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Kick the can or kick the habit?

By Jagadeesh Gokhale 9:00 AM 07/19/2011

President Obama's dire alarms over the approach of the federal debt ceiling, and subsequent calls for $4 trillion in debt reductions over 10 years, are starkly lacking key ingredients: substance and coherence as to what such a fiscal package should contain.

House Republicans, by contrast, have a program for long-term economic stewardship — Cut, Cap and Balance — that would deliver much larger savings than anything the president has put on the table. Before appreciating why such a program would be better, one must consider why a deal to achieve $4 trillion in savings over the next decade — whatever its contents — would be insufficient.

Given the weak economy, budget savings of $4 trillion will not be implemented immediately, but will be back-loaded with a multiple-year lag. However, estimates made by the Social Security and Medicare trustees and actuaries suggest that those two programs face cumulative, inflation-adjusted, long-term (75-year) fiscal gaps totaling $39.2 trillion. This implicit debt will accrue interest and grow larger over time. The cumulative interest cost of that shortfall over 10 years, under a conservative, inflation-adjusted interest rate of 2.9 percent per year (the rate used by the Social Security actuaries), amounts to $13 trillion — implying that not making any fiscal adjustments for the next 10 years will increase the budgetary imbalance to $52.2 trillion. Thus, scheduling a heavily back-loaded reduction of those costs by just $4 trillion through 2020 is unlikely to improve the federal government's fiscal condition.

These are conservative estimates, because they include only shortfalls in entitlement programs and assume that the recent health care reform (the Patient Protection and Affordable Care Act of 2010) will appreciably reduce Medicare's net unfunded obligations. But these estimates exclude the sizable increases in non-entitlement shortfalls and increases in future state Medicaid costs resulting from health care reform — not to mention the fact that Congress is likely to strike the proposed future reductions in Medicare, as it has routinely done for decades.

Thus, for a 10-year, $4 trillion budget deal to significantly reduce the nation's *long-term* fiscal imbalance, we will have to stick to fiscal discipline well beyond 2020, which means not enacting new unfunded entitlement benefits or rapidly increasing spending. The fate of the 1990 Budget Enforcement Act, which was abandoned as soon as budget surpluses emerged, does not bode well for a similar deal now unless it is accompanied by constraints against reversals by future Congresses — constraints that the Cut, Cap and Balance program would introduce.

In order to prevent lawmakers from initiating new entitlement (or "investment") programs with inadequate funding schemes, those constraints should be an integral part of the next budget deal. And such a budget process constraint should itself be protected from repeal except through a large supermajority in Congress. The political price of voting for tax increases to fund new benefits would dampen lawmakers' enthusiasm to expand entitlements — in contrast to the adoption of the Medicare prescription drug benefit in 2003 or last year's health care reform, where lawmakers were shielded from the political costs of actually paying for the new programs.

The alternative to increasing the debt limit without sufficiently large spending reductions will amount to kicking the deficit can ahead, to just beyond the 2012 elections. We'll then tolerate fierce campaigns soliciting support for liberal and conservative visions of a long-term budget fix. Chances are, however, that a polarized electorate won't yield an unambiguous mandate for the direction of fiscal adjustments beyond 2012.

President Obama is exhorting legislators to swallow bitter medicine now because doing so will only become more difficult as the 2012 election draws closer. But had he seized the pro-budget-reform momentum generated by his own Simpson-Bowles deficit reduction commission last year, things may have turned out better for him politically and for the nation economically. Now we may remain in the current policy limbo until after next November, caught between the irresistible force of entitlement spending and the immovable object of Republican opposition to tax increases.

Along the way, we'll increase the debt limit, one back-loaded bit at a time, without much prospect of avoiding an even larger fiscal calamity down the road. Maybe it's time for the one sure way of curing this disease: to shred and discard the federal credit card by enacting Cut, Cap and Balance.

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