## View from the Beltway

# Time for Fiscal Restraint

**BY OWEN ULLMANN**

*For the common good.*

The budget-cutting deal President Joe Biden and House Speaker Kevin McCarthy (R-CA) reached to raise the federal debt ceiling may have averted a catastrophic first-time default by the U.S. government. But it did little to slow the projected growth of the nation's burgeoning debt—or calm critics convinced the country is headed for bankruptcy.

A June analysis by the politically neutral Congressional Budget Office concluded that a $1.5 trillion reduction in deficits anticipated over the next ten years would reduce the projected federal debt held by the public (which excludes debt government agencies hold) a paltry 3 percent by 2033—from $46.7 trillion to $45.2 trillion. As a share of GDP, it would edge down from 119 percent to 115 percent, still a record.

That forecast assumes we stay on this dangerous trajectory, as gutless politicians in Washington duck their responsibility to ensure the nation's long-term fiscal and economic health. It's possible we'll get lucky if there are no major fiscal policy changes and unexpected events improve the outlook, much as the collapse of the Soviet Union and rise of the internet era during the 1990s produced a huge economic premium for the United States. By contrast, an already dire outlook could worsen, as happened with the double blow of the seismic housing bust of 2007 and later the Covid-19 pandemic that caused unprecedented pain never anticipated.

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As the debate over the burgeoning debt heats up, it's important to remember that this is a problem the United States has been dealing with since its declaration as an independent nation nearly 250 years ago. Even as the nominal debt has swelled with each passing decade, the U.S. economy has thrived, emerging as the world's largest for a century. And the dollar has been the world's dominant reserve currency for sixty years.

That's because periods of sharply rising debt burdens as a share of GDP—usually as a result of wars—have been followed by longer periods of falling debt-to-GDP ratios thanks to a combination of sound fiscal policies to keep deficits in check and the resilience of an economy that has led the world in innovation, productivity, and reinvention. Add to that the important contributions of a Federal Reserve that—while far from perfect—has sought to keep the economy from collapsing during financial crises and moved aggressively to combat high inflation, as it is doing now.

A look at the history of the national debt, which has bounced around from beastly to benign over the

*Owen Ullmann is* TIE*'s executive editor and author of* Empathy Economics, *a biography of Treasury Secretary Janet Yellen published in September 2022.*

## Bipartisan Giants

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*—O. Ullmann*

**President Ronald Reagan** *signs the Social Security Amendments Act of 1983. Left to right:* **Representative Claude Pepper (D-FL), House Minority Leader Bob Michel (R-IL), President Reagan, Senator Daniel Moynihan (D-NY),** *and* **House Speaker Tip O'Neill (D-MA).**

centuries, is useful to put the issue in perspective.

Leaders of the American Revolution borrowed $54 million from individuals, Netherlands, and France to finance the war against Britain. By 1790, the debt was $77 million ($2.5 billion in today's dollars). Treasury Secretary Alexander Hamilton observed at the time: "A national debt, if it is not excessive, will be to us a national blessing." It's still good advice to heed.

The debt grew rapidly to finance the War of 1812 and an expanded federal government. Populist President Andrew Jackson, who despised the debt—along with every other symbol of federal authority—sold off vast tracts of government land in the West, allowing the government to be debt free in 1835. A financial triumph? Hardly. A subsequent real estate bubble, financial troubles from his elimination of the National Bank, and other economic woes at the time led to the Panic of 1837 and a subsequent depression. The government was forced to borrow again and has been in debt ever since.

The debt shot up to finance the Civil War, then edged down steadily as a share of GDP during subsequent decades as a result of economic growth and, at times, prudent fiscal policies. The debt exploded again to pay for World War I, and again came down until the Great Depression and World War II sent the debt soaring above 100 percent of GDP for the first time.

An economic boom during the post-World War II period saw the debt held by the public plummet to 26 percent of GDP. It climbed back over the next decade to nearly 50 percent of GDP, as President Ronald Reagan's tax cuts and defense spending increases produced chronic record deficits. The "supply-side" miracle—the belief by Reaganites that stronger economic growth spurred by the tax cuts would produce a revenue bonanza—did not materialize.

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An unexpected revenue boom did occur, but during Bill Clinton's presidency, thanks to a productivity boom and surging stock market as the internet came of age. The budget produced surpluses four years in a row during Clinton's presidency, from fiscal 1998 through 2001, the last inherited by his successor, George W. Bush. As a result, the debt-to-GDP ratio declined again. It didn't last.

The dot.com bust of 2000, President George W. Bush's tax cuts, and spending for the wars in Afghanistan and Iraq quickly turned the surpluses into deficits and the debt took off again. It has been rising ever since to new heights, spurred by massive federal spending during Barack Obama's presidency to offset the 2007–2009 housing crash and Great Recession, President Donald Trump's tax cuts, and a mind-boggling $7 trillion approved during the Trump and Biden Administrations to offset the economic collapse caused by the Covid-19 pandemic.

What this history lesson reveals is instructive. From a financial perspective, U.S. securities have always been in demand around the globe, often at rock-bottom interest rates. They remain a safe-haven investment—at least for now. From a political perspective, there is no doubt that both political parties have contributed to our current debt crunch and neither can rightly claim to be guardians of fiscal responsibility. Republicans consistently cut taxes and

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com



raise defense spending as Democrats fight off domestic spending cuts to pay for those tax cuts; Democrats consistently boost domestic programs as Republicans block tax increases needed to pay for them. And so, we have routinely run annual budget deficits averaging about 3 percent of GDP.

The problem is worsening because the debt is growing faster than an economy that is hampered by slowing population growth and productivity growth averaging nearly a full percentage point below that during the three decades after World War II and half the rate of twenty years ago.

Clearly, another bipartisan deal—a much larger one than the debt-ceiling agreement—is essential to bring the debt down to a more sustainable debt-to-GDP ratio and lessen the onerous interest payments on that debt. There are many reasonable proposals

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from across the political spectrum if Congress and the president show the courage to act in the public interest rather than for partisan advantage.

■ **Entitlement reforms.** Social Security, Medicare, and Medicaid account for nearly half of all federal spending and will keep growing as the population ages without needed reforms that most politicians seem unwilling to go near. Left untouched, the Medicare Trust Fund won't be able to pay 100 percent of benefits in just eight years; the same will happen to Social Security in ten years.

Faced with a similar problem in 1983, a conservative Republican President Reagan and a liberal Democrat House Speaker Tip O'Neill cut a deal to shore up Social Security under a compromise that raised the retirement age and payroll tax. They acted at the eleventh hour. A similar deal that slows rising costs and boosts revenue is needed soon. Whatever anger voters may show when a deal is cut will turn to gratitude when the most successful and popular federal program is preserved for future generations, as Reagan and O'Neill discovered.

Slowing the rising cost of health programs is more complicated, but many solutions abound that involve a combination of cost-cutting, revenue increases, and more attention to preventative care that avoids costly treatments down the road.

■ **Defense cuts.** The Pentagon's budget is nearly $1 trillion a year—more than the next ten countries spend combined. Yet many defenders of the Pentagon argue that defense spending needs to increase in a world that has become more dangerous and hostile to U.S. interests, particularly from China. Senator Susan Collins of Maine, the top Republican on the Senate Appropriations Committee and hardly a prominent defense hawk, expressed concerns this spring that the budget won't be enough to reach the Navy's goal of 373 ships. She noted that China is on pace to have a fleet of 400 ships compared to 296 U.S. ships currently commissioned.

Yet increased spending does not necessarily mean increased national

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security if the defense budget is filled with wasteful projects that members of Congress champion only to benefit their districts. The Congressional Budget Office detailed in December how to cut more than 10 percent of unnecessary defense spending over a decade. Mark Thompson, a national security analyst for the watchdog organization Project on Government Oversight, estimates the savings could

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be closer to 20 percent, without damaging U.S. national security interests.

"There was no reason to launch the $400 billion F-35 program; upgrades to our existing fighters could have done the job," says Thompson, a Pulitzer Prize-winning journalist who has covered the Pentagon for four decades, including as a senior correspondent and deputy Washington bureau chief at *Time* magazine from 1994 to 2016.

"We are spending more than $10 billion annually on missile defense, about half of which goes to a national missile defense program—the Ground-Based Midcourse Defense system—that isn't needed and won't work if it is deployed," he notes. "We continue to produce $20 billion aircraft carriers (including planes that can't fly far enough) that the Chinese call 'targets'. We need to stop building these super-carriers and replace them with smaller vessels outfitted with drones and missiles.

"The United States continues to view the nuclear triad—those bombers, subs, and ICBMs originally built to deter the Soviet Union—as sacrosanct. That's why it's willing to spend $1.5 trillion over the coming thirty years to rebuild each leg and keep them running. The triad was an accident of the Cold War that is now cited as vital to the nation's defense. It would take real leadership to do what should be done: scrap the bomber and ICBM legs, relying on sub-launched missiles alone.

"And we need to shutter the 20 percent-plus of bases the Defense

Department says it doesn't need. But given that we haven't shut any U.S. bases in about twenty years, don't hold your breath for that, or any of these other proposals to happen. The military-industrial complex loves the status quo, and its patriotic sheen has made it invulnerable to the top-to-bottom reform it so desperately needs."

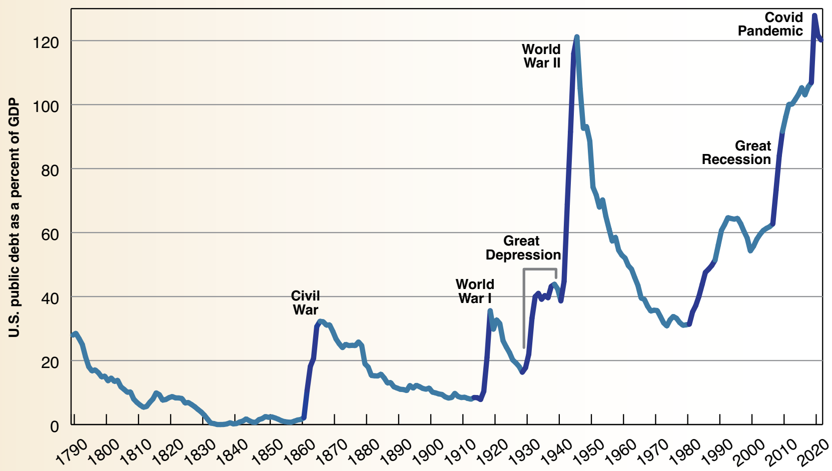
■ **Domestic spending restraint.** After three years of record stimulus spending to help the economy recover from pandemic shutdowns—and stoking a surge of inflation—a freeze or minimal growth of discretionary domestic spending for a few years isn't draconian. A sharp slowdown in U.S. population growth also justifies a spending pause for non-essential programs if the economy continues to edge ahead, albeit slowly, with very low unemployment.

New programs should be paid for with new revenue. A good example is the $1 trillion bipartisan infrastructure act that Biden signed into law in November 2021. It is at least partially paid for with new sources of revenue, although how much is in dispute among experts who have analyzed the legislation. Nonetheless, it addresses numerous transportation, climate, and internet access needs that should have a beneficial effect on economic growth and global warming.

■ **Revenue increases.** Any broad-based tax increase is highly controversial and aggressively fought by those affected and their representatives in Washington. But it's high time we come closer to paying for all the government largesse we seem unable to do without.

An easy way to start would be to improve ways to collect legally due taxes that go unreported every year. The Internal Revenue Service estimates that amount could be in the neighborhood of $500 billion a year, the result

**U.S. public debt as a percent of GDP, 1790–2022**




Sources: Treasury Direct, Congressional Budget Office, Federal Reserve Bank of St. Louis.

of years of declining staff and audits. A new infusion of money will go in part to increase audits of those earning $400,000 or more annually. Expecting everyone to pay their legally obligated taxes—particularly those who can most afford to—is only fair.

Closing so-called "tax loopholes" is tricky since some interest groups always find a way of defending such a break as a necessity that protects the target's financial viability and benefits the overall economy. Even so, it's hard to justify breaks such as the "carried interest" loophole that lets private equity and hedge fund managers classify their salaries as investment income that is subject to the capital gains tax rate rather than the higher personal income tax rate.

Fairness also would require a minimum corporate tax to avoid the annual negative publicity surrounding the roster of large, profitable companies that paid no federal income taxes.

Such moves toward fiscal responsibility may seem hopeless during these times of partisan rancor and division. Yet the small debt-reduction bill raises hope that there are still politicians willing to stick their necks out for the good of our economic future.

A relatively modest course correction now for a federal budget that appears to be running amok could push the U.S. economy and its national debt in a healthier direction over the long term. That would bolster investor confidence, maintain the dollar's dominance as a global reserve currency, lower interest rates, and make annual debt payments less burdensome. We'd still have a very large nominal national debt, but one that grows slower than the economy and that can be serviced without financial strain.

We just need our elected representatives to act with common sense for the common good. ◆

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