Budgets III

- The argument is that the performance of the American economy over the last decade has been so strong that we are facing a new era with different choices
  - Real output since 1991 is 3.1%
  - 16 million new jobs since 1991 real incomes up
  - Consumer price index is up only 2.8% annually since 199
  - Some increase in inequality but see real income growth

III

- This economic boom has led to budget conditions not seen since the 1950’s
  - The unified budget has been in surplus for four consecutive years for the first time since Andrew Jackson
  - The surplus is about 1% of GDP and is expected to go to 3% by the end of the decade
- How was this done?
  - 1990, 93 and 97 yielded budget acts that raised taxes and cut expenditures
    - Various mechanisms used include—caps—pay go which were extended in the 1993 1997 acts

III

- Most of the cuts were in defense spending only in the first Republican Congress were domestic expenditures slowed
- Federal Reserve and Greenspan did a good job
- The strong economy generated extra taxes and fewer payments
- Luck
  - Rise of HMO’s
  - Income inequality meant high earners paid more taxes
  - Collapse of Soviet Union allowed defense spending to be lowered
  - Bad economies elsewhere kept cheap exports coming in

III

- Soaring stock market gave rise to option cash ins
- Lower numbers of folk on welfare
- How likely are the projected surpluses?
  - Obviously the projected surpluses hang on the accuracy of the projections where small increases in inflation and income growth have long term consequences
  - Nevertheless there is agreement that under most reasonable scenarios there will be surpluses for the foreseeable future
  - The surpluses are not only in the unified budget but are in the non unified part of the budget for the first time in 50 years
III

- So the question is how should these surpluses be spent?
  - The liberal answer is that they should be spent to further the nations aims thus in defense, aging and a number of other areas such as family policy present expenditure levels under budget caps are not acceptable
  - In social security policy taxes should be raised and benefits reduced slightly such that over time we can accommodate the baby boomers
- We now turn to these arguments in specific policy areas

III

- Down from 50% of the budget in the 1950’s and 60’s
- Down from the 1980’s buildup
- By 2004 military spending will be about 3% of GDP
  - The U.S. spends much more on defense than its allies in fact 33% of total world defense spending is U.S.
  - Most of the world’s defense spending is in the West 2/3rds however 4/5ths of the economic production is there
  - Conclusion is that without U.S. military power the globe would be less stable

III

- Military policy
  - U.S. is the most influential military in the world
  - Even in a peaceful era there is a need for a strong military
    - Oil prices in Gulf area
    - Korea
    - Middle East
    - Central Europe
    - Africa and so on
  - Military spending has declined in real terms over the past 50 years

III

- The Quadrennial Defense Review concluded
  - Defense levels will be 1/3 smaller than cold war
  - Troops down to 1.36 million from 2 million
  - Streamlining equipment
  - Too many bases (why is this true)
  - Reforms in admin procedures will not save much money
- Policy debates
  - Readiness
  - Weapons
III
- Readiness means how prepared are forces relative to how they could do and at issue are
  - Equipment outdates
  - Quality of personnel
  - Base funding down
- However, readiness is not poor
  - Best educated personnel
  - Peacetime casualty rates are down
  - Funds adequate for first to fight units
- Weapons are
  - Stocks and arsenals are best in world
  - Ships and planes must be replaced

III
- Pentagon approach is to buy new systems
- Liberal argument is that this is too costly
- Question how do you have an adequate defense on 300 billion a year?
  - Adopt a 1 and 1/2 war system not a 2 war system
  - Reduce the number of carrier groups by airlifting replacements—reduces carriers from 12 to 8
  - Reduce nuclear deterrent size to START II levels
    - This included under Clinton a missile defense system
  - Utilize low cost advanced munitions communications and computer equipment
  - Shift NATO policy to move troops

III
- Paying for an aging population
  - Between now and 2040 population over 62 will go from 41 million to over 80 million
  - As they age they will consume an increasing proportion of resources
- Aaron distinguishes between
  - The government budget costs for SS, Medicare and other programs for elderly
  - The impact of those costs on budgets and living standards

III
- In regard to international affairs
  - Increase development aid
  - Pay and support UN
  - Reduce spending to Egypt and Israel
III

Demographics
- 2008 oldest boomers turn 62 by 2040 ¼ of population will be over 62 and 11.4% of population will be over 75
- It is important to note that the distribution of burden varies by size and age
  - Children cared for by parents
  - School age by state and local governments
  - Elderly shifts burden from families to government and to the federal government rather than state

Social Security
- Pays retirement, disability and survivors benefits to 44 million
  - Average 894 month
  - Taxed at 12.4% of income up to about $75,000
- These benefits have four distinguishing characteristics
  - Depend on each workers history
  - Benefits are progressive
  - Protected against inflation
  - Joint survivor annuities
- Reserves held in low yield government guaranteed assets
  - In 2021 these benefits will be lower than reserves because current retirees get much more than they paid in - the unfunded liability

III

Actuarial
- Revenues will fall short of expenditures by 2.07 percent of payroll in the next 75 years
  - Raising the taxes by that amount or cutting expenditures would not fully fund social security
  - By 2075 you would need a 4% increase to solve problem
- Now is the time to solve problem
  - People need time to adjust their lifestyles to change
  - Budget surplus and economy make timing right
- Reforms fall into three categories
  - IRA
  - 401K
  - Fix current

The first two options are privatizing and are not the liberal alternative thus I discuss fixing the current
- Which requires a combination of benefit cuts, payroll tax increases, higher returns on trusts or infusions of new revenues from other taxes
  - Advocates of fix the system argue that personal accounts can lead to
    - Greater inequalities and possible added burdens on welfare
- Fixing the system could include
  - Increase payroll tax to include 90% of earnings
  - Increase full benefits age
  - cover all state and local employees
  - Increase averaging to 40 years
III
- Other measures
  • USA accounts
  • Social Security Guarantee
  • 21st Century Retirement Security Act
- When all is said and done the argument for keeping the present system boils down to
  - If you fund from general revenues you erode the contributory aspect and monies spent here not available elsewhere
  - Personal accounts could also erode support for SS

III
- Thus there are two sharply divergent views of SS
  - Traditional and liberal view is that ensuring basic income during retirement is a shared responsibility where risk is shared and benefits are progressive
  - Personalized accounts where individuals are responsible for their own choices—citizens get control over accounts and bear the risks associated with this

III
- Medicare
  - Problems are roughly the same although more imminent in case of Medicare with three solutions
    • Strengthen present system but keep structure
      - This reduces need for supplemental insurance thus lowering and costs set by market prices not administrative decisions
    • Premium support
      - Set up like federal employees system
    • Privatizing Medicare like SS
  - Problems are complicated by medical technology—rising costs

III
- Medicaid
  - Not thought of as a old persons program but reality is
    • Elderly make up only 29% of beneficiaries but 73% of costs
    • Of this acute care is 42% and long term care the rest
  - Program is critical for the very old who will be increasing as proportion of population