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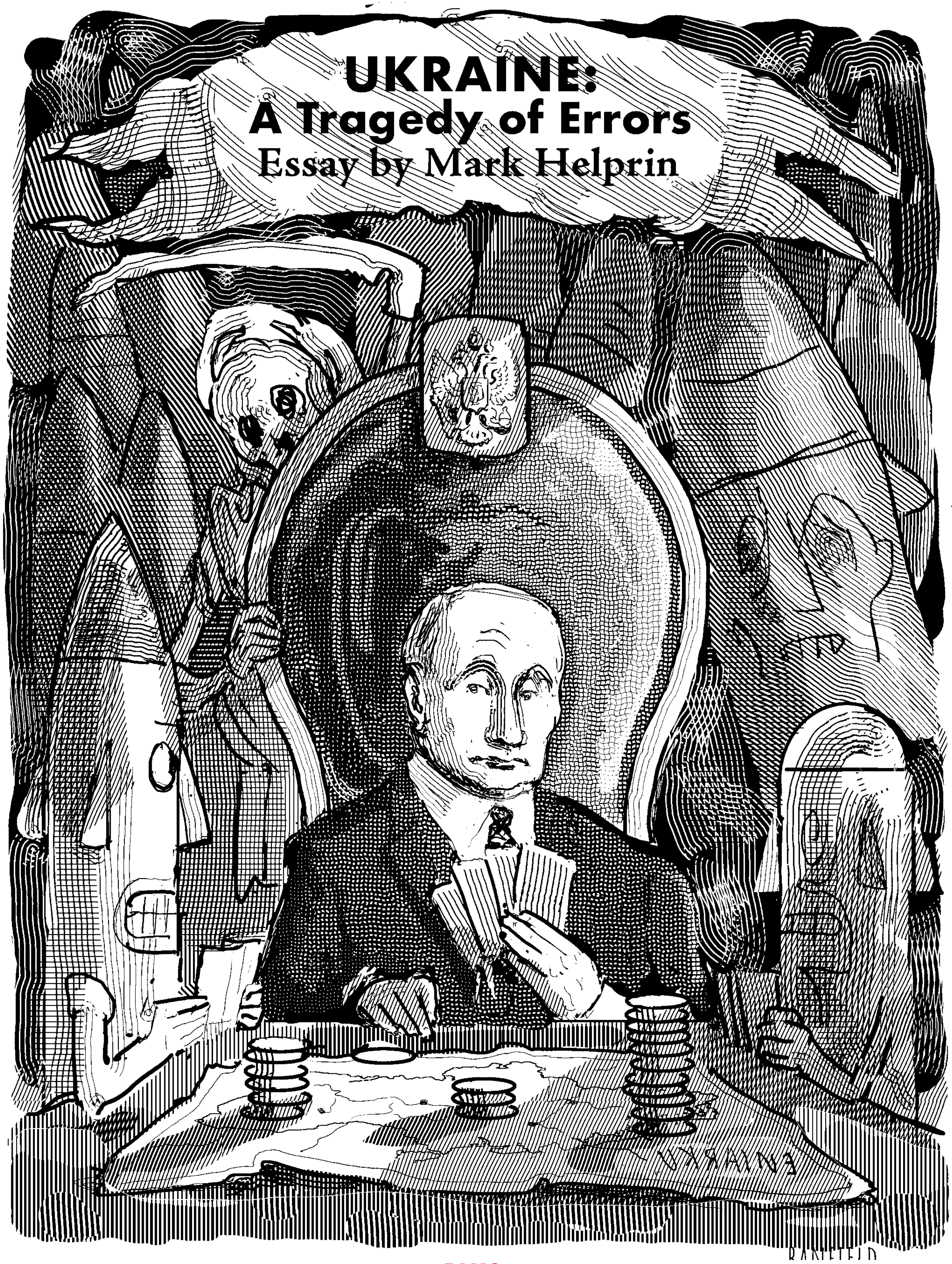

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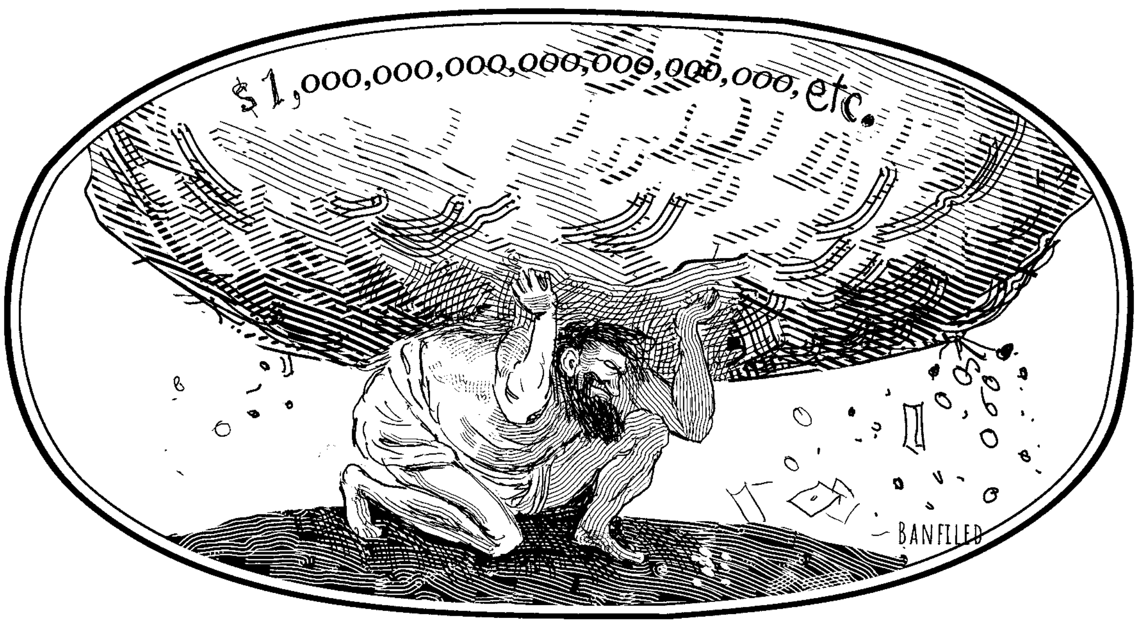
Essay by Jeffrey H. Anderson

In the Red

Our glidepath to insolvency.



When ross perot won an impressive 19% of the popular vote as an independent candidate for president in 1992, his main issue was the national debt. In one of his unusual, half-hour-long campaign ads, Perot declared, "Just this year, we ran up $341 billion in new debt.... That's *our* legislators and *our* president trying to buy *our* vote, *this* year, with what used to be *our* money."

Three decades later, our national debt—which reached $4 trillion the year that Perot ran—has hit $30 trillion. If our debt were to keep rising at that rate over the next 60 years, it would increase more than 50-fold and surpass $1.5 quadrillion (a quadrillion, which sounds like a made-up number, is a thousand trillions).

The portion of the national debt that really matters is the almost 80% that's held by entities—whether foreign or stateside—other than the federal government. Such "debt held by the public," which is fueled by deficit spending, has to be paid back to outside entities, whereas debt *not* held by the public merely involves intragovernmental transfers. Foreign holdings compose about a third of all debt held by the public. Japan and China hold by far the most (over $1 trillion each), some of which belongs to private investors and some to government entities. Put another way, China—an increasingly hostile world superpower—has more than $1 trillion of leverage over us.

It's getting worse, fast. Our recent deficit spending has been truly historic. In 2020, based on official federal tallies (the basis for all figures in this essay), the federal government brought in $3.4 trillion in tax revenues and dished out $6.6 trillion in spending—so, for every $10 that came in, $19 went out. This lavish expenditure smashed the deficit record like New York's Bob Beamon smashed the long-jump record in the 1968 Olympics. Beamon soared past the previous record—27 feet, 4-3/4 inches—to make an astounding 29-foot, 2-1/2-inch jump. In similar fashion, with the deficit record sitting at $1.4 trillion, the federal government in 2020 spent a spectacular $3.1 trillion that it didn't have. In 2020 *alone*, the government racked up more deficit spending than it had during the first 36 fiscal years of the postwar era (1947 through 1982), and that's after adjusting for inflation.

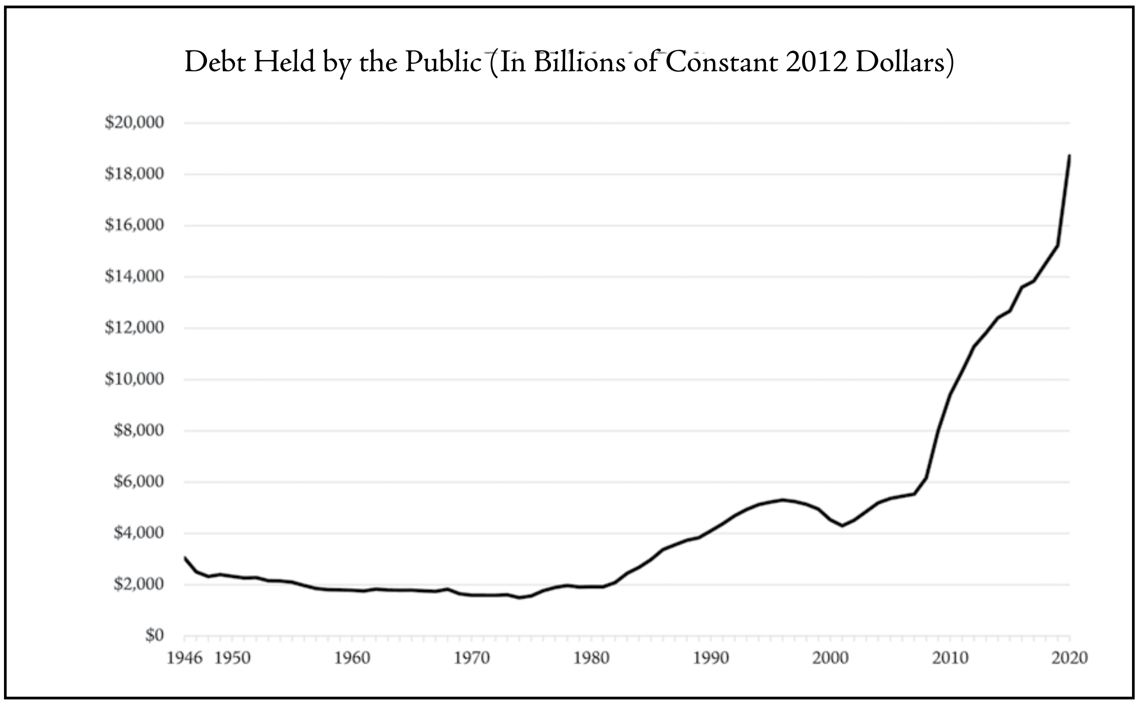
Even before our blowout spending during COVID, our deficits had already reached breathtaking levels. In constant 2012 dollars (to adjust for inflation), the average annual deficit during the four years from 2016 through 2019—a stretch of relative peace and prosperity—was $700 billion. In comparison, during the four years from 1942 through 1945—during which we funded and fought a two-front war against Nazi Germany and Imperial Japan—the average annual deficit was $505 billion in constant 2012 dollars. After the war (using the Office of Management and Budget's composite deflator), we owed $3 trillion of debt held by the public in constant 2012 dollars (four times what we owed when the war began). Subsequent statesmen succeeded in cutting that tally in half by 1974 (to $1.5 trillion), but it rose back to end-of-World-War-II levels by 1986 (to $3 trillion), doubled end-of-World-War-II levels by 2008 ($6 trillion), tripled them by 2010 ($9 trillion), quadrupled them by 2014 ($12 trillion), quintupled them by 2019 ($15 trillion), and sextupled them by 2020 ($18 trillion).

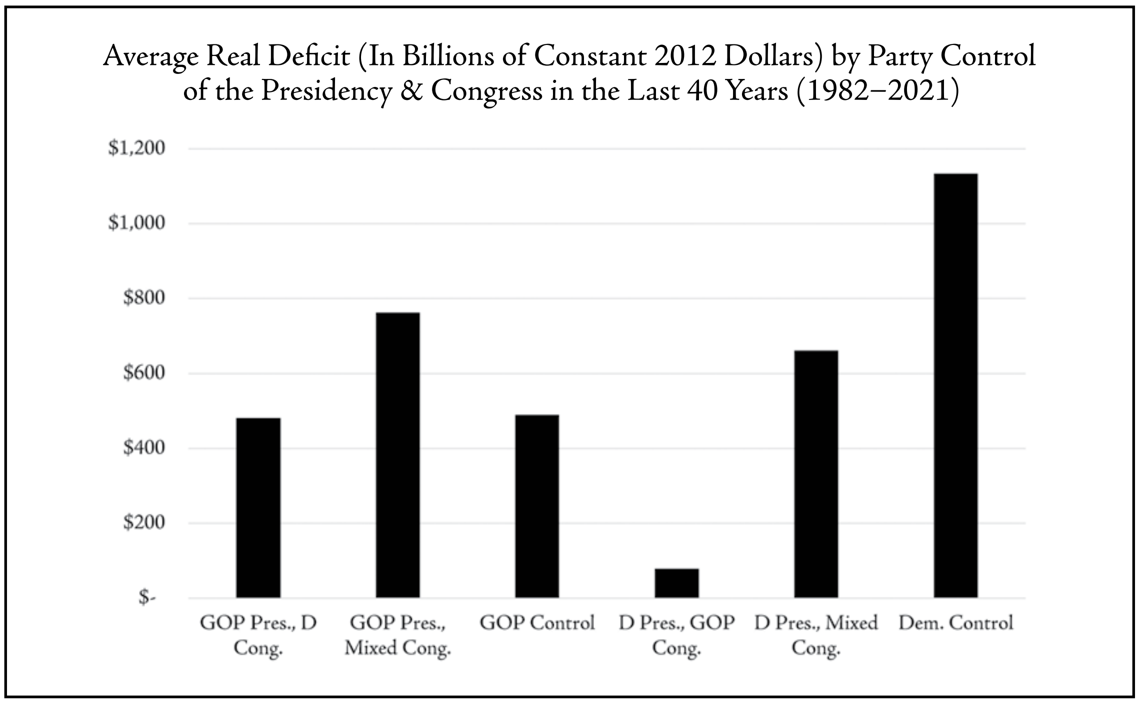
In other words, we added as much debt held by the public in 2020 alone as we did from the end of World War II to the end of 2008, and we racked up more debt in the 12 months of 2020 than we did during the four years of the Second World War. That's after adjusting for inflation.

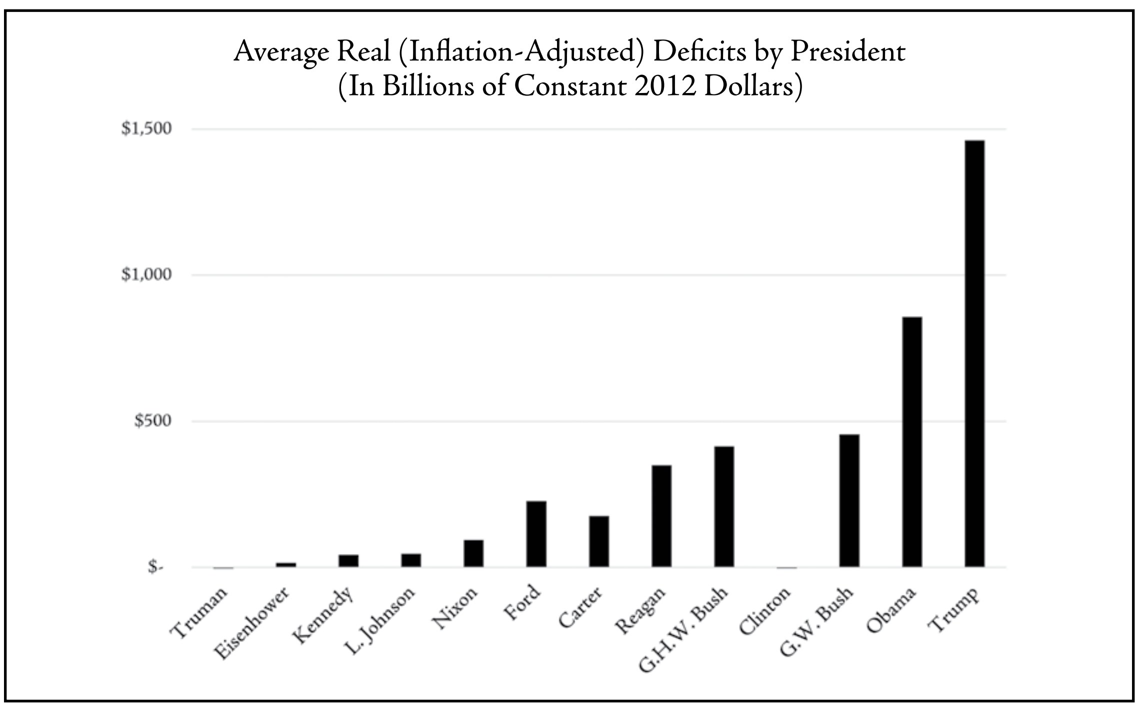
No Big Deal

And yet, incredibly, many politicians and commentators claim that our staggering indebtedness is nothing much to worry about. Unwilling to face the challenge of reining in the budget, we seem to have thrown up our hands in recent years and chosen to treat our ballooning deficits as funny money.

Debt apologists like to measure taxes, spending, and debt in relation to the gross domestic product (GDP), rather than in relation







to inflation or population growth. That way, if Americans' tax bills double, but the economy doubles in size over that same span, it can be said that Americans aren't paying any more in taxes (as a percentage of GDP). The same thing is true with the debt, which only rises by this measure if it increases faster than economic output.

This way of talking partially masks the magnitude of our debt problem by assuming that our government should grow every bit as fast as our economy. Even so, by the percent-of-GDP measure, debt held by the public is now at approximately end-of-World-War-II levels. But whereas it fell dramatically after World War II, there is no reason to think it will do so now. It more than tripled from 2001 (32% of GDP) to 2020 (100% of GDP), putting us on course to surpass 300% of GDP if it grows at the same rate from 2020 to 2039.

For all of the myriad cultural, technological, and moral problems we face, few things would guarantee the undoing of the founders' experiment in self-government more surely than continuing to pile on the burden, to ourselves and our posterity, of runaway debt. Thomas Jefferson described fiscal profligacy as a precursor to inevitable misery and suffering, the first in a stampede of apocalyptic horsemen. "[T]he fore horse of this frightful team is public debt," he wrote. "Taxation follows that, and in its train wretchedness and oppression." This wretchedness will only be more keenly felt as interest rates rise. Too much debt puts power in the hands of our enemies and renders the average American poorer every year.

Mandatory Bankruptcy

The first step in avoiding a truly calamitous, debt-ridden future is to understand how we got ourselves into this predicament to begin with. It is not national defense or even the New Deal but rather the Great Society that is bankrupting us.

A fundamental preliminary question is whether our government taxes too little or spends too much. The answer is easy to determine. In 2021, the federal government collected more than three-and-a-half times as much money, in real dollars per capita—that is, above and beyond inflation and population growth—as it did at the start of the postwar period. But it spent nearly seven times as much. From 1947 (the first postwar fiscal year, as FY 1946 began in July of 1945) through 2021, the population of the United States rose 2.3-fold, while prices rose nearly 13-fold. Combining these two factors, the federal government could have collected and spent 29 times as much in nominal dollars in 2021 as it did in 1947 without collecting or spending any more in real (inflation-adjusted) dollars per capita. Instead, the federal government taxed more than 100 times as much in 2021 as in 1947 and spent almost 200 times as much. By any reasonable standard, our government isn't afflicted by a shortage of tax revenues but by an almost endless appetite for spending.

What are we spending all of that money on? *Contra* the Left's repeated claims, it isn't defense—and our debt problem wasn't created by Ronald Reagan. We actually spend less per capita on defense now, after adjusting for inflation, than we did during the Kennedy Administration. Real per-capita defense spending fell from $2,283 in 1962 to $1,953 in 2020, a drop of 14%. Even at the height of the Reagan defense buildup, we exceeded the 1962 level by only 2%. Meanwhile, real per-capita spending on everything *but* defense increased more than eight-fold (from $1,930 in 1962 to $15,646 in 2020). If overall federal spending had followed the same trajectory as defense spending, we would have had a surplus in 2020 of $2.1 trillion instead of a deficit of $3.1 trillion.

The problem isn't defense: it's health care. More specifically, it was Lyndon Johnson and his (mostly) Democratic congressional allies who put us on a glidepath toward insolvency with the passage of their Great Society programs. The New Deal put strain on the federal budget, to be sure, but not enough to break it. By 1964, over three decades after Franklin Roosevelt had taken office, federal debt held by the public had fallen more than 40% from the end of World War II, in real (inflation-adjusted) dollars. The real deficit was 1/68th as large as it would be in 2020. As the first Ford Mustangs rolled off the assembly line, the country's debt was manageable and dropping, its deficits were minimal, and seven of the postwar years had actually produced surpluses. The next year, Johnson signed legislation creating Medicare and Medicaid.

Broadly speaking, there are two ways to fund federal programs. Congress either decides how much funding a program will get ("discretionary" spending), or just puts a program on autopilot and finds out later how much it turned out to cost ("mandatory" spending). With discretionary spending, Congress decides each year how much money to appropriate (for something like national defense), taking into account such quaint notions as what we need and what we can afford. With "mandatory" spending, Congress creates a program and pledges to fund it at the same time, even though no one knows what its price tag will be.

Within "mandatory" spending, there are programs that have a dedicated and generally sufficient revenue stream (such as Social Security), and there are those that do *not* have a dedicated revenue stream that comes anywhere near covering their costs—such as Medicare and Medicaid (and Obamacare, part of which expanded Medicaid). Payroll taxes cover only about a third of Medicare's costs and none of Medicaid's. In other words, no one who launched these programs had any idea how to pay for them.

This has had extraordinary consequences. The first year that Medicare spending visibly hit the books was 1967. From that point through 2020, Medicare and Medicaid cost a combined $17.8 trillion, while our combined federal deficits over that same span were $17.9 trillion. In essence, our deficit problem is a Medicare and Medicaid problem.

The Father of Our Debt

By 1975, a decade after they were created, Medicare and Medicaid were entrenched. From that point through 2019—the most recent "normal" (pre-COVID) spending year—real per-capita Medicare and Medicaid spending rose nine-fold (more than triple the rise in Social Security costs over that period). In 1975, we spent more than five times as much on defense as on Medicare and Medicaid combined. By 2019, we spent 56% more on Medicare and Medicaid than on defense.

In 2019, the federal government collected about $10,500 in revenues per capita and spent about $13,500. Here's how Americans' contributions to the federal treasury were allocated. The first $1,000 essentially just went into the trash—it was used to pay interest on the debt, not to buy anything. About $2,000 was spent on defense and another $2,000 on non-defense discretionary spending. Roughly $3,000 was spent on Social Security, $3,000 on Medicare and Medicaid (with about a 60%-40% split between them), and $2,500 on other "mandatory" spending, to include much of Obamacare, unemployment, welfare, etc. So, in all, about $4,000 (or roughly 30%) was discretionary spending, actually voted upon by Congress, and about $9,500 (roughly 70%) was either "mandatory" spending or payments on the national debt.

If we had a Mount Rushmore of deficit spending, then, Lyndon Johnson would merit George Washington's place of honor as the father of our debt. Beside him would be the three most recent presidents. For we have run up more debt under Barack Obama, Donald Trump, and Joe Biden—even after adjusting for inflation—than we did under the previous 42 presidents combined. After a brief period of fiscal responsibility under Bill Clinton, the average annual deficit soared to $455 billion under George W. Bush ($41 billion more than under his father), $857 billion under Obama, and $1.462 trillion under Trump (who was averaging $805 billion even before COVID hit).

Again—amazingly—these figures are adjusted for inflation. They are based on each president's having been responsible for the deficit the year after he took office—for example, Obama, who took office when fiscal year 2009 was already underway, was responsible for fiscal years 2010 through 2017. But note the following exceptions: the $179 billion in Obama-signed "stimulus" funds spent in 2009, and the $1.115 trillion in Biden-signed COVID "stimulus" funds spent in 2021 are treated as part of Obama's and Biden's deficit tallies, respectively; and the $147 billion in TARP loans repaid in 2010 ($110 billion) and 2011 ($37 billion) are counted as reductions in George W. Bush's deficit tallies, as they paid back money that was counted as deficit spending when it was loaned out on Bush's watch.

Clinton is the obvious outlier, having managed an average annual surplus of $3 billion during his eight years in office, six of them with a Republican Congress. After Perot sounded the alarm and Republicans won the House for the first time in four decades, Speaker Newt Gingrich and his Republican colleagues—working with Clinton—made good on the Contract with America's pledge to balance the budget. They cut defense spending, passed welfare reform, benefitted from a strong economy that increased revenues, and were able to lower federal interest payments as the debt fell. Most surprisingly, however, they managed to cut Medicare spending, via reforms passed through the Balanced Budget Act of 1997 (BBA). After Medicare's costs had quadrupled from 1982 to 1997, they actually *dropped* from 1998 to 1999—not just in comparison to inflation, but in terms of the actual number of dollars that went out the door.

It was around this time that the "experts" decided the work was done and the free-spending days could return once again. In 2002, after the George W. Bush tax cuts had been enacted, the Congressional Budget Office (CBO) projected that the federal government would run a surplus in nine out of the ten years from 2003 through 2012 and a decade-long surplus of $2.3 trillion. It turned out that the federal government ran a deficit in all ten of those years and a decade-long deficit of $7.1 trillion. The CBO also projected that debt held by the public at the end of 2012 would be $1.3 trillion. It turned out to be $11.3 trillion, so the CBO was off by $10 trillion and a factor of nearly nine.

Despite this subsequent debt explosion, the Clinton-Gingrich era was a successful one in terms of fiscal responsibility. Indeed, over the past 40 years, deficits have been lowest when a Democrat has been in the White House and Republicans have controlled both houses of Congress. The second-best scenario has been a Republican president with either party controlling both houses of Congress. Next-best has been a Democratic president paired with a mixed Congress (with each party controlling one house), followed by a Republican president paired with a mixed Congress. The worst scenario has been Democratic control of the whole government. Over the past four decades, Democratic control (average deficit of $1.1 trillion in constant 2012 dollars) has been more than twice as costly as Republican control ($490 billion).

No matter who is in power, however, about 70% of our spending—consuming about 90% of our tax revenues—is on autopilot. To balance the budget by focusing solely on cutting those portions of the budget that Congress actively controls through the appropriations process, we would have to cut discretionary spending—which includes defense—by about 75%. Any realistic effort to balance the budget, therefore, must focus on "mandatory" spending.

Fixing Our Mess

Medicare absolutely must be reformed. Its autopilot has malfunctioned and is flying not only the plane but also the country into the ground. We came tantalizingly close to fixing things back in 1999, when the National Bipartisan Commission on the Future of Medicare grew out of the BBA and drafted an appealing blueprint for reform. The Commission, chaired by Democratic Senator John Breaux and Republican Congressman Bill Thomas, floated a variety of proposals, most notably "premium support," which would utilize private competition to keep public costs down. But events intervened: *Politico* healthcare editor Adriel Bettelheim writes that "with the Monica Lewinsky scandal festering and the threat...of impeachment growing, [Clinton] took a very public turn to appease his left flank" and turned against the commission just as it was wrapping up its 11 months of work.

Nevertheless, the commission was a serious effort at exploring promising ideas, many of which Congressman Paul Ryan picked up during his Obamacare-fighting era. Ryan's advocacy of premium support did not keep him from being tapped as Mitt Romney's 2012 running mate, nor did it hurt the Romney-Ryan ticket (Romney did that all on his own). This suggests that Medicare reform can be politically viable when advanced with determination and skill.

Medicaid also cannot go on in its present form. Its funding system, whereby every $1 of state funding is matched by between $1 and $9 of federal funding, invites waste and inefficiency. The more a state spends on Medicaid, the more federal money it gets. If it manages to reform its Medicaid program, it gets at most half of the savings—usually far less. Also, states often hire consultants who concoct elaborate shell games to exaggerate states' Medicaid funding, thereby bringing in even more federal money, much of which funds non-Medicaid ventures. If Medicaid were reformed so that each state simply received a given amount of federal funding, independent of the state's level of funding, that would presumably remove most of these perverse incentives and reduce Medicaid's costs.

Social Security has always been self-funded, but it too is projected to dip into the red about a dozen years from now. It poses nowhere near the threat to our fiscal solvency that Medicare and Medicaid do, but its costs have still risen faster than overall federal spending, and it does need to be sensibly revised. The percentage of the U.S. population that is over age 75 is roughly the same as the percentage that was over age 65 when Social Security was created, yet the eligibility age for receiving full retirement benefits has been raised just two years (from 65 to 67) over the past eight decades. Gradually (but not too gradually) raising that age to reflect current biological and fiscal realities is an obvious and necessary fix.

> We seem to have thrown up our hands and chosen to treat our ballooning deficits as funny money.

In addition to changing individual programs, there are measures we can take to promote fiscal responsibility more generally. Simply demanding a balanced budget, either as a matter of policy or through a constitutional amendment, will not do: the state could still spend as much as it accrued, which might encourage ever-greater levels of taxation to fund an ever-larger government, as in many European countries. Instead, we ought to focus on measures that can keep spending itself low.

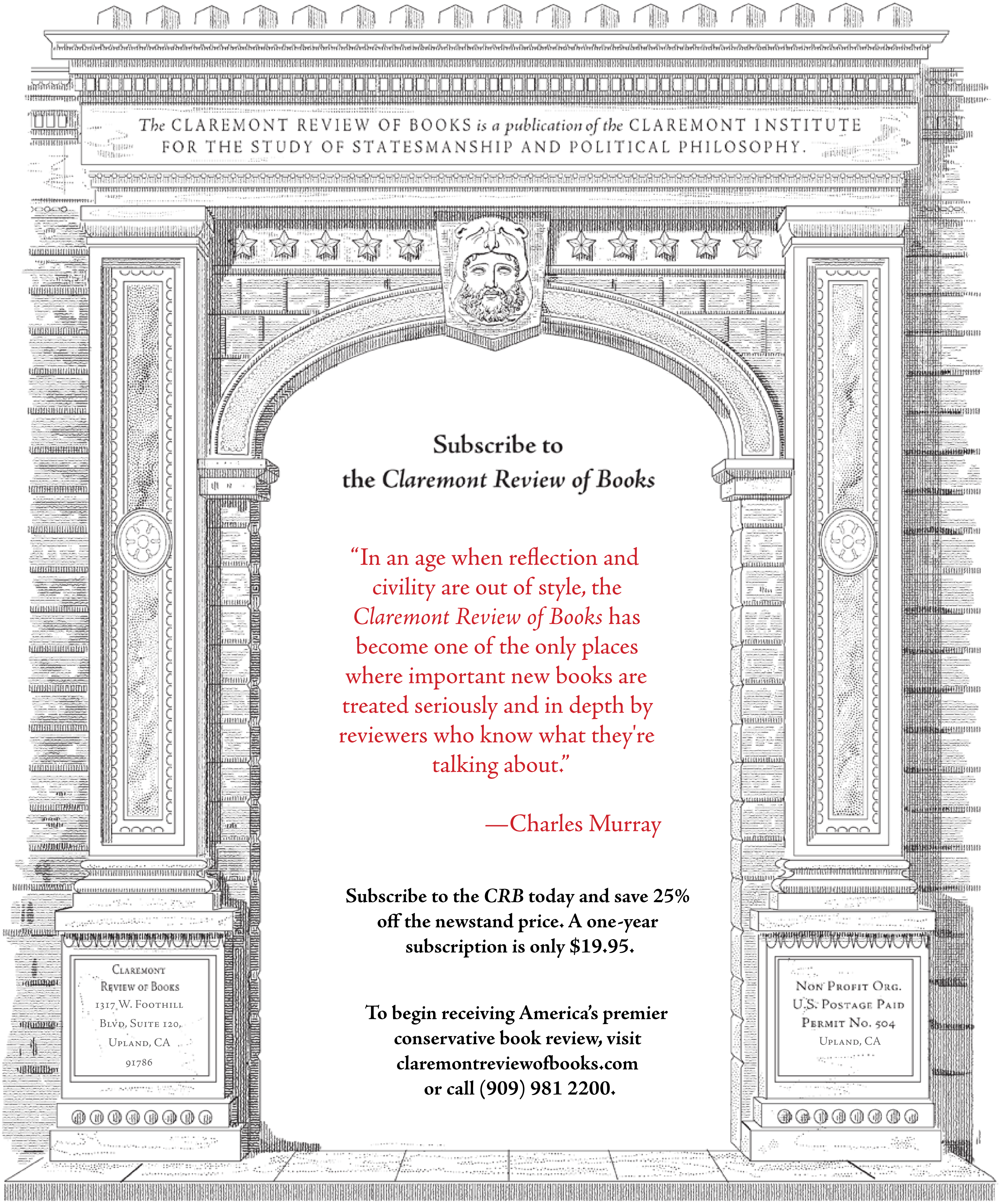
For instance, the American citizenry would be more apt to view the debt as a shared concern if nearly everyone paid at least *some* income tax, as Florida Senator Rick Scott has proposed. At the least, no one's income tax bill should go negative, as it does when tax credits are made "refundable"—available not as a tax cut but as a payment to those who don't pay income tax. A few years ago, I released "The Main Street Tax Plan" (Hudson Institute, 2016), which the Tax Foundation said would reduce deficits. It declared, "Nearly everyone should be paying something in income tax, however small, and Americans shouldn't regard April 15 as a payday."

Some, such as Senator Mitch McConnell, oppose Scott's proposal because—in McConnell's words—it "raises taxes" (for people who don't pay income taxes). Those who share this concern should consider pairing refund reform with an end to the Medicare payroll tax. Unlike the Social Security payroll tax, which is vital and funds Social Security as a (more or less) pay-in-for-yourself program, the Medicare payroll tax funds only about a third of Medicare and helps perpetuate the false notion that Medicare too is mostly pay-in-for-yourself. Eliminating the Medicare payroll tax would soften the perception of Medicare as an entitlement, simplify the tax code, and ease the tax burden of the working poor. Combining this with Scott's plan would encourage more people to care about the size and scope of the federal government.

In 2010, back when the Tea Party was ascendant and the national debt was $13 trillion rather than $30 trillion, I proposed (in *National Affairs*) a Limited Government Amendment to the Constitution. Such an amendment would limit annual increases in federal spending to inflation plus two percentage points, except during a formally declared war, or if two-thirds of Congress and three-quarters of state legislatures authorized additional spending for other reasons. An amendment in this spirit could greatly facilitate fiscal restraint.

It has become fashionable to think of constitutional amendments as relics from the past. But then, so are fiscal responsibility and—increasingly—representative government. The founders made the Constitution amendable for a reason, and we should take our cues from them. In the late 1990s, we showed—briefly—that it's possible to take action to reverse our course and help save our country from the tragic fate that Jefferson described. But the first step is to recognize that the $30 trillion elephant in the room isn't going away. It's just growing bigger.

Jeffrey H. Anderson is president of the American Main Street Initiative and served as director of the Bureau of Justice Statistics at the U.S. Department of Justice from 2017 to 2021.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