FISCAL DEMOCRACY

OR

Why Sound Fiscal Policy, Budget Consolidation, and Inclusive Growth Require Fewer, Not More Attempts to Control the Future

OECD-WB Conference on Challenges and policies for promoting inclusive growth

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The Urban Institute
Deficits and Debt – Symptom or Disease?

- Problem far greater than deficit or budget consolidation

- Attacking short-run deficits does not address the modern disease
The Modern Disease

- Competing to control most, all, or more than all of future resources of government

- Building permanency and growth into programs & public expectations
  - Health and retirement and tax
  - Permanent commodity subsidies (food, energy)
  - Guarantees

- Reducing taxes below levels necessary to support those promises
Four Related Economic Problems

- Long-term budget sustainability
- Ability to conduct counter-cyclical policy
- Fiscal sclerosis: lack of adaptability & decreased investment
- Aged social welfare structures
  - Fail to promote inclusive growth & address *current* needs
Three Related Political Dilemmas

- Decline in fiscal democracy
  - Little give or slack for future voters

- A classic prisoners’ dilemma
  - Loss to both left and right if act independently

- Difficulty in fixing government
  - Requires reneging on some past promise
Why It Really is Different This Time

➢ Traditional problem: fiscal profligacy year after year
  ❖ Succeeding periods of give-away legislation (tax cuts, spending increases)
  ❖ But long-term budgets in balance
    ❑ 10 year projection under current law in 1830, 1910, 1950, 1970, or even 1942 – huge surpluses

➢ Now long-term budgets out of balance
  ❖ For many countries, unique in all their history
Steuerle-Roeper Fiscal Democracy Index

Fiscal Democracy Index, Germany 1970-2009
Federal Government Total Revenue

Source: Streeck & Mertens 2010.
Traditional Budget Projections: Flat or Declining Spending
New Budget Projections
Built-in Growth in Spending

Current Year

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Future Years

Expenditures - higher economic growth

Revenues - higher economic growth

Expenditures Under Current Law

Revenues Under Current Law
Fiscal Sclerosis: Two-fold Case

(1) What business or household would sign contracts for spending its growth 100 years into the future?

(2) Bias against investment, children, mobility
The President's Priorities for Changes in Outlays 2016 compared to 2011 levels ($2011)

Source: C. E. Steuerle and S. Rennane, the Urban Institute 2011. Data from OMB, FY2012 Budget. Medicare outlays assume Sustainable Growth Rate relief is continued through 2016. Other Mandatory includes unemployment insurance, SNAP, other income security programs, as well as disaster costs and funds reimbursed from TARP. Discretionary non-Defense includes, among others, most education funds, and energy.
Aged Social Welfare Structure

- Issue not just investment
- Also inclusiveness & equity
  - No “give” for new needs & opportunities
    - Less for both the truly old and the young because of middle-age retirement
    - Less for new health needs: autism; Alzheimer’s
    - Less for newly recognized needs of formerly excluded minorities
Notes: Calculations based on mortality data from the 2010 OASDI Trustees' Report. Calculations for a couple assume that at least one partner is still living. ERA was set at 62 for women in 1956 and men in 1961. C. E. Steuerle and S. Rennane, Urban Institute 2010.
Variation Across Countries

- Wide variation
  - Parliamentary/Presidential/hybrid systems
  - Taxes (do more consumption taxes help?)
  - Demographics
  - Retirement systems
  - Health

- Still, much in common:
  - Higher levels of promises, expectations, guarantees
  - Automatic inclusion of new health services
  - Retirement years & effective “wage” indexing
Middle & Lesser Developed Nations

- Delayed retirement & health effects
- But usually less capacity on tax side
- Other “permanent” expectations:
  - Subsidized food, energy
- Crucial here, as well: level of built-in growth
- Sclerosis or fiscal space to make investments
  - Recent attention during periods of fiscal consolidation
The Political Dilemmas

- Fiscal Democracy
  - Future voters treated like adolescents
  - Even sustainability under *current law* doesn’t give voters freedom to decide
- Classic Prisoners’ Dilemma
  - Unilateral efforts hurt left and right in achieving success in their agenda and in politics
- Difficulty in fixing government
  - Must renege on a past promise to:
    - Reduce debt
    - Reform a program
    - Do anything new
Lessons for Fiscal Policy & Fiscal Rules

- A constitutional (but not necessarily Constitutional) issue
- Deficits/debt only one symptom to be treated
  - Often leaves six of seven problems outlined here
  - And probably the seventh—sustainability
    - Due to emergencies, economic cycles, & voter demand
- Fiscal democracy must be made a goal
  - Significant give or slack in long-term budget
  - Some “constitutional” “prisoners’ bargain” to constrain unfunded promises for future
- Vital to measure historic and projected fiscal democracy
  - Not necessarily to set a numerical goal
  - But to understand extent of each country’s fiscal problems