

# FACING THE BUDGET DEFICIT



Murray Weidenbaum  
April 2012

# Magnitude of the Budget Task

	Official Budget Outlook (\$ Trillions)		
	<u>2010-2012</u>	<u>2012-2016</u>	<u>2017-2021</u>
Expenditures	3.6	3.9	4.9
Revenues	<u>-2.3</u>	<u>-3.3</u>	<u>-4.5</u>
Deficit	1.3	0.6	0.4

BUT — Key Assumptions:

1. No new spending programs or elimination of old ones.
2. No changes in existing programs or statutes.
3. All tax cuts expire as now scheduled.
4. No new changes in rates, deductions, exemptions, etc.

# Composition of Federal Revenues

## Fiscal Year 2012, Estimated (\$ Billions)

### Receipts

Personal income taxes	\$1,165
Social insurance taxes	840
Corporate income taxes	237
Excise taxes, etc.	<u>226</u>
<b>Total</b>	<b>\$2,468*</b>

\*Net after effect of special deductions and credits.

# Major Tax Preferences in 2013 (\$ Billions)

Employer contributions for health insurance	\$148
Pension contributions by employers	147
Reduced rate on dividends and capital gains	110
Mortgage interest deductions	90
Medicare benefits	73
Deducting state and local taxes	69
Earned income credit	58
Charitable deductions	47
Flexible medical spending accounts	39
Interest on municipals	38
Investment income on life insurance	30
Capital gains on home sales	26
Credits for children under 17	26
Total	\$901

Source: Joint Committee on Taxation.

# Federal Spending Challenge

## Fiscal Year 2012 (\$ Billions)

Social security	\$778*
Medicare	485*
Interest on debt	<u>225</u>
<b>Total, fixed charges</b>	<b>\$1,488°</b>
Other health and income security	942^
National security	772+
All other	<u>594</u>
<b>Grand Total</b>	<b>\$3,796</b>

\*Policy changes do not affect current beneficiaries or those retiring in 5-10 years.

°Not included in annual appropriation bills.

^ Includes Medicaid and unemployment compensation.

+ Mainly Department of Defense.

# Some Principles of Good Budgeting

“Good Budgeting is the Uniform Distribution of Dissatisfaction.”

—Gore every ox (fairness will be a plus).

Avoid simpleminded quick fixes.

—Across-the-board freezes are only temporary (sooner or later they melt).

—Standard percentage cuts in every program set wrong incentives.

Substantive changes are more likely to be durable.

—Eliminate programs that have served their purposes (or have outlived their usefulness).

—Substantially reduce low-priority programs.

Beware of new spending proposals with low initial price tags.

—The budgetary camel can be very stubborn after it gets into the tent.

Distrust high-sounding labels.

—The pork barrel has lots of fancy justifications.

President Truman was right.

—“I never saw a budget that could not be cut.”

# “All Other” Is Not Too Small to Fuss With

Early rule: Never tell (or write) a taxpayer that the government is *only* going to spend a billion (or a million) on some program.

(Note: For most people, \$100,000 is a fortune — or maybe \$50,000!)

Where to start:

- Subsidies to special interest groups.
  - Few expenditures are labeled “subsidies.”
  - You have to dig them out.

## “All Other” (cont.)

- “Nice to have” programs.
  - Don't you want to encourage senior citizens to do volunteer work?
  - Wouldn't it be nice to encourage family activity?
  - Warning: it's nice to do good with other people's money.
  - Reminder: Reducing the awesome deficit is a task for everyone.
- “Everybody is doing it.”
  - You can bolster your agency's budget by hopping on the cause of the day.
  - Secure the homeland, clean the environment, stimulate the economy, etc.

# Farm Subsidies Are No. 1

Most of the money goes to large commercial farms

Farm incomes are consistently higher than the national average

- Farm sector is now stronger than manufacturing or services

Family farms receive most of their income off the farm

Subsidies beget more subsidies

Farm price supports raise food costs for consumers

- Lead to food stamps for low-income people

High domestic farm prices inhibit exports

- Lead to subsidies to help farmers sell overseas

Our artificially low export prices hurt farmers in poor countries

- Lead to foreign aid programs to offset adverse effects

## Farm Subsidies (cont.)

### Farm subsidies generate other adverse effects

High subsidized domestic price of sugar encourages raising sugar in Florida

- Destroying the Everglades
- Multibillion dollar plans are being developed to offset environmental damage

Dept. of Health and Human Services now encourages people to reduce their intake of meat

- Produced by animals fed price-supported grain
- Also, USDA sponsors marketing programs to promote sales of key farm products (rarely fruits and vegetables)

# Energy Subsidies Are No. 2

## Common Characteristic

A variety of uncoordinated subsidies each dedicated to promoting a different energy source

- Result is great variation in types of subsidies and benefit rates
- Subsidies cover both coal and other fossil fuels
- As well as solar and wind power; also ethanol

## Specific programs result from pressures from interest groups

Rather than careful analysis of opportunities and need for government support

- And of alternative ways of achieving energy objectives

National energy policy must be inferred from these specific subsidies

## Energy Subsidies (cont.)

### Independent judgment

“Government energy programs have invested heavily in technologies that were not competitive at the time but seen as needed in the future to meet public policy goals. Unfortunately, such programs usually don’t work out very well.”

Retired president of Resources for the Future

# Other Subsidies

## Corps of Engineers (civil functions)

Individual localities urge these “high priority” local projects

- Federal taxpayers pay most of the cost

Pioneered benefit-cost analyses, but they are rigged

- Use low interest rates to discount future benefits
- Very generous in adding indirect benefits

Note: Bureau of Reclamation is a smaller version of this activity, in the Interior Department

## Other Subsidies (cont.)

### Department of Transportation

Subsidies to the Merchant Marine, railroads, small airports, etc.

### Many other “benefactors” of interest groups

Programs in the Departments of Commerce and Homeland Security,  
Environmental Protection Agency, Small Business Administration

# Federal Programs That Are “Nice to Have”

## Wouldn't It Be Nice to Encourage Development of Neighborhoods That Are More Attractive and Environmentally Friendly?

The Department of Housing and Urban Development has responded to this desire with a “modest” annual outlay of \$25 million for “choice neighborhoods.”

HUD has also joined forces with the Department of Transportation and the Environmental Protection Agency “to lower the cost of living while improving the quality of life in local communities.”

Their specific efforts include “better leveraging federal investments.”

## “Nice to Have” (cont.)

### Who Can Oppose “Effective Teaching and Learning for a Complete Education?”

The Department of Education has budgeted over \$1 billion for this generous purpose.

### Wouldn't It Be Nice if State Government Employees Could Go on Sabbatical?

The U.S. Labor Department has urged states to establish new programs of paid leave

- The Department has sought an initial \$50 million appropriation for starters.

This at a time when state governments are forced to lay off employees due to inadequate funding.

# MANY AGENCIES WANT TO GET ON THE BANDWAGON OF POPULAR PROGRAMS

EPA declares that it is a vital contributor to homeland security

The Department of Justice thinks of itself as a key contributor to stimulating the national economy

HUD volunteers to lead the crackdown on the culprits in the mortgage finance fiasco

After encouraging financial institutions to grant low-income people mortgage debts that they could not handle

Interior says that it plays a key role in supporting the President's plan to create a clean energy future

The Department is also establishing climate science centers

- Apparently the Energy Department and EPA need some competition in spending money for that purpose

# Points of Effective Control Over Spending

## 1. Authorization

A statute that authorizes a program or activity to be undertaken by the federal government.

Sometimes the statute includes a budgetary authorization to spend money.

- Social Security and Medicare are prime examples.

## 2. Appropriation

A statute that grants authority to a federal agency to incur obligations and to make expenditures to cover the obligations it makes for a program or activity previously authorized.

It is the equivalent of a credit card with a fixed limit.

For most agencies and programs, this is the key point of control.

# Effective Control Over Spending (cont.)

## 3. Obligation

OMB has general authority to dole out appropriations in quarterly installments (not necessarily equal).

The idea is to prevent an agency from running out of money early in the year and having to ask for a supplemental appropriation.

Typically, an appropriation must be “obligated” by September 30 of the fiscal year.

Military procurement and construction are usually funded by “no year” money – good indefinitely.

## 4. Expenditures

This is the point at which the government pays its bills.

Usually, each agency has two years after obligations are incurred to pay them off.

# Effective Control Over Spending (cont.)

## 5. Ceiling on Public Debt

- For many years, Congress has established a dollar limit on the amount of public debt the Treasury can issue.
- When substantial deficits are incurred from time to time, Congress is asked to raise the debt limit.
- Unless it does so, new expenditures are limited to the inflow of new revenue.
- Many short-term adjustments can delay the need for raising the debt ceiling.
  - Running down the Treasury's cash balance
  - Delaying the payments required to liquidate obligations already made
  - Speeding up the recording of Treasury receipts
  - Delaying the investments in Treasury debt by trust funds, especially Social Security

# Effective Control Over Spending (cont.)

- Many people do not understand the debt ceiling
  - It is not the credit card available to a federal spending agency.
  - Refusing to raise the ceiling does not affect the amount that the government owes to Social Security and Medicare beneficiaries, suppliers of goods and services, holders of existing Treasury debt, etc.
  - The debate does mean that Congress has not done its job of matching appropriations to the desire for economy in government.