Brookings Institution, just keeping the federal debt-to-GDP ratio at its current levels over the next 75 years would require a combination of tax hikes and spending cuts worth about 3.5 percent of GDP annually, or more than $500 billion at current levels.

The clarity of the problem is matched by its apparent intractability. Debates among policy wonks and elected officials have been a staple of public discussion for some time, and there is little reason to believe that these discussions by themselves can affect the larger picture. Of course, as the late economist Herbert Stein famously observed, “If something cannot go on forever, it will stop.” But if left unchecked, the fiscal imbalance could “stop” in damaging ways, creating punishingly higher tax burdens, disrupting spending on Social Security and Medicare, and eviscerating other government programs.
Avoiding such a fate requires legislators to rethink not just policy but process as well. Radical changes in federal spending have made the budget process dangerously out of date. Historically, government debt tracked war and peace—Washington borrowed heavily during conflict and pared back during peacetime. Other spending was also self-regulating: Congress could quickly raise taxes or lower spending to avoid long-term imbalances. In recent decades, however, discretionary spending, which undergoes regular review, has diminished in importance relative to so-called mandatory or entitlement spending, which is subject to fewer checks. This type of spending made budget deficits appear small when entitlement programs, such as Medicare and Social Security, were in surplus. Now that aging Americans are beginning to cash in, though, those programs are set to run major deficits.

The looming fiscal crisis has not gone unnoticed, of course. A chorus of economists warning of massive unfunded liabilities—tens of trillions of dollars’ worth in Social Security and Medicare alone—has spurred various proposals for reform, such as introducing personal accounts to Social Security and reducing Medicare subsidies for more affluent retirees. But the last major accomplishment on this front—a package of reforms to Social Security that increased revenue from payroll taxes and raised the age at which maximum benefits could be received—came in 1983. Moreover, those reforms were exceptional, since they responded to an imminent cash flow crisis and were enacted extremely slowly (the increase in the retirement age won’t be fully in place until 2027, long after the reform’s young champions on the National Commission on Social Security Reform have retired). The years since have seen a succession of failures. The presidential administrations of Bill Clinton and George W. Bush each fumbled compromises to shore up Social Security. And unfunded liabilities—future financial obligations that Washington hasn’t figured out how to pay—for new spending increased during both the Bush and Obama administrations.

The need to act and the pressure to act remain. The need reflects the basic arithmetic of an imbalance between revenue and spending that demands correction. The pressure reflects a political concern for the present, the future, and the programs themselves. In the present, legislators are struggling to fund discretionary spending on such priorities as defense, education, infrastructure, and scientific research. And in the future, the fiscal imbalance will dramatically reduce benefits and increase the tax burden for generations to come. Relying on quick fixes could damage critical programs, compromising the quality of the benefits older Americans receive.

There is another way, however: Congress could restructure the budget process before it attempts to rebalance the budget. Although focusing on rules would delay changes in policy, it would offer the best hope of reforming federal spending to reduce long-term debt and safeguard social insurance programs. The new approach would emphasize three steps: addressing information, policy debate, and budget discipline.

The first step would be to provide better information to facilitate debate among the public and elected officials on how to address long-term budget problems. At present, the White House’s Office of Management and Budget, the Joint Committee on Taxation, and the Congressional Budget Office provide detailed information on revenue and spending within periods of five or ten years. Longer-term measures are not standardized, making analysis difficult. Congress and the president should therefore provide a standardized definition of the government’s unfunded liabilities over the long term. Such information would show annual changes in liabilities, and map out a clearer path toward achieving long-term fiscal balance.

The second step would be to amend the budget process to require debate over policies that worsen or improve the U.S. fiscal position over the long run. The Congressional Budget Office would be tasked with keeping a running calculation of the U.S. government’s total unfunded liabilities and inform Congress of how any significant legislative proposals would change that calculation. And any bill increasing unfunded liabilities could not be implemented without new taxes or spending cuts to offset its cost. An even better step would be to require such action for any changes in accrued liability. Another possible reform would be to fast-track proposals that reduce the government’s unfunded liabilities in the long run.

The third step would be instilling budget discipline by enforcing restraints on the long-term fiscal imbalance. The overall goal of budget process reform should be to encourage proposals that make taxes and spending consistent with budget targets. To provide discipline, budget caps would need to apply to mandatory spending as well as to discretionary spending. Currently, Social Security and Medicaid are exempt from caps, and Medicare cuts are limited to those that reduce payments to healthcare providers. A reformed system would put all programs on the table, but focus on cutting benefits for wealthier recipients (for example, a progressive indexation of Social Security benefits, requiring higher-income Medicare beneficiaries to pay...
more for their coverage). Required reductions in Medicaid spending could be balanced by removing insurance mandates on states. Any process of sequestration should be adjusted as tax and spending estimates change over time. And savings should be allowed to materialize over five-to-ten years, so as not to require radical annual adjustments.

Such changes in the budget process would force legislators to consider how to address the nation’s fiscal challenges without biasing how tax increases would be balanced against reductions in spending.

Why would elected officials—who have time and again failed to achieve consensus on policy—agree to a process reform that raises similarly thorny political concerns? For two reasons: First, providing standardized and accurate information about fiscal challenges—information about which it would be difficult to disagree—would motivate the public to push for more meaningful debate over fiscal policy in Congress. Second and more important, both conservative and liberal elected officials could find it easier to forward proposals they champion.

Conservative efforts to reform the tax code or Medicare have been hampered by the fact that gains from the policy change would take a long time to materialize. For example, a move to allow businesses to count the entirety of their capital investments as expenses would lose revenue in the short run (as expensing would be more generous than existing write-offs), but generate additional investment, GDP, and tax revenue over time. Premium support in Medicare—in which participants would purchase health insurance from one of a number of competing plans, with the federal government covering only part of the cost—would likely lower Medicare costs substantially over many years because of greater competition and consumer price sensitivity, but generate few such savings in the five-to-ten period considered by the current budget process.

Similarly, liberals’ emphasis on the need for greater federal spending on education and vocational training is frustrated by a focus on near-term outcomes in the existing budget process. But the returns on improved human capital in higher wages and revenue would eventually offset the upfront cost.

The stakes for action are high. If elected officials recklessly avoid changes to entitlement programs, a crisis will eventually force resolution. But building a better budget process offers a chance to prevent the damage such a crisis would bring. Taking that step will require both public pressure and leadership. The outcome of the latest midterm elections has provided the former. Increasing that pressure during the 2016 presidential campaign can produce the latter.