Taxes and Spending

9. The Federal Budget

Congress should

- balance the budget without raising taxes;
- reduce domestic discretionary spending by more than \$350 billion, thereby cutting the discretionary budget from 7.9 percent of GDP to 5 percent;
- reform Social Security by moving toward a system of individual savings accounts;
- reform Medicare to cut costs, and freeze Medicaid spending at current levels and distribute the funds to states as unrestricted block grants;
- establish a ''sunset'' commission to automatically review all federal programs on a rotating basis and propose major reforms and terminations;
- change the rules of the budget process to make it easier to keep spending under control; and
- institute a strong spending cap that does not allow government spending to grow faster than population plus inflation.

The federal government is estimated to have spent roughly \$2.3 trillion in fiscal 2004. If the spending categories that account for the core functions of the federal government as outlined in the Constitution were subtracted from this amount, the government would still spend around \$1.6 trillion. That means the federal government is currently at least three times bigger than it needs to be to carry out its enumerated powers. This spending bloat is a result of a multidecade accumulation of programs that expanded the reach, power, and cost of the federal government. Congress and the president need to arrest this growth as quickly as possible and return the federal government to its proper limits.

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The Mess We're In

The estimated budget deficit for fiscal 2004 is $413 billion, and the deficit for fiscal 2005 is expected to be $348 billion. That puts the deficit in the range of 4 percent of GDP for 2004 and 3 percent for 2005. In fact, deficits exist for as far as the eyes of estimators can see: the estimated cumulative deficit for 2005–09 is $1.6 trillion.

Those deficits pale in comparison with the train wreck that awaits entitlement programs when the baby boomers start to retire. In just 13 years—by 2018—the Social Security Trust Fund will begin to run a deficit. And the amounts of unfunded liabilities that await everyone are staggering. Social Security's unfunded liability is estimated by its Board of Trustees to equal $10.4 trillion.

Economists Jagadeesh Gokhale and Kent Smetters estimate that in 2003 the federal government would have had to come up with $36 trillion to cover all of Medicare's future deficits. Now that the Medicare prescription drug benefit has been added and the population has aged a couple of years, the Board of Trustees of the Medicare system has estimated that the unfunded liabilities have grown to $61.6 trillion. That's close to 30 times the size of the federal budget today. It's obvious that any plan to balance the budget in the short term must also include reforms to entitlement programs for the long term.

How We Got into the Mess

The economic boom of the 1990s was good to everyone, including elected officials. Revenue flowed into state and federal coffers faster than they could spend it. That led, in 1998, to the first balanced budget since 1969. But by 2002—just four years later—the federal budget was in deficit again. What happened?

There was, very simply, too much spending. The surplus opened the floodgates of government expenditures. Consider this: In the four years before 1998, the average annual increase of total government spending was 3.1 percent. In the four years between 1998 and the return of the deficit in 2002, total government spending increased at an average annual rate of 5 percent.

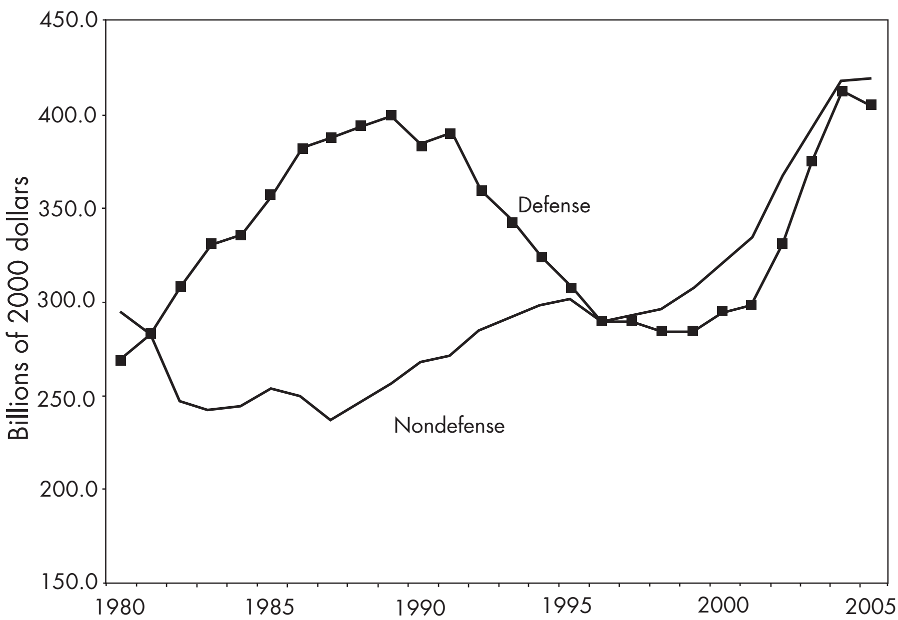
In the years leading up to 1998, entitlement spending drove most of the spending growth. After 1998, however, out-of-control discretionary spending on defense and nondefense programs alike drove the spending binge. The average annual rate of growth in discretionary spending was

.5 percent between 1994 and 1998, but it exploded to 7.3 percent between 1998 and 2002 (Figure 9.1).

When the revenue began to dry up, one would have expected spending to slow, too. But spending grew even faster after the deficit appeared: the average annual increase in defense and nondefense discretionary spending from 2002 to 2004 was 11.2 percent.

Some observers argue that the terrorist attacks on September 11, 2001, and the subsequent invasions of Afghanistan and Iraq, not to mention the increased resources devoted to homeland security, drove much of the spending growth. Defense spending accounted for about 56 percent of discretionary spending growth between 2001 and 2004. The rest went for increases in pork projects, corporate welfare, and various government programs that are far outside the realm of a properly limited government. Those programs were not vital to the defense of the United States, and it is very hard to argue that overall spending had to go up as much as it has across the board to fight the war on terrorism.

Figure 9.1
Real Discretionary Outlays: Defense and Nondefense



SOURCE: *Budget of the U.S. Government FY 2005*. FY 2004 and FY 2005 are estimates.

Some budget hawks argue that President Bush's tax cuts were a primary cause of the deficit. As it turns out, that's not true. A look at the numbers since 2000—the last year revenues posted a rise—shows that the revenue drop accounts for about 23 percent of the decline in federal finances. Indeed, revenue actually began to decline before most of the provisions of the Bush tax cut kicked in. There is no question that spending is driving the deficit: it accounts for 77 percent of the change (Table 9.1).

The main culprit is a culture of spending in Washington that has beaten the Republicans in Congress and the White House into submission. The class of Republican members of Congress who planned to aggressively cut government has lately presided over budget increases not seen since the days when ''Tip'' O'Neill and the Democrats controlled the House.

Indeed, Republicans in Congress over the past 10 years have completely lost their moorings on spending control. They originally promised to slash the federal budget to its bare essentials, but Leviathan is now substantially bigger than it was when they took control of the reins. In fact, by 2000—just six years after the 1994 electoral victory that came to be known as the Republican Revolution—95 of the largest programs they promised to eliminate had actually grown by 13 percent.

Four of the top five fastest growing agencies since fiscal 1995 are agencies that have no explicit mandate in the Constitution: Education, Labor, Commerce, and Health and Human Services (Figure 9.2).

Over the past two years, spending in both defense and nondefense categories grew rapidly. As Figure 9.1 depicts, this is quite a change from the relative prudence of the Reagan years when nondefense spending was cut to make room in the budget for the defense buildup of the 1980s. Indeed, it's even a change from the Clinton years, when defense spending was cut in the wake of the end of the Cold War and overall spending rates stayed relatively tame.

Table 9.1
Spending Drove the Deficit (in billions)

	2000	2004	Change in Dollars
Revenue	$2,025	$1,880	$154
Expenditures	$1,789	$2,293	$504
Deficit or Surplus	$236	−$413	$658

SOURCE: Author's calculations based on data from the Congressional Budget Office.

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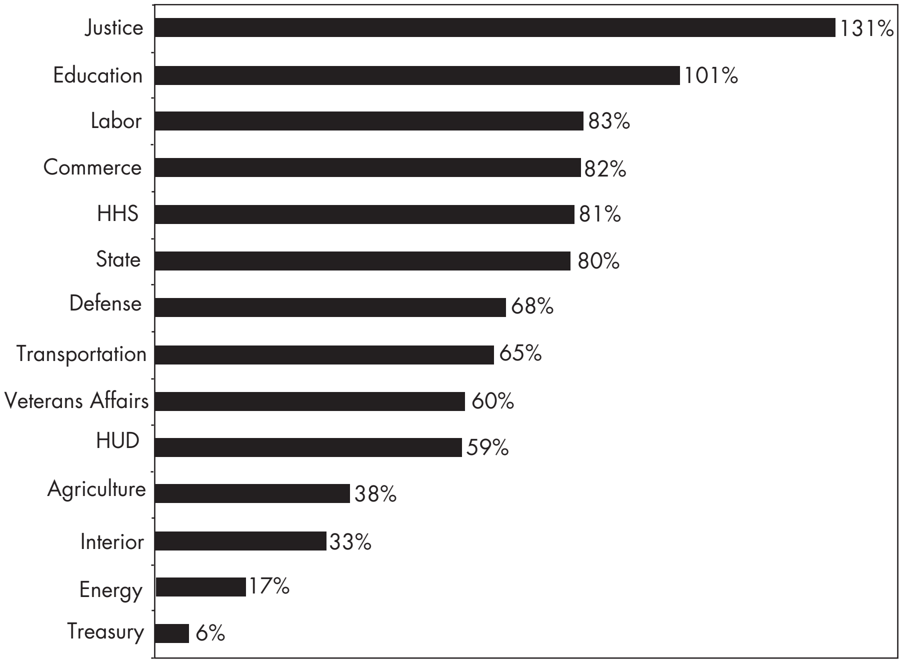
Figure 9.2
Growth in Outlays by Federal Department under the Republicans, FY1995–FY2004



SOURCE: Veronique de Rugy, "The Republican Spending Explosion," Cato Institute Briefing Paper no. 87, March 3, 2004, p. 9.

To make matters worse, the Republican Congress and the Bush administration were able to do what no big-spending Democratic administration since Lyndon Johnson's has been able to do: pass the single biggest expansion to the Medicare program since its inception. The prescription drug benefit—debated on the floor of Congress under the false impression that it was going to cost $400 billion over 10 years, when the actual cost was closer to $534 billion—will only further damage the fiscal stability of the budget in the future.

Getting Out of the Mess

It is vital that Congress and the president get control of spending and reform increasingly expensive entitlement programs. Some ground rules need to be kept in mind:

1. Taxes should not be raised to balance the budget. As explained above, the problem is not that government is receiving too little money but that it is spending too much. More money to spend is the last thing Congress needs, and the last thing workers beleaguered by a complex tax code and an increasingly expensive tax burden need is higher taxes. In fact, a plan to balance the budget could conceivably include a plan to reform the entire tax system. For details on this, see Chapter 11.
2. Any attempt to balance the budget should also be an attempt to realign the priorities of the federal government and make it smaller while returning it to its constitutional boundaries.
3. Finally, any budget-balancing plans should include ways of making sure that the rules of the game, which currently stack the deck in favor of new spending, are rewritten so the gains from balancing the budget by cutting spending are not merely temporary victories but lasting contributions to fiscal restraint.

Cut Discretionary Spending

The cuts outlined in the Appendix to this chapter represent more than $350 billion in savings to taxpayers. Eliminating the programs listed in the Appendix from the federal budget—and keeping them out of the budget in the future—would balance the budget in five years. Not only would doing that allow the government to balance its books without raising taxes (indeed, it would balance the budget while simultaneously keeping intact all of President Bush's tax cuts), it would also show that Congress is serious about scaling back the role of the federal government.

Not all of the program terminations require the activities of the programs to disappear. Some of those government functions could be devolved to the state level. For instance, many of the Department of Transportation's (DOT's) activities are properly state and private-sector responsibilities. It makes no sense to collect gasoline taxes from citizens, send the money to Washington, then dole it back out to the states—minus the costs of the DOT bureaucracy (which has more than 100,000 full-time-equivalent employees) and its meddlesome rules. Moreover, Congress uses the DOT budget to deliver pork-barrel projects of dubious value. The federal government should end the federal gasoline tax and cease its highway, road, and mass transit spending functions. (For more on this subject, see Chapter 36.)

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Even more savings can be found by privatizing federal assets and government-operated businesses. For instance, the federal government owns about one-third of the land in the United States and continues to accumulate more holdings. Yet only a fraction of federal land is of environmental significance, and the government has proven itself to be a poor land custodian. The process of federalizing the nation's land should be reversed by identifying low-priority holdings to sell back to citizens. In addition, numerous government-run enterprises, such as the U.S. Postal Service and Amtrak, could be run more efficiently by the private sector and should be privatized. For further information, see Chapter 33.

Reform Entitlement Programs

Social Security should be reformed to allow workers to invest a portion of their payroll taxes in accounts they own and control. See Chapter 4 for a plan to do just that. Medicare can be reformed through the widespread use of health savings accounts, and Medicaid spending can be frozen and the program block-granted to the states. (Reforms for Medicare and Medicaid are addressed in Chapter 8.)

Reject New Spending Programs if Unconstitutional

The U.S. Constitution confines federal spending authority to a few limited areas. Article I, section 8, allows for spending mainly on basic functions, such as establishing courts, punishing crime, and maintaining an army and navy. The General Welfare Clause in section 8 has been interpreted extremely broadly to provide a justification for much of today's federal spending. But much federal spending is not for the ''general welfare'' at all. It is for the benefit of particular groups and individuals. For example, corporate welfare spending is aimed at narrow interests, not the general interest. Members of Congress take an oath to uphold the Constitution. They should start taking that oath seriously. When a dubious program comes before them, they should ask whether there is proper constitutional authority for it.

Create a Federal ''Sunset'' Commission

To structure the process of terminating federal programs, Congress should establish a federal ''sunset'' commission. Sunsetting is the process of automatically terminating government agencies and programs after a period of time unless they are specifically reauthorized. One of the main

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problems today is that there are sunsets to tax cuts but not to spending programs. A sunset commission could review federal programs on a rotating basis and recommend major overhauls, privatization, or elimination.

Since the 1970s numerous state governments have adopted the sunset process, and it is currently used in about 16 states. In the late 1970s there was strong bipartisan support to pass a federal sunset law introduced by Sen. Edmund Muskie (D-ME) that would have sunset most federal programs every 10 years. Supporters at the time ranged from Sen. Jesse Helms (R-NC) to Sen. Edward Kennedy (D-MA). Although it gained strong support in the Senate, the legislative effort failed in the House.

Today, sunsetting is needed more than ever. There is no structured method to reform or terminate agencies when they no longer serve a public need or when better private alternatives become available. As a result, government agencies rarely disappear. For example, the Rural Utilities Service (formerly the Rural Electrification Administration) was created in the 1930s to bring electricity to rural homes. Virtually all American homes have had electricity for 20 years or more, yet the agency still survives. A sunset commission would make it much harder for such unjustifiable agencies to survive.

Changing the Budget Rules

Congress has done little to reform the budget rules that skew political decisionmaking in favor of ever-larger outlays. Now that the federal budget again has huge deficits, it is even clearer that lasting reforms to the budget process are needed. There has been much debate about which particular reforms would best restrain spending. But there is little to lose from experimenting with different budget control mechanisms, and any or all of the following reforms should be pursued.

Supermajority Tax Limitation Amendment

With a supermajority tax limitation, any tax increase would require a two-thirds vote in the House and Senate for passage. When the economy grows, federal tax revenues tend to grow faster than incomes, even without legislated increases. Given that automatic upward tax bias, taxpayers should be provided with the extra protection of such a limitation against legislative tax increases.

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Zero-Based Budgeting

Zero-based budgeting would end the current practice of baseline budgeting. With baseline budgeting, most programs can exist on autopilot, since budgets are written to assume an expected growth rate in all government programs. The current system reinforces the ridiculous notion, for instance, that a 2 percent increase in spending can be called a ''cut'' if the expected baseline budget increase was supposed to be 3 percent. Zero-based budgeting would assume that every government program started the year with zero taxpayer money, and every program would have to justify its budget request from the bottom up.

Give the Budget Resolution the Force of Law

Currently, the budget resolution that outlines the budget ''blueprint''—including the spending levels that both houses of Congress agree to at the beginning of each budget cycle—is mostly a symbolic document. That's because the Rules Committee in the House routinely exempts particular bills from the spending caps in the resolution. Thus, converting the present concurrent budget resolution into a joint budget resolution that requires a signature by the president would give the budget blueprint the force of law. The provisions in the budget blueprint, such as spending caps, would be harder to circumvent as a result.

Put Limits on ''Emergency'' Spending

So-called emergency spending is one of the biggest reasons for the budget bloat. Originally designed to modify the spending caps for genuine emergencies such as natural disasters or times of war, it has been abused dramatically over the last few years. For instance, in the 2000 budget the constitutionally mandated decennial Census was treated as an unexpected ''emergency'' expense. Between 1999 and 2002 the Congressional Budget Office estimates that Congress spent $154 billion on ''emergencies,'' only a fraction of which can honestly be worthy of the distinction. Safeguards need to be put in place to keep the emergency clause from being abused. Creating a law that defines explicitly what can qualify as an emergency expense would go a long way toward remedying the problem.

Freeze ''Advance'' Appropriations

One of the games that Congress plays with the budget is shifting funding into a future budget to get around the spending caps. The abuse of this practice should end. Congress should be required to pay for all spending it intends to do in the year in which it intends to do it.

Require a Two-Thirds Majority to Waive Spending Caps

Currently, spending caps can be waived by a three-fifths majority. Although a two-thirds majority will not always keep a tight lid on spending, it would certainly make it harder for big spenders to ignore the fiscal restraint required by the rules of the budget process.

Enact a Tax and Expenditure Limitation

Although many of the budget process reforms listed above would make it harder for Congress to expand government without a few hurdles, they may not necessarily effectively limit government growth. An innovative way of doing that would be to enact a cap that restrains the growth of government spending each and every year. The cap would hold government spending to a growth pattern no faster than that of population plus inflation.

The experience of the states that have some sort of strong spending cap has been very positive. Colorado's innovative Taxpayer's Bill of Rights (TABOR) has been the most successful budget cap of them all. (For more information on the success of these limits, see Chapter 35.)

An upper limit on spending would create an incentive to reprioritize the federal government. If there is a spending ceiling that Congress can't overturn by a simple majority or ignore, cuts in nonessential programs become more feasible. Adding this limit to the constitution would ensure the strongest possible fiscal restraint, but it is not necessary. Some of the budget process rules discussed above could be successful in controlling spending if coupled with a TABOR-like proposal.

Conclusion

Bold reform is needed if Congress and the White House are serious about getting the federal government's fiscal house in order. Business as usual is not going to reduce the deficit or cut spending. Policymakers need to realize that the federal government does far more than it should. Cutting spending is only the first step. Reforming entitlements and changing the rules of the game are also vital.

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Appendix: Proposed Program Terminations (FY2004 outlays in $millions)

Department of Agriculture	
Economic Research Service	$71
National Agricultural Statistics Service	$124
Agricultural Research Service	$1,154
Cooperative State Research, Educ., and Extension Serv.	$1,082
Agricultural Marketing Service	$1,021
Risk Management Agency	$4,034
Farm Services Agency	$15,780
Rural Development	$1,043
Rural Housing Service	$1,549
Rural Business Cooperative Service	$107
Rural Utilities Service	$108
Foreign Agricultural Service	$1,917
Forest Service: Land Acquisition Programs	$154
Forest Service: State and Private Forestry	$455
Total Cuts to Department of Agriculture	$28,599
Department of Commerce	
Economic Development Administration	$417
International Trade Administration	$364
Minority Business Development Agency	$22
Fisheries Loans and Marketing	$32
National Marine Fisheries Service	$754
Office of Oceanic and Atmospheric Research	$557
Advanced Technology Program	$195
Manufacturing Extension Program	$40
Other Nat. Inst. of Standards & Tech. Programs	$421
National Telecommunications & Info. Admin.	$104
Total Cuts to Department of Commerce	$2,906
Department of Defense (see Chapter 51)	
Department of Education	
Eliminate entire agency	$62,815

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(Appendix continued)

Department of Energy	
General Science, Research, and Development	$3,405
Energy Supply	$714
Fossil Energy, Research and Development	$590
FreedomCAR	$246
Other Energy Conservation Programs	$636
Strategic Petroleum Reserve	$171
Energy Information Administration	$78
Clean Coal Technology	$19
Power Marketing Administration Subsidies	$155
Total Cuts to Department of Energy	$6,014
Department of Health and Human Services	
Health Professions Education Subsidies	$409
National Health Service Corps	$170
Family Planning	$278
Healthy Start	$98
Community-based Abstinence Grants and Education	$95
Indian Health Service	$2,584
Substance Abuse and Mental Health Serv. Admin.	$3,133
Agency for Health Care Research and Quality	$327
Temporary Assistance for Needy Families	$18,866
Payments to States for Family Support Programs	$4,098
Low-Income Home Energy Assistance	$1,892
Promoting Safe and Stable Families	$414
National Institutes of Health: Applied R&D	$12,500
Child Care Entitlements to States	$2,866
Block Grants to States for Child Care and Dev.	$2,237
Social Services Block Grant	$1,767
Grants to States for Foster Care and Adoption	$6,442
Head Start	$6,775
Children and Families Services Faith-Based Centers	$1
Administration on Aging	$1,313
Total Cuts to Department of Health and Human Services	$66,265

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Department of Housing and Urban Development	
Eliminate entire agency	$46,177
Department of Homeland Security	
State and Local Programs	$3,768
Firefighter Assistance Grants	$399
Transportation Security Administration	$2,810
Coast Guard—Boat Safety Grants	$65
Total Cuts to Department of Homeland Security	$7,042
Department of the Interior	
Bureau of Indian Affairs	$2,180
Bureau of Reclamation	$1,234
U.S. Geological Survey	$840
State and Tribal Wildlife Grants	$65
Sport Fish Restoration Fund	$336
Land Acquisition and State Assistance Programs	$249
Total Cuts to Department of the Interior	$4,904
Department of Justice	
Antitrust Investigations	$133
Juvenile Justice Programs	$208
Community Oriented Policing Services (COPS)	$1,271
State and Local Law Enforcement Assistance	$1,516
Weed and Seed Program	$31
Drug Enforcement Administration	$1,642
Total Cuts to Department of Justice	$4,801
Department of Labor	
Training & Employment Services	$5,600
Welfare to Work	$181
Community Service for Seniors	$445
Occupational Safety and Health Administration	$456
Trade Adjustment Assistance	$770
International Labor Affairs	$110
Total Cuts to Department of Labor	$7,562

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Department of State/International Assistance Programs	
Education and Cultural Exchange Programs	$325
United Nations	$317
United Nations Peacekeeping Operations	$893
Inter-American Organizations	$129
Org. for Economic Cooperation & Dev. (OECD)	$82
Migration and Refugee Assistance	$782
Int. Narcotics Control & Law Enforcement	$520
Andean Counterdrug Initiative	$966
East-West Center	$20
Economic Support Fund	$3,760
Multilateral International Assistance	$2,632
Foreign Military Financing Program	$5,432
Foreign Military Sales	$3
Total Cuts to Department of State/International Assistance Programs	$15,861
Department of Transportation	
Eliminate entire agency	$58,010
Department of the Treasury	
Community Development Financial Institutions	$43
Total Cuts to Department of the Treasury	$43
Executive Office of the President	
Office of National Drug Control Policy	$27
Office of Science and Technology Policy	$7
Total Cuts to Executive Office of the President	$34
Other Agencies and Activities	
Accounting Oversight Board	$97
Agency for International Development	$4,613
Appalachian, Delta, Denali Commissions	$94
Cargo Preference Program	$443
Commission on Civil Rights	$9
Corporation for National and Community Service	$609

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Corporation for Public Broadcasting	$437
Davis-Bacon Act	$1,100
Drug Control Programs	$500
Army Corps of Engineers	$4,308
Equal Employment Opportunity Commission	$325
Environmental Protection Agency	$8,129
FTC—Antitrust Enforcement	$82
International Military Training	$89
International Trade Commission	$60
Legal Services Corporation	$341
Millennium Challenge Corporation	$298
Military Bases (excess facilities)	$5,000
NASA	$14,604
National Endowment for the Arts (NEA)	$118
National Endowment for the Humanities (NEH)	$132
National Labor Relations Board	$242
National Mediation Board	$11
Neighborhood Reinvestment Corp.	$114
Peace Corps	$302
Selective Service System	$26
Service Contract Act	$610
Small Business Administration	$3,978
Trade and Development Agency	$62
U.S. Postal Service Subsidies	$60
Total Cuts to Other Agencies and Activities	$46,793
Total Proposed Budget Savings	$357,826

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—Prepared by Stephen Slivinski

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