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## *Federalist* No. 30: What Is to Be Done About the Federal Budget?

*Federalist Nos. 12 and 30–36 describe the benefits of a national fiscal system with independent revenues, arguing that a strong national government cannot exist for long without the means to raise revenues on its own. This essay examines the national fiscal policy process during this period of economic crisis and rising national debt. It provides a detailed assessment of needed reforms in the budget system that would meet the tests imposed by an increasingly uncertain global economy.*

**B**udget processes frame the most important decisions made by a political system in a given year. How much of the economy to devote to government through taxes and how to allocate the spending of limited resources are the most important decisions that political leaders at all levels of government must make each year. It is no wonder that Wildavsky (1961) called budgeting the lifeblood of government, the financial reflection of what government does and intends to do.

Over the more than 200-year life of the nation, the federal budget process has evolved through several distinct fiscal policy regimes. For much of our history, fiscal policy was an island of stability for a government that perennially was challenged by economic volatility, demographic and territorial change, and war. Challenged at the outset to overcome the fiscal impotence that hamstringing the national government during the Revolutionary War and after, the balanced budget and public financing regime instituted by the founders became the foundation for fiscal policy for the next 150 years.

The second regime had its origins in the New Deal, but it came to full flower in the late 1960s through the present time. The federal role in balancing the economy supplanted older balanced budget rules as the watchword for fiscal policy makers. Failing to adhere to norms of balance or surplus during periods of economic expansion and inflation, deficits became deeply embedded and were transformed from cyclical to more permanent structural imbalances between spending and revenues. Traditional policy-making

institutions and rules that anchored federal budgets to incremental norms were unseated by increasingly novel open-ended entitlements and tax expenditures that grew according to their own gyroscopes.

We stand on the precipice of a potential third shift in fiscal regime brought about by the unprecedented fiscal challenges arising from an aging population and higher health care costs. Already facing the highest deficits in peacetime arising from the financial crisis, the budget will remain in structural imbalance even when the economy returns to full employment. Unlike previous recoveries, the budget faces escalating and economically unsustainable deficits for decades to come, absent dramatic policy reforms in spending and revenues. Burgeoning deficits and debt will consume nearly all of the savings that private markets rely on for their own capital investment and growth. In sharp contrast to the first fiscal regime, the federal budget will become a destabilizing force for the nation's political and social order.

The founders' system, which was designed to curb the exercise of power, now must be mustered to foster broad support for the unwinding of tax and spending policies that have undergirded our political coalitions for the past 80 years. Other nations have succeeded in achieving reforms in pensions and fiscal reforms, but they may have the advantage of doing so within more cohesive parliamentary settings and more insistent bond market pressures.

Solving these vexing problems requires seemingly heroic acts of collaboration across the institutional separations and conflicting interests of our system. It calls for policy makers to do what many think is a politically unnatural act—administering fiscal sacrifice today for the benefit of future generations. And they must do this in a system featuring greater electoral anxiety by public officials, party polarization, and 24/7 media coverage, which conspire to undermine the governance by insulated elites that may very well be necessary to make the hard choices facing the nation.

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## Budgeting in the Early Republic

The founding of the U.S. Constitution had a compelling financial impetus. Simply put, the lack of effective financial resources made the national government increasingly impotent during the years preceding the Constitutional Convention. Troops suffered during the Revolutionary War for the lack of resources to acquire clothing and provisions. The loose confederation of states under the Articles of Confederation lacked the central taxing power necessary to do much of anything. States promised but typically failed to turn over revenues to the national government, as it became increasingly difficult for them to collect revenue. The private economy was moribund, with spiking interest rates and debt burdens. States printed paper money that quickly proved to be worthless (Kimmel 1959).

### *Federalist Papers*

Against a backdrop of economic and financial crisis, it is surprising that the *Federalist Papers* do not devote more attention to public finance and budgeting. Fiscal issues are dealt with in a number of chapters, often in the service of making broader points about the need for a stronger national government.

Strong arguments for a national fiscal system with independent revenues are made in *Federalist* No. 12 and *Federalist* Nos. 30–36. Referencing the experience under the Articles of Confederation, Publius argues that a nation cannot exist without revenue sources independent from those of the states. Revenues should be commensurate with responsibilities, a principle that caused the authors to reject arbitrary limits on taxation.

*Federalist* No. 30 provides a compelling case for a strong national fiscal system, arguing that the defense of the nation rests on the financial credibility of its budget and revenue sources. Importantly, the argument is grounded in two premises. The first is that government should be freed from fiscal shackles to enable it to exercise energy in order to advance prosperity at home and abroad. The second is that forming a fiscal system involves an exercise of foresight—not only to provide fiscal capacity for the relatively limited government of its time, but also to enable the nation to respond to emerging challenges and crises that it may grow into over time.

While tethered to balanced budget norms, as discussed later, Publius made a strong argument that crises require borrowing through public debt. This financial reality requires the nation to engender fiscal credibility with worldwide credit markets, lest it meet the fate of the nation under the Articles of Confederation, when it could only receive loans “with a sparing hand and at enormous premiums.”

### *Balanced Budget Regime*

From the beginning of the republic, budget balance was the most important fiscal rule for budgeting, even though that norm rarely was expressed publicly (Kimmel 1959, 7). Federalists and Jeffersonians alike agreed on this fundamental fiscal imperative. While higher

revenues could have enabled government to grow even within a balanced framework, for the most part, balanced budgets served to constrain the role of the national government. Federal spending remained at or below 2 percent of gross domestic product (GDP) from 1789 through 1860.

Webber and Wildavsky (1986) characterized budget balance as our national religion. Until the New Deal period, even economic depressions failed to sway the nation’s elites from the balanced budget course. Far from justifying governmental aid, depressions were attributed to government spending extravagance, which soaked up capital that otherwise would be available to expand businesses and private sector wages.

Within the broad agreement on budget balance, partisan conflict over the role of government nonetheless broke out, with a focus on the federal debt. Federalists favored a more activist government, using debt to expand the economy and the capacity of government to finance infrastructure improvements. Hamilton’s view was that national debt, if not excessive, would be “a national blessing . . . a cement to our union” (Wright 2008, 13). He succeeded in building a stronger public and a private financial system by allowing the national government to consolidate its existing war debts, paying off debt of states, and financing new federal capital projects.

The Jeffersonians and, later, Jacksonians feared a stronger national government, instead favoring state and local primacy. Jefferson went so far as to support a balanced budget amendment to the Constitution. While acknowledging the necessity of debt, he argued for federal borrowing to be paid off within 20 years to avoid intergenerational cost shifting.

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Notwithstanding the broad agreement on fiscal balance, a nation saddled with wartime debts could not reach this goal immediately in 1789. Presidents George Washington and John Adams resorted to long-term debt to cover deficits—in 1800, 30 percent of the budget went toward interest payments. Fortunately, the expanding economy in the early 1800s enabled the government to repay debt, reduce taxes, and acquire the Louisiana Territory while still balancing the budget. While the War of 1812 increased spending and debt, this was paid back over the next several decades. By the mid-1830s, the nation was debt free, having accumulated budget surpluses that succeeded in liquidating the outstanding federal debt.

### *Institutional Reinforcement*

The fiscal balance regime was supported by a set of policy-making and budgetary institutions and norms that served to further check government’s growth. The strong role of Congress in formulating the real budgets that matter for government helped limit spending by checking both the president and other committees in the Congress. As Wildavsky and Caiden (2001) have written, the powerful role of congressional fiscal committees exemplifies the principles articulated in *Federalist* No. 51 of ambition checking ambition.

Not only did these committees keep control of budgetary totals, but also they kept a tight rein on agencies' management and operations through detailed line-item controls and legislative directives. For much of our history, line items specified positions and even names of officials. Agencies were constrained to spend within the line items appropriated, and they generally were forbidden to transfer funds across accounts or even within accounts without congressional approval. Unexpended funds by agencies reverted to the Treasury, and strict limits were placed on the number of employees that could be hired each year.

Political executives from Hamilton's time forward chafed at the degree of micromanagement from Congress through the appropriations process (*Federalist* No. 71). Indeed, Leonard White (1950) ruminated that it hardly could be said that a budget had existed for the more than 130 years when agencies were required to submit their budget requests directly to Congress without presidential review. The executive budget was not to come until 1921.

Other norms and practices accompanied congressional control of appropriations that reinforced fiscal restraint. Budgeting was the poster child for incrementalism. There was broad agreement on the base, with conflict channeled to the marginal increases or decreases sought by agencies. As late as 1960, nearly 70 percent of federal outlays were determined by annual appropriations, as opposed to entitlements, a figure destined to change in more recent years, as will be discussed later.

The broader political system generally supported this fiscally conservative budget process over the years. In the first half of the twentieth century, Congress was able to incubate sustained fiscal leadership and consensus on appropriations issues thanks in part to the numerous noncompetitive states and districts that sent longtime members, without serious opposition.

In the 1960s, Donald Matthews wrote that broadly agreed rules of the game or folkways "formed a glue holding Congress together, enabling it to navigate potentially sensitive issues that could have imploded or ground down lesser institutions" (Matthews 1960). This reflected the stabilizing presence of strong centrists in the Congress; these officials often formed cross-partisan and bipartisan coalitions to enact budget as well as other major legislation. Presidents, too, had incentives to appeal to the center. Until the 1970s, they were nominated by party leaders who were sensitive to the general electorate, not by a frenzied primary process driven by the party fringes.

Figure 1 illustrates the duration of this fiscal balance regime. The chart shows that the budget was in balance or surplus from the founding of the republic to the late 1960s, except for those times marked by major economic crisis and war. Even fiscal conservatives acknowledged the need for borrowing when the very life of the nation was at stake. What is impressive is how rapidly deficits were eliminated in the immediate aftermath of wars, reflecting the bounce-back of the economy and the disestablishment of extensive federal wartime agencies and staff.

### The Second Fiscal Regime

As shown in figure 1, the "civil religion" of budget balance was defrocked after 1970, as the nation experienced nearly three

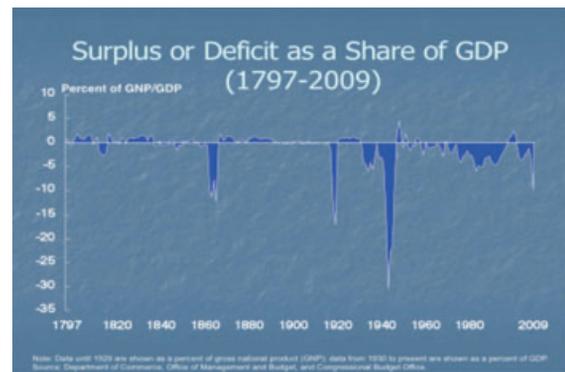


Figure 1 Surplus or Deficit as a Share of Gross Domestic Product, 1797–2009

### COMPOSITION OF FEDERAL OUTLAYS

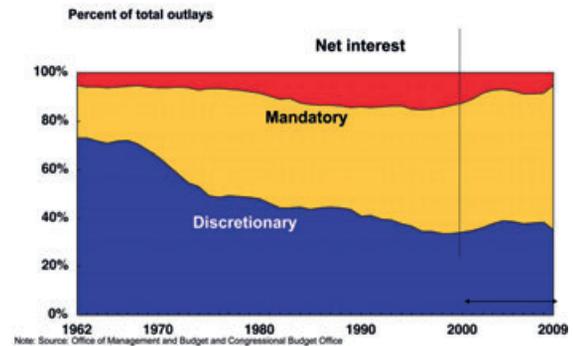


Figure 2 Composition of Federal Outlays

decades of deficits in the absence of great wars or recessions. The embrace of Keynesian economics by both parties, the growth of entitlements, and the greater public pressure on presidents and members of Congress to deliver publicly funded programs and tax cuts all contributed to the erosion of this norm. Even while the new regime became ascendant, elements of the first balanced budget regime remain, including a strong congressional role and a vestigial, albeit episodic, public attachment to balanced budget norms.

### The Shifting Nature of Spending

The shifting nature of federal spending helped erode the previous bipartisan consensus on budgeting in Washington. Appropriated spending shrunk from nearly 70 percent of the total in 1960 to only 37 percent in 2011. In its place, entitlement spending now represents 57 percent. These trends are shown markedly in figure 2. It should be noted that the chart does not include tax entitlements—the more than \$1 trillion in revenues lost each year because of the effects of some 170 tax expenditures that operate like entitlements.

By their very nature, open-ended entitlements are less controllable than closed-ended appropriations because their purpose is, in effect, to transfer risk from clients to the government. Accordingly, the fiscal burden of continuing entitlements is reversed. Under appropriated programs, agencies must surmount the congressional obstacle course to obtain approval for continuation of program budgets.

By contrast, entitlements automatically are presumed to continue; positive congressional action is required to reform or cut those programs. Allen Schick (1981) has remarked that it is ironic indeed that government's efforts to influence private living standards and behavior have undermined its own control of the public sector.

### ***Institutional Conflict and Dissensus***

If the growth of open-ended programs made budget and deficit control more difficult, the erosion of the political base for consensus on the budget and national priorities undid the political foundation for the old balanced budget religion. The past 30 years have witnessed the collapse of the middle ground in national policy institutions as the parties realigned regionally and became more polarized.

As the primary system has become the dominant model for nominations across the nation, members of Congress became increasingly sensitive to the positions of the more ideologically extreme factions within their parties that dominate turnout in primary election contests. The median voter, who traditionally was posited as being at the forefront of political leaders' calculations in position taking in Washington policy making, now is being supplemented or even supplanted by the median *primary* voter—a far more polarizing force that arguably accentuates the incentives for gridlock and stalemate in policy formation and leadership in Washington.

Members of Congress and presidents alike had to become more entrepreneurial as they became responsible for assembling coalitions and raising funds to support their own nominations and reelection. David Mayhew (1974) chronicled the consequences for national policy making—members pursuing the “electoral connection” became concerned with claiming credit for popular choices, generating visible benefits for their districts, and avoiding blame for negative and sometimes unavoidable choices that were required to sustain fiscal balance.

The interest group system disintegrated into a veritable Babel of newly emergent groups capitalizing on the lower costs of participation and the higher powers of the Web, among other factors. The media core was replaced as well by a far more competitive system of more diverse publications, narrowcasters and Web-based outlets all searching for new stories and angles. Old Washington policy-making processes featuring bargaining by elites in closed sessions were replaced by a far more open and conflictual process in which elites pursued influence through appeals to broader publics throughout the nation.

The trade-offs and hard choices that budgeting requires are far more difficult to achieve under this new political system. The virtual fishbowl of media and interest group coverage makes forming coalitions and winning necessary concessions far more difficult and even politically hazardous for members and presidents alike. The disappearing middle in Washington removed the ballast that often is so essential to bring about fiscal order from the political cacophony that is Washington today.

The institutions of national policy making changed accordingly. Congressional committees responsible for making hard choices, such as appropriations and ways and means, became open and ever-more inclusive, inviting in the resource consumers as well as the fiscal guardians. Even though members were elected with incredibly safe margins, they felt unsafe at any margin, in Thomas Mann's (1978) words. The political relationships between presidents and the Congress became ever more contentious, as the president's budget slipped from being the congressional starting point to being “dead on arrival” during periods of divided government.

Ironically, as the political system became more conflictual, formal rules and structures became more essential for budgeting. Members needed more formal institutions to enable them to make the hard choices and trade-offs that once were embedded in folkways, centrist coalitions, and other more informal institutional arrangements. However, the fact that the budget process had become more central to budgetary decision making also made that process more vulnerable and less sustainable.

The congressional budget process marked a new step in the evolution of budget control in Congress. Decades after the president acquired the executive budget, Congress established its own comprehensive budget process that required it to go on record as supporting a broad fiscal policy first. Coupled with other changes in party system discussed earlier, this polarized budget debates in ways that were diffused and defuse under the older disaggregated system. Both the president and Congress had incentives to reach for overly ambitious and symbolic fiscal goals that often were difficult to sustain in subsequent appropriations and authorizations to enforce those decisions. Differing fiscal goals are embraced by each party as a proxy for overarching differences in policy priorities and governance competency. Over the past decade, Congress was unable to pass a budget resolution during election years, poignantly illustrating that no budget process reform can save the political system from itself.

### ***Divided We Budget***

The founders' framework of separated institutions sharing powers casts its long shadow over the fiscal governance of the nation. While the system served to constrain spending and reinforce budget

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It often is more important for parties to be on the “right side” of the issue than to collaborate with the other party in achieving fiscal goals. When the parties control different branches whose support is critical to pass a budget, government shutdown can loom as a real possibility. A budget process that prized agreement and stability now has become destabilizing to the broader government and the economy.

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balance for much of our history, in recent decades, the combination of polarized parties and divided control of the presidency and Congress has made forging budgetary agreements more difficult. More polarized parties use budget issues as a central stage on which to appeal to their core constituencies at the expense of the median voter and the broader economy in some cases. It often is more important for parties to be on the “right side” of the issue than to collaborate with the other party in achieving fiscal goals. When the parties control different branches whose support is critical to pass a budget, government shutdown can loom as a real possibility. A budget process that prized agreement and stability now has become destabilizing to the broader government and the economy.

This is not to say that fiscal balance and restraint cannot occur in the second fiscal policy regime. To the contrary, deficits have been reduced and even eliminated at times, but only on an episodic basis, not as a regular outcome driven by deeply rooted values and institutions. In the 1990s, Congress and the president were able to agree on fiscal consolidations that collectively resolved deficits and moved the nation to four years of budget surpluses under the second fiscal policy regime. Paradoxically, the experience of the 1990s illustrates that divided government actually can provide cover for making hard choices. Two of the three major deficit reduction actions during that decade occurred under a divided regime.

The fiscal progress reached was undermined when unified government returned to Washington under President George W. Bush and a Republican Congress, when ten-year surpluses of \$5.6 trillion were dissipated thanks to two rounds of major tax cuts, prescription drugs for seniors, and homeland security actions following 9/11, all unpaid for by compensating fiscal actions.

“Divided we govern” is the watchword for any policy arena, as David Mayhew (1991) has taught us. Indeed, our own experience and that of other OECD (Organisation for Economic Co-operation and Development) nations has shown that it is not only possible but often necessary to achieve cross-partisan involvement in fiscal consolidation (OECD 2010). Case studies on fiscal and pension reforms suggest that governments that engage multiple parties and factions in collaborative fiscal sacrifice are more likely not only to enact consolidations but also to sustain these reforms over time (Pierson 1994). However, action often occurs after prolonged periods of gridlock and even government and fiscal dysfunction.

This dynamic illustrates that the consistent budget balance norm has been replaced by what we might call the thermostatic model of budgeting. As Allen Schick has pointed out, we collectively come to grips with deficits only when they rise to alarming proportions. But as Schick notes, the self-correction works in both directions. As surpluses emerge, we reverse fiscal course, expanding spending and cutting taxes (Schick 2007).

This pattern of on again, off again fiscal restraint may be all we can expect in a polarized system characterized by divided government. However, we pay a steep fiscal price for the delays, gridlock, and crisis-oriented governance that this regime imposes.

The threat that divided government and polarized parties pose for fiscal policymaking was notoriously illustrated by the debt ceiling crisis of the summer of 2011. While never an easy vote for either party, Congress has never refused to increase the debt ceiling, fearing the consequences of what would amount to a default on the nation’s outstanding debt. Republicans in the Congress, particularly those aligned with the tea party, raised the political stakes in the summer of 2011 by threatening to withhold approval for raising the debt ceiling.

The resulting debt ceiling crisis preoccupied the nation’s politics and policymaking agenda for much of the summer of 2011. Following protracted negotiations between President Obama and the Republican leadership in the Congress, an agreement was ulti-

mately reached to stave off default by increasing the debt ceiling. In return, the president agreed to a new round of spending cuts exceeding \$2 trillion over ten years, to be achieved by new discretionary spending ceilings and a new Congressional “supercommittee” charged with achieving savings across the entire budget, including tax changes.

While the agreement has saved the nation from the ravages of default, it has left disillusionment in its wake. The spectacle of fiscal brinkmanship during the debt crisis caused many to lose faith in the capacity of a nation with increasingly polarized parties to make the hard choices necessary to overcome fiscal deficits. Indeed, well-founded skepticism exists whether the new joint committee process discussed above will in fact be able to surmount substantial conflicts between the two parties, particularly with a presidential election in the offing in 2012. The disillusionment with the American system was the basis for the downgrade of U.S. Treasuries by Standard and Poors. Coming during the week when Congress and the Obama administration resolved the debt ceiling crisis, the downgrade served as a downbeat report card on the political and fiscal resolve of the nation’s leaders.

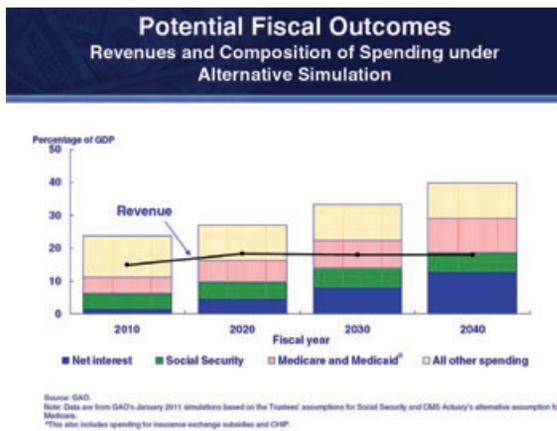
### **Toward a Third Fiscal Policy Regime?**

The United States, along with most advanced nations, faces nearly unprecedented fiscal risks, both in the medium and in the long term. The Great Recession prompted deficits to escalate to more than 10 percent of the economy, the highest ever in peacetime. Deficits are scheduled to return to modest levels only if the Bush and Obama tax cuts expire by 2012, the higher alternate minimum tax is extended to the middle class, and other provisions such as large cuts to Medicare doctor fees are actually imposed. Since these appear unlikely at the present time, the Congressional Budget office projects that deficits will continue at over 6 percent of the economy through the next decade even after a full economic recovery (Congressional Budget Office, August 2011).

Recent deficits are a prelude to an even more daunting long-term fiscal outlook. An aging population and rising health care costs, in the absence of policy changes, will send the budget into a tailspin, with deficits and debt rising to unsustainable levels that eventually will cause an economic shock. As these spending pressures accumulate, a smaller cohort of workers will be left behind to finance these costs. Our standards of living assuredly will decline, and the precipitous policy changes necessary to rescue the nation from economic meltdown will cause lasting damage to the political fabric of the nation.

Figure 3 illustrates the nature of the long-term challenges. In a little more than two decades, deficits will grow to more than 20 percent of GDP, if we do nothing to reverse these trends on the tax and spending sides of the budget. Assuming that taxes remain at recent levels—18 percent of GDP—the federal government would be able to do little else but write checks to the elderly and their doctors. At these levels, deficits would become economically unsustainable, as rising government debt crowds out nearly all private investment and growth.

Economist Herbert Stein long ago suggested that if something is unsustainable, it will stop. But there is a corollary—how it stops



**Figure 3 Programs as a Share of Gross Domestic Product**

matters. Will these trends be reversed through a gradual process brought about by policy interventions or by a rude shock caused by economic forces over which we will have little control? Bringing about a more sustainable fiscal policy calls for early action that will pay dividends by addressing the growth of debt before it requires hasty actions in the face of an economic, social, or ecological crisis. If started early enough, needed changes in spending and taxes can be phased in gradually, giving people and businesses time to make adjustments in their own plans and expectations. Earlier action also can intercept the vicious cycle of interest costs before it consumes nearly all revenue at current tax rates.

The alternative is an unavoidable crisis that will cause harm to current and future generations. Such a crisis would force policy makers to make far more painful and precipitous policy changes than those required to meet the challenge now. Such a so-called hard landing in fact has occurred in other nations where restive financial markets lost confidence in fiscal and economic management, causing a flight of foreign investment, significant currency depreciation, and interest rate increases. Under this scenario, policy makers would be forced to undertake major spending cuts and tax increases in very short order in a desperate attempt to restore the confidence of markets—actions that would affect the social, economic, and political affairs of the nation for years to come.

### The Democratic Dilemma

Accordingly, one of the central questions facing our system and those of other advanced nations dealing with similar fiscal outlooks is whether a democratic nation such as ours can take proactive leadership before a crisis forces our hand. With debt projected to grow to 100 percent of GDP by 2020, the United States may be more vulnerable to such a crisis than commonly is recognized, particularly because foreign ownership of the federal debt is approaching 50 percent. Leonard Burman, a leading public finance scholar and former public official, has suggested that we might be setting ourselves up for a “catastrophic budget failure” in which financial markets lose confidence abruptly, forcing a spike in interest rates stemming from investors’ fear of a default or monetization of the debt. Even if this does not give rise to default, the economic and political price that our nation would pay in the form of inflation, possible currency freefall, and recession would constitute a crisis (Burman et al. 2010).

Most seasoned observers question the political wherewithal of the United States to respond to such challenges with early and timely action. Dealing with the longer-term budget problems facing the nation poses even more vexing political challenges than shorter-term fiscal deficits. Taking on the drivers of long-term deficits raises intertemporal challenges for the current generation of decision makers and voters alike. The critical question is whether current generations of elected officials should take on political risks today by changing current benefits and taxes to head off a projected crisis for future decades. To take Social Security as one example, the trust fund will not be depleted for more than two decades. Yet taking action by reforming benefits and taxes for today’s workers will enable a more modest level of changes to be phased in over time in order to strengthen that program and head off a crisis in 2037, when the government no longer may be able to write checks to beneficiaries.

Dealing proactively with the long-term fiscal chasm facing the nation calls for a level of foresight by policy makers that many suggest goes against the political grain. Those who must bear the short-term costs of higher taxes or lower spending will have louder voices than those looking out for the interests of future generations of taxpayers.

In this view, only a crisis will force leaders to overcome their short-sightedness. Indeed, national fiscal elites have in the past staged what we might call “contrived crises” to force action that would be difficult to justify in normal times (Posner 2011). The debt limit “crisis” in the summer of 2011 was precipitated by the actions of political actors seeking to hold the proverbial sword of Damocles over the nation’s economy to force action to reduce deficits over the short and longer term.

Because a crisis would have such wrenching effects, it is heartening to note that democratic policy makers have a greater capacity to act with foresight than commonly is recognized. William Keech (1995), among others, argues that political leaders have incentives to exercise at least a modicum of economic foresight because voters judge them based on retrospective voting—that is, how well the economy has done under the leader’s term. Gary Jacobson notes that most members of Congress in fact are long-term careerists whose time horizons extend well past the next election cycle. They have an interest in providing for deficit reduction to free up fiscal space for their own future initiatives.

Indeed, OECD nations, including the United States, have reformed their social security and pension systems years ahead of when they absolutely needed to (Myles 1998). The 1983 commission on Social Security reform headed by Alan Greenspan succeeded in gaining political consensus behind reforms to Social Security that placed that program on a sound fiscal footing for several decades (Light 1995).

Imposing loss is never easy in democratic systems, and leaders need to think consciously about how to both justify and indemnify themselves from the political fallout (Pal and Weaver 2003). Successful nations have deployed several strategies that defused opposition and promoted political consensus across party lines:

- **Framing:** Leaders who refocus attention on the broader collective effects of reform on national economies can win the battle to determine what the debate is all about.

- **Shared sacrifice:** Such strategies promote the perception of fairness and help reassure groups that their sacrifices will not be exploited by political competitors who might dodge the deficit bullet.
- **Compensating losers:** Packages can cement coalitions by providing gains to offset a portion of the losses of major groups.
- **Phasing in cuts:** Wedge-shaped cuts that grow over time can blunt their political impact by providing ample time for transition and adaptation.
- **Large sweeping changes:** Ironically, larger packages improve political prospects by enhancing potential economic gains and including most major stakeholders in the process of fiscal consolidation. A former high-level Swedish finance official writes that a broader package of changes helps offset distributional effects, particularly if both spending cuts and tax increases are included (Henriksson 2007).

Conventional wisdom and academic theory to the contrary, intriguing studies suggest that not only have national leaders taken the initiative to pilot consolidation through the political straits, but also they were rewarded electorally as well. Brender and Drazen used data from 23 OECD nations from 1960 through 2003 on 164 elections. They found that governments that achieved lower deficits through policy actions actually increased the probability of their reelection. Controlling for changes in the economy, a reduction of 1 percentage point in the deficit-to-GDP ratio increased the probability of reelection for existing regimes by 5.7 percentage points. The authors attribute this surprising finding to the fact that voters do not like deficits because they perceive that deficits will entail tax increases or spending cuts in subsequent years (Brender and Drazen 2006). A 1998 study published by the Brookings Institution echoed similar findings, concluding that more radical fiscal adjustments actually delivered greater electoral rewards to government leaders (Alesina, Perotti, and Tavares 1998).

### A Framework for Foresight: *Federalist Papers II*

It is clear that the nation's fiscal and economic future will be determined in no small part by how our leaders respond to these long-term fiscal challenges. There is a need to reach for a new fiscal policy regime to enable our leaders to address these challenges.

Our fiscal regime needs to reinforce and support the exercise of foresight by our leadership. While not impossible, concerted action to reform entitlements and taxes is never easy, and it is even more challenging when our separated institutions are occupied by increasingly polarized parties. No budget process or fiscal framework will magically transform the political roots of fiscal choices or make leaders deal with these issues before their political time. However, leaders with the inclinations to be proactive about fiscal challenges can be strengthened by shifts in decision rules, political institutions, and budget processes.

If one were writing the *Federalist Papers* today, it would be fitting to augment what now appears in *Federalist* No. 30. As discussed earlier,

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[This paper] lays out the case for a strong fiscal regime with the necessary fiscal credibility across international credit markets to enable the nation to grow and respond to evolving challenges. . . . While we may have a longer leash than nations such as Ireland and Greece, we, too, will face our day of fiscal reckoning unless our leaders take concerted action to resolve the nation's long-term fiscal gap.

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this is a foundational paper that lays out the case for a strong fiscal regime with the necessary fiscal credibility across international credit markets to enable the nation to grow and respond to evolving challenges. It is fitting indeed that the nation's primary fiscal vulnerability stems from the increasing reliance on those worldwide credit markets to finance our burgeoning deficits and growing accumulated debt. While we may have a longer leash than nations such as Ireland and Greece, we, too, will face our day of fiscal reckoning unless our leaders take concerted action to resolve the nation's long-term fiscal gap.

### Appendix to *Federalist* No. 30

*In the original Federalist No. 30, we worried that a lack of adequate taxation would enfeeble government and undermine its energy and stability and confidence both at home and abroad. We wondered, "How is it possible that a government half supplied and always necessitous, can fulfill the purposes of its institution, can provide for the security, advance the prosperity, or support the reputation of the commonwealth?"*

*We find ourselves alarmed that the long-term fiscal challenges facing the nation now threaten to sap the capacity of government to respond to the needs of a growing population. As health care and Social Security programs increasingly encumber the nation's available revenues under current tax policies, the nation's priorities will be predetermined by older commitments, with little slack to finance investments that can help the nation continue to grow and thrive. It is no wonder that Admiral Michael McMullen, the chair of the Joint Chiefs of Staff, stated that the national debt is the most important threat to national security.*

*The U.S. economy has emerged as the strongest in the world. The nation's government and its people reap significant rewards by the high regard for the solvency of our debt and the solidity of our currency. However, this advantage could prove to be fleeting, undermined by growing structural deficits. One source of growing vulnerability is the dependence of the Treasury on foreign creditors, who now own nearly half of the federal debt. This exposes our Treasury to the potential for rapid disillusionment and disinvestment by these creditors, with consequent shocks to the value of the dollar, financial markets, and government costs of borrowing.*

*As we said in Federalist No. 30, formulating fiscal policy involves not only providing for the nation's needs today but also securing the capacity of government to respond to emerging needs in future decades. The nation's leaders are stewards not only for the current economy, but also for the nation's economic and fiscal future.*

*The need for fiscal foresight by our leaders never has been more important. Tackling the long-term fiscal challenges sooner rather than later is critical to promote a smoother social and economic transition by an aging society. While always painful, the trade-offs necessary to restore fiscal and economic sustainability can be made more palatable if changes are phased in over time, permitting time for people and businesses alike to adjust their own plans and priorities. If we fail to take timely actions, restive credit markets may well take matters into their own hands,*

*precipitating painful economic shocks and dramatic shifts in tax and spending policies literally overnight. The deliberative framework of our republic would be undermined, as the judgment of the wise men and women elected by the people would be supplanted by the crude calculus of the bond market.*

*Taking significant actions to address fiscal challenges in a timely fashion will challenge our leaders to be bold, decisive, and unified—traits that arguably are discouraged in our current policy-making process.*

*The careful deliberative system established in our Constitution ensured that elected officials would take appropriate action only upon careful deliberation, reflecting the interests and values brought by separated institutions sharing powers. Major policy actions are taken only once a broad consensus exists. This system, reinforced in recent years by long periods of divided government, has encouraged cautious and incremental approaches to problems. We generally have been well served by both waiting until problems are evident and addressing them in small steps, which has helped us avoid taking foolish leaps of faith that risks public confidence and fiscal profligacy alike.*

*Ironically, however, cautious and incremental decision making does not serve us well when we are facing known long-term threats that grow exponentially over time. In these cases, the failure to take decisive and early action will lead to more radical and less measured changes over the longer term. While we always must be mindful of making decisions armed with appropriate information and wisdom, the consequences of taking decisive action are reversible—that is, if we make mistakes, we can correct them. By contrast, the consequences of failing to act are worse in that they are irreversible—in the absence of reforms, the next generations will face a series of economic crises as well as lower living standards and policy choices that will leave them worse off than their parents or grandparents.*

*We are under no illusions about the degree of difficulty of the task facing the nation's leaders. The voices of the beneficiaries of the current fiscal regime—those benefitting from the many spending programs and tax expenditures—are likely to overwhelm the broader publics who would gain from a sustainable fiscal policy both now and the future. Interest groups and media conspire to make it more difficult to make hard choices in today's ever more transparent public fishbowl.*

*While there is no substitute for electing wise men and women, there are modest changes we can recommend to strengthen the resolve and incentives facing leaders to address these fiscal issues. Our Constitution stands as evidence of the efficacy of well-designed institutional rules and constraints in influencing the behavior of rulers in complex democracies.*

*First, we should do what we can to extend the time horizons of policy makers beyond the next election and even beyond the conventional 10-year budget baseline to capture the long-term implications of current decisions. The president and Congress should be required to show how the fiscal policy in their respective budgets will play out over at least two decades, with a focus on how much their policy choices will help solve the long-term fiscal problem.*

*Second, the president and Congress should agree on fiscal goals to justify the case for fiscal sacrifice. This could be done by establishing benchmarks for near- or long-term deficits, levels of debt, fiscal gaps, or other measures that could become broadly supported by the people. Other*

*nations, such as New Zealand and Sweden, have managed to sustain budgetary surpluses for many years, thanks in part to their adoption of overall fiscal targets that serve to reframe debates by justifying the case for fiscal sacrifice (Gordon and Posner 2000). One recent commission, the Peterson-Pew Commission on Budget Reform (2010), recommended that a glide path be established to achieve a 60 percent debt-to-GDP target over several years, a level far lower than current policy.*

*Third, like Odysseus, it would be useful to establish binding constraints on leaders by establishing fiscal rules that they would be bound to follow. While every leader is free to elude the chains of prior leaders, or even current ones, they may face political consequences if they do so. These rules would establish overall deficit reduction targets, caps on spending and tax expenditures, among other things. A set of triggers could be established to bring about automatic cuts or tax increases or both should leaders fail to live up to their fiscal goals.*

*Fourth, the debt ceiling crisis of 2011 illustrated the perils for our policymaking process arising from increasingly polarized parties. If we are going to move to a sustainable economic future, political leaders must find ways to come to agreement on some very difficult choices affecting all Americans, young and old alike. We question whether our current party system produces the kinds of officials who can work together to make decisions with the broad majority's interests in mind. Our current system produces too many candidates from the extreme wings of each party and not enough seeking the support of independent voters in the political mainstream. Major reforms are in order, including reexamining the reliance on exclusive primaries to nominate candidates and the drawing of congressional districts to produce more ideologically pure constituencies.*

*Finally, governing institutions need to be strengthened to give voice to the broad public interest on fiscal policy. From the early days of the republic, Congress and the executive branch have become splintered and divided into numerous committees and agencies. This has frustrated the thoughtful consideration of the nation's budget expenditures and revenues—the parts often have been stronger than the whole. The congressional budget committees generally have lacked the ability to steer the authorizing and appropriations committees to support specific fiscal targets and policies. The president generally has lacked a central office to help consider overarching policies that cut across individual agencies and programs.*

*While the fragmentation of government may have served us well when government was expanding its commitments, we believe that current arrangements clearly are insufficient to forge the coalitions necessary to make the hard choices that we face today. Accordingly, it is in order to strengthen the president's primary fiscal agency, the Office of Management and Budget, to enable it to conduct analysis of issues across the government and enforce adherence to more demanding fiscal targets by the agencies. Such an agency should be able to develop broad performance goals and targets, bringing greater coherence to the broad array of programs and tools that have grown up in nearly every major policy area. One example involves tax expenditures. Operating like spending programs by another name, tax expenditures are not formally considered by agencies or the OMB when formulating the president's budget, but instead are overseen by the Treasury Department. Such programs should be integrated with related spending programs so that the president and his cabinet leaders can comprehensively consider the most cost effective tools for achieving important national goals.*

We also believe that Congress will need to strengthen its own budget process by centralizing the ability of leadership to both formulate fiscal goals and enforce them for relevant committees. One way this could occur would be for Congress to transform its budget committees into leadership committees comprised of the leadership of each chamber as well as chairs of key committees, with the responsibility of bringing about periodic fiscal reform packages changing revenue and spending commitments. This would help by engaging all of the major leaders of committees in developing and buying into congressional fiscal goals. These committees would then be beholden to observe these fiscal goals and constraints when developing subsequent appropriations and authorization legislation.

We are confident that these actions will embolden Congress and the president to act together to make the choices necessary to save today's economy and tomorrow's. A government needs to act with energy when facing challenges, whether they be economic, military, or environmental. Our system is not built to act in haste. But when we must act, we have risen to the challenge, as we must yet again.

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