

# WebMemo



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## Any Stimulus Legislation Must Include Budget Reforms to Address Long-Term Challenges

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Congress and President-elect Barack Obama have set their sights on a massive economic stimulus bill crammed full of spending projects intended to “jolt” the economy into recovery. By some counts this package may reach \$1 trillion, or nearly 85 percent of the total of all budget bills passed last year.<sup>1</sup>

This is not the way to spur economic recovery. Even Obama recognizes he faces a difficult challenge: how to keep the stimulus focused on short-term deficit spending and avoid a huge, long-term expansion of the federal government—and with it a dramatic increase in the staggeringly large unfunded obligations due mainly to Social Security, Medicare, and Medicaid. To deal with that challenge, Obama should work with fiscally responsible Members of Congress to include four key budget reforms in any stimulus legislation:

1. Put long-term obligations from Social Security, Medicare, and Medicaid front and center in the budget process;
2. Establish a bipartisan congressional commission to develop a package of long-term reforms for entitlements;
3. Establish equitable policies for assessing and enforcing spending and revenues changes in the budget; and
4. Create a long-term budget for entitlement spending.

**Spending and Deficits Hit New Records.** Federal spending is projected to top 25 percent of GDP in 2009, according to the Congressional Budget

Office (CBO), the highest it has been since World War II, and that is *before* any stimulus legislation. The deficit is projected to reach \$1.2 trillion by the end of this year, and any stimulus would likely push the deficit to more than \$1.6 trillion.

Similar large deficits are projected to continue into the future.<sup>2</sup> Such deficits are a loud alarm to which policymakers must listen: Federal spending is out of control. But even they ignore the deeper fiscal problems of Social Security and Medicare. These programs together, not even counting Medicaid, have an unfunded obligation that is equivalent to a mortgage of \$43 trillion.<sup>3</sup> Future generations will be forced to pay for those obligations through higher taxes unless the programs are modernized.

**Budget Restraint.** While making the case for his massive short-term stimulus proposal, President-elect Obama acknowledged the threat entitlements pose to the economy, noting, “If we do nothing, then we will continue to see red ink as far as the eye can see.” He called budget reform “an absolute necessity,” and he has pledged to confront the problems from Social Security and Medicare in his budget.

Budget writers in Congress are also alarmed. Senate Budget Committee Chairman Kent Conrad

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(D–ND), called the deficit “jaw dropping,” and House Budget Committee Chairman Jack Spratt (D–SC) was suffering “sticker shock.”<sup>4</sup> They and their ranking member counterparts have encouraged lawmakers to tackle the long-term budget problems posed by these entitlement programs. Conrad and Senator Judd Gregg (R–NH) have urged Congress to link the stimulus with action to address the long-term budget crisis.<sup>5</sup>

If President-elect Obama is serious about fiscal responsibility, he and responsible Members of Congress must insist on budget reforms to prevent further deterioration of an already alarming long-term budget problem and require action to tackle these challenges directly. To that end, he and responsible lawmakers should insist on these four key budget reform measures being included in any stimulus package:

**1. Put long-term obligations from Social Security, Medicare, and Medicaid front and center in the budget process, with an up-or-down vote on any budget that will increase debts on future generations.** Such a measure could easily be incorporated into the annual budget resolution. This would provide a more accurate and transparent assessment of the federal government’s commitments and provide all Americans with a vivid picture of the problem. All major policy changes should be scored over the long term to indicate what impact they would have on the total unfunded obligations of the gov-

ernment. That would provide lawmakers and the public with a better understanding of the true long-term costs of new legislation. And to put Members on record on their attitude to burdening our children and grandchildren, they should have to vote during the annual budget process if the proposed budget will increase long-term obligations.<sup>6</sup>

**2. Enact a bipartisan congressional commission to develop a package of long-term reforms that will make these programs affordable.** Bipartisan legislation to implement this type of commission was introduced in the previous Congress: the SAFE Act (H.R. 3654), co-sponsored by Representatives Jim Cooper (D–TN) and Frank Wolf (R–VA), and the Bipartisan Task Force for Responsible Fiscal Action Act (S 2063), co-sponsored by Conrad and Gregg. Under both bills, a commission would craft detailed recommendations for a fast-track vote in Congress. The SAFE Act would have the added advantage of a two-step process. Its first phase would be a series of nationwide public hearings to talk frankly about the long-term fiscal problem and the tough options for fixing it and to build public support for congressional action on a broad plan of action.<sup>7</sup>

**3. Establish equitable policies for assessing and enforcing spending and revenues changes in the budget.** Any budget enforcement mechanism is based on changes in projected spending and revenues. The CBO projects a spending baseline by

1. Estimated FY 2008 appropriations \$1.154 trillion, prior to all enacted supplementals. Office of Management and Budget, “Budget of the United States Government Fiscal Year 2009: Historical Tables,” Table 5.4, at [www.whitehouse.gov/omb/budget/fy2009/hist.html](http://www.whitehouse.gov/omb/budget/fy2009/hist.html) (January 9, 2009).
2. See Brian M. Riedl, “CBO Budget Baseline Shows Historic Surge in Spending and Debt,” Heritage Foundation *WebMemo* No. 2193, January 7, 2009, at <http://www.heritage.org/research/budget/wm2193> (January 9, 2009).
3. Department of the Treasury, “2008 Financial Report of the United States Government,” December 15, 2008, p. 41, at <http://fms.treas.gov/fr/index.html> (January 9, 2009).
4. Lori Montgomery, “Congress Urges Spending Restraint,” *The Washington Post*, January 8, 2009, at <http://www.washingtonpost.com/wp-dyn/content/article/2009/01/07/AR2009010701156.html?hpid=topnew> (January 9, 2009.)
5. Senators Kent Conrad and Judd Gregg, “A Fiscal Battle on Two Fronts,” *The Washington Post*, January 5, 2009, at [http://www.washingtonpost.com/wp-dyn/content/article/2009/01/04/AR2009010401436\\_pf.html](http://www.washingtonpost.com/wp-dyn/content/article/2009/01/04/AR2009010401436_pf.html) (January 9, 2009).
6. Alison Acosta Fraser, “Federal Budget Should Include Long-Term Obligations from Entitlement Programs,” Heritage Foundation *Executive Memorandum* No. 1004, June 22, 2006, at <http://www.heritage.org/Research/Budget/em1004.cfm>.
7. Alison Acosta Fraser, “The SAFE Commission Act (H.R. 3654) and the Long-Term Fiscal Challenge,” testimony before the Committee on the Budget, U.S. House of Representatives, June 25, 2008, at <http://www.heritage.org/Research/Budget/tst062508b.cfm>.

assuming that all the laws authorizing spending—such as the highway or farm programs, or even appropriations—will be extended year after year and spending levels will continue even if they expire regularly under existing law. But when it comes to taxes, the CBO's baseline is current statute, and any rates reductions, deductions, credits, etc., that are scheduled to expire are assumed to do so. The lopsided result is that spending is given a free ride under the baseline while any reduction in the growth of taxes is assumed to be temporary.

This skewed baseline means current “PAYGO” rules are biased toward tax increases. Thus, for any enforcement mechanism to be considered fair and to be effective, it must be based on the same baseline treatment for both spending and revenues. Indeed, Obama's own advisors have already criticized this lopsided policy treatment, which stacks the deck in favor of higher spending and higher taxes.<sup>8</sup>

**4. Create a long-term budget for entitlement spending.** Unlike “discretionary” programs such as defense and education, “mandatory” entitlement programs like Medicare and Social Security are not budgeted annually. Entitlement spending grows on auto-pilot, in conjunction with the programs' regulatory framework, so there is not an open or transparent consideration of priorities or budgetary trade-offs. And since spending levels are simply the product of individuals using their entitlement, there is in a sense no budget—just a projection of likely total costs. And as they grow unchecked, these entitlements crowd out other programs and priorities.

This must change, by constraining entitlement programs with a real budget. To be sure, retirement programs require longer time horizons and planning than typical discretionary programs so that beneficiaries will not face unexpected annual

changes in benefits. Therefore, Congress should create a long-term framework for a constrained entitlement budget that would be periodically evaluated to ensure that these programs are sustainable and affordable over the long term. This could be done by creating a long-term budget window—for example, 30 years. All spending would be reviewed every five years, and the commission could recommend measures for Congress to ensure that the programs live within this budget framework.<sup>9</sup>

There are many reasons to be concerned over the unprecedented stimulus spending now being proposed, including the ineffectiveness of Keynesian pump priming, the perils of such an immense hike in government spending, and the creation of new permanent government programs. With the first baby boomers recently retiring, America is experiencing the first waves of the entitlement tsunami. The stimulus legislation could set the stage for a permanent sea of red ink and an even larger tsunami of debt. Substantive budget reforms are needed to prevent such a scenario from occurring.

**Truly Serious?** Since President-elect Obama is intent on signing a massive spending bill, he must insist that it does not result in huge permanent government programs and thus potentially trillions of dollars in new burdens on our children and grandchildren. He must demonstrate his commitment to tackle the long-term entitlement challenges by working with Members of Congress to build sound budget process reform measures into the stimulus legislation. If he does not do so, the young Americans who voted for him should question how serious he is about protecting their financial future.

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8. J. D. Foster, Ph.D., “Obama to CBO Revenue Baseline: Nuts—and He's Right!,” Heritage Foundation *WebMemo* No. 2019, August 11, 2008, at <http://www.heritage.org/Research/Budget/wm2019.cfm>.
  9. Stuart M. Butler, Ph.D., Alison Acosta Fraser and Other Authors, “Taking Back our Fiscal Future,” Heritage Foundation White Paper, March 31, 2008, at <http://www.heritage.org/Research/Budget/wp0408.cfm>.