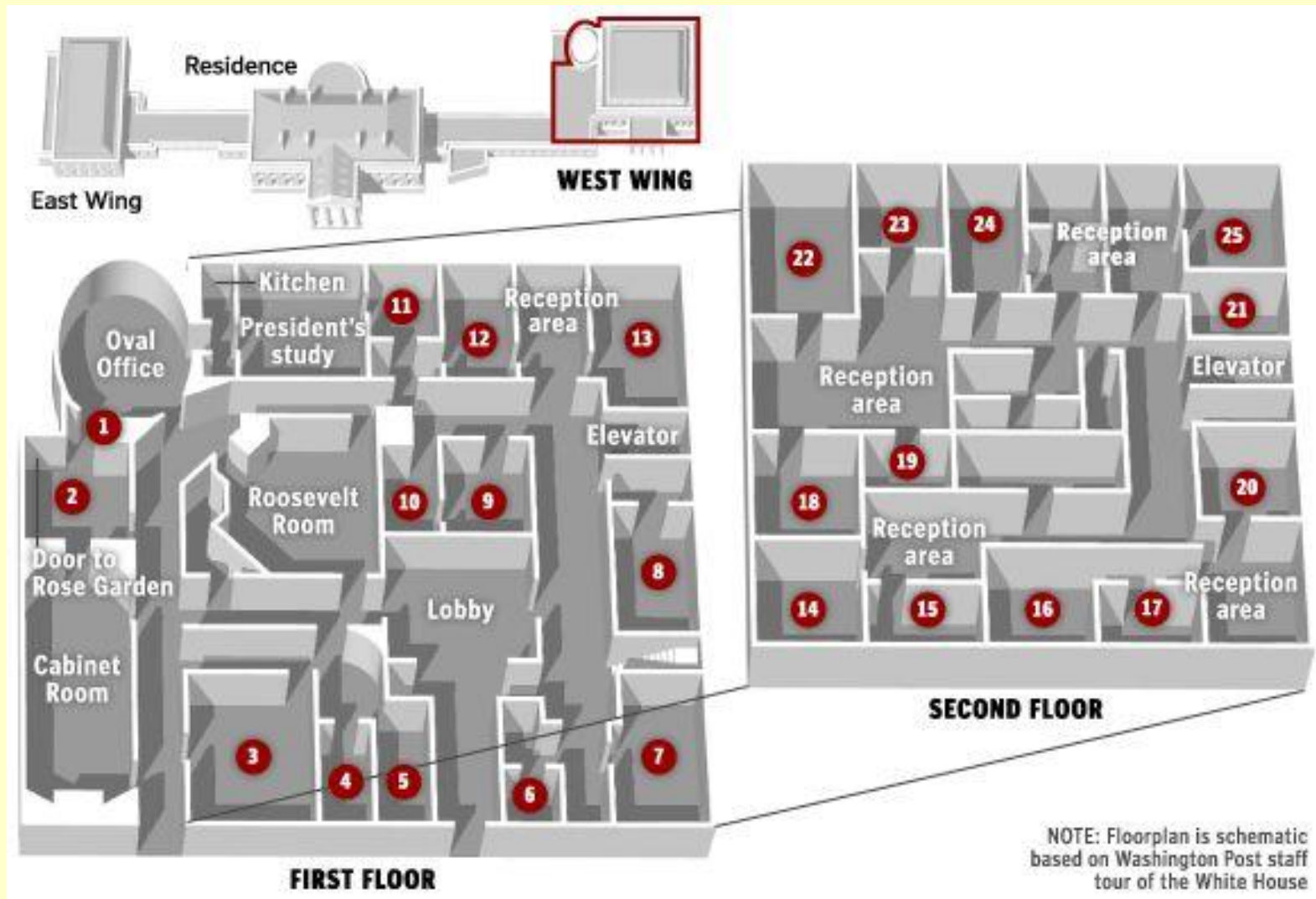


# **Demographics, Recession Economics and the Growth of Government**

*Perspectives from a White House Insider Turned Outsider*

Charles P. Blahous  
September 24, 2009

# Things Look Different on the Inside



**Thesis: The federal government is in the process of becoming much larger than it has ever been before. Unless this trend is redirected very soon, it will be irreversible and embody a fundamental change in Americans' economic experiences.**

**-- The public senses the reality of this transformation, reflected in concerns now being expressed around the nation.**

**-- There is less awareness of the detailed causes of this transformation.**

**-- The almost-certain consequence is that, unless we fundamentally redirect our path, younger Americans and those who follow will permanently experience lower after-tax incomes than previous generations enjoyed.**

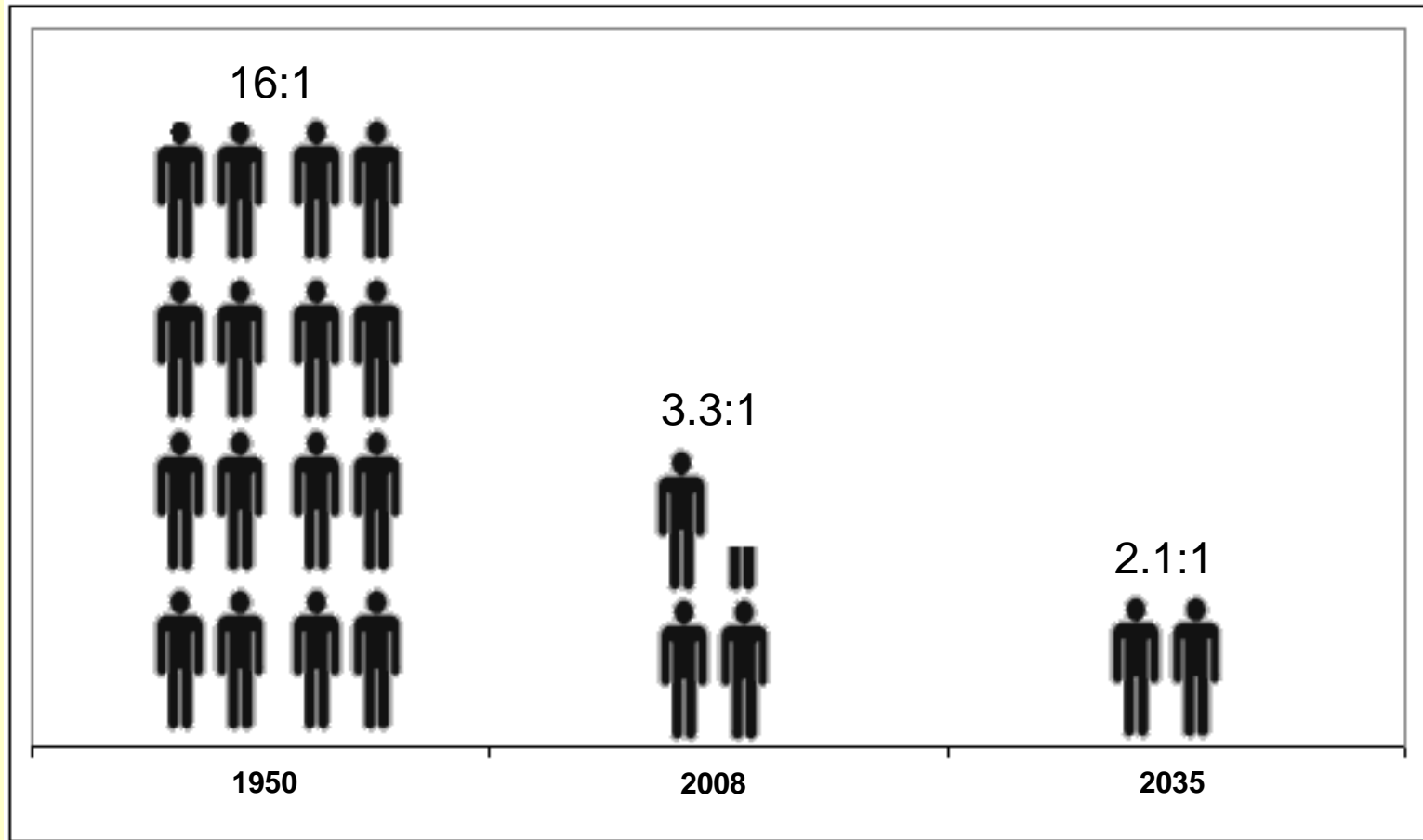
# **The Irreversible Growth of Government:**

## **Four Primary Causes**

- Population aging.**
- Federal program indexing methods.**
- Recession economics.**
- Policy preferences of the current Administration/Congress.**

# Factors Driving Government Expansion:

## Factor 1: Population Aging



Ratio of Contributing Workers to Social Security Beneficiaries

# **Factors Driving Government Expansion:**

## **Factor 2: Federal Program Indexing Methods**

- Automatic indexing is employed throughout the federal government.**
- Almost invariably, indexing methods require the taxpayer to shoulder higher costs whenever a particular variable grows faster than inflation. Examples:**

### **Indexation of Medicare premiums to program cost growth:**

- Some costs passed to beneficiaries.**
- Most costs passed on to taxpayers.**

### **Wage-indexation:**

- Initial Social Security benefits.**

### **Price-indexation:**

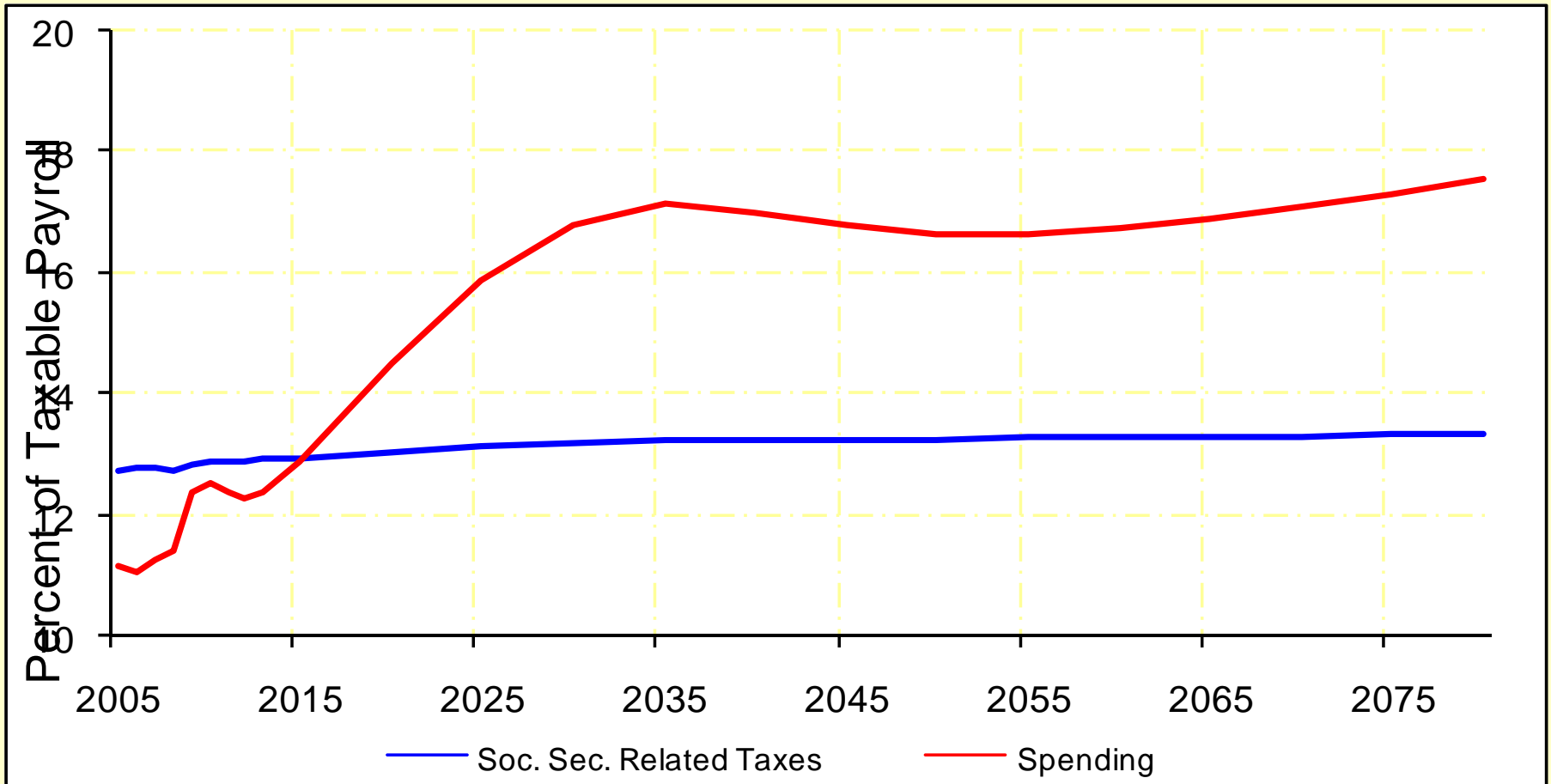
- Income tax brackets**
- Social Security COLAs**

### **No indexation:**

- AMT**
- Social Security benefit taxation.**

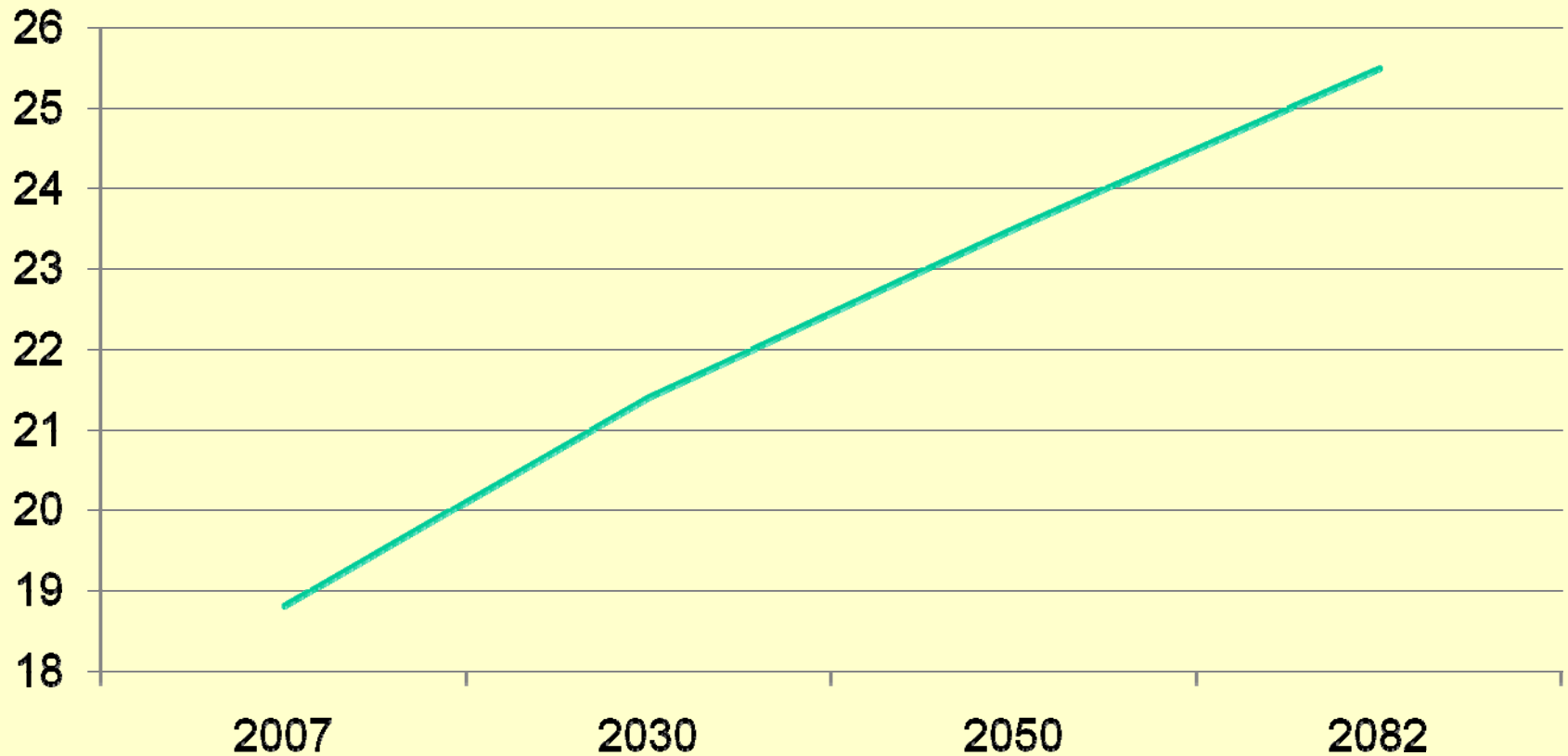
# The Social Security Outlook:

Cost increases driven by aging and wage-indexation



Even before recent events, CBO's projections for current law showed taxation absorbing a perpetually increasing share of the economy.

### **2008 Projections: Federal Revenue as a % of GDP**



# **Factors Driving Government Expansion:**

## **Factor 3: Recession Economics**

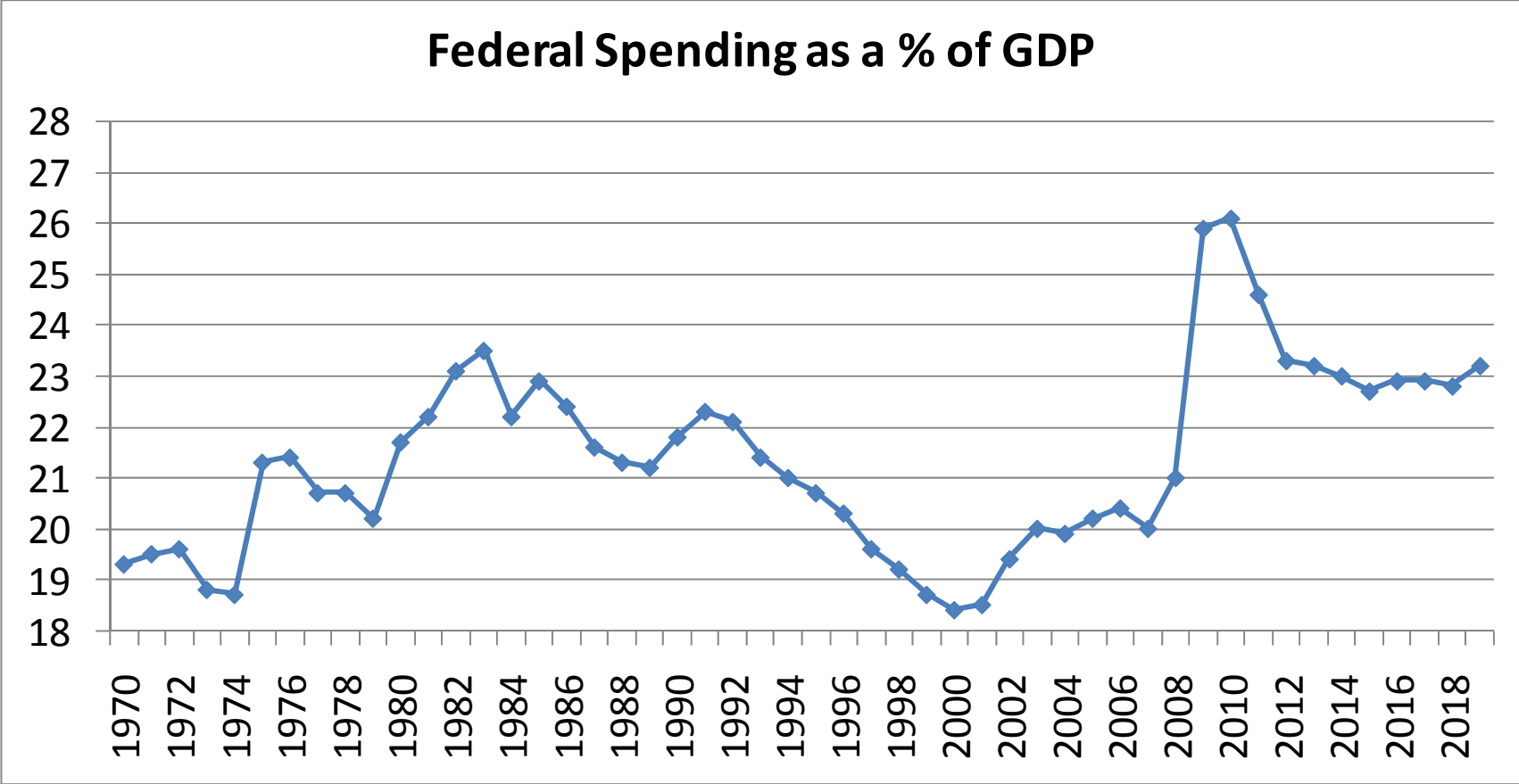
- Both in the last year of the Bush Administration, and in the first year of the Obama Administration, the government undertook a number of unprecedented actions to counter the effects of the financial market collapse.**
- Many actions intended to be temporary, but some likely to be permanent.**
- TARP Financial Stabilization Program:**
  - \$700 billion**
- Stimulus package:**
  - \$787 billion over ten years**
  - Administration has already proposed permanence of some portions**
- Expanded government role in several areas:**
  - Automobile industry**
  - Student loans and grants**
  - Small business loans**
  - Underwriting of commercial and mortgage loans**
  - Deposit Insurance**
  - Mortgage write-downs**
  - Unemployment benefits and health insurance premium support**
- More actions likely:**
  - Financial regulatory reform**
  - Pensions**

# Factors Driving Government Expansion

## Factor 4: Governing Philosophy of Administration/Congress

- General, Part I: The inauguration of the Obama Administration has concided with a historic inflection point arising primarily due to demographic change.
- General, Part II: For many years the consensus has been that the projected demographically-driven spending explosion was a *problem* to be *averted*. This view is not shared by current decision-makers, who see the baseline trend as one to be *embraced* and *accelerated*.
- Health care: Effort to expand federal commitments by \$900 billion over the next ten years and more thereafter. Fiscal goal that reform be “deficit-neutral” – repairing none of the government’s fiscal imbalance while swelling net outlays.
- Social Security: Rejection of measures to reduce or pre-fund projected costs means that taxes must ultimately be increased.
- General expansion of federal spending commitments requiring substantial tax increases to finance going forward. Blurring of the lines of taxes/spending.
- Philosophical attraction to behavioral economics: “Nudging.”
- Administration’s smallest deficit *target* of \$739 billion in 2015 is larger than any previous deficit in history.

# The Administration's Budget Goals Would Accelerate the Permanent Expansion of Government



# Personal Opinions

- The proportion of our nation's economic resources commanded and reallocated by government *does* matter.
- *We should* care about the amount of income our children and grandchildren are able to possess and enjoy after taxation.
- A distinguishing and beneficial feature of our society, relative to many others, has been the extent to which the private economy has retained the freedom and resources to innovate.
- The future of the American economy, if left as free as it has heretofore been, will be bright.
- The economic strength and prosperity of America has meant a positive difference not only in the lives of Americans, but of countless others around the world.

# Recommendations and Conclusions

- I respectfully disagree with the Administration on many policy issues, but as former WH staff I empathize with their challenges, and as an American I feel a shared stake in their success.**
- Although I would criticize some of the Administration's choices in financial stabilization, I believe they built reasonably upon actions taken last year, and I support their efforts to wind down TARP and to achieve financial regulatory reform.**
- We need fundamental Social Security reform that either contains or pre-funds a portion of currently-projected costs.**
- We should go back to the drawing board on health care reform and reduce rather than expand our unsustainable financing commitments.**
- We should re-index federal programs so that economic growth above inflation benefits taxpayers as well as beneficiaries.**