



The Daily Dish

Getting a Better Grade on Fiscal Policy

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Attentive Eakinomics readers will have noticed that the federal government has a budget problem. Indeed, the Treasury just closed the [books](#) on [fiscal year 2024](#) (which ended September 30) and the red ink totaled \$1.8 trillion, or 6.3 percent of gross domestic product (GDP), in an economy operating at full employment, not at war, and not in the midst of an economy-wide emergency. And, if left on autopilot, it will get worse, and the damaging economic fallout will rise.

So, autopilot should not be an option. But what path should one pick? Enter AAF's [comprehensive plan](#) to take on the future of fiscal policy. (The quick-read version is [here](#).)

Now, one way to describe a plan is to list the elements of reform; that is, what it does to taxes and spending programs. But an important feature of the plan should be emphasized: It envisions a disciplined role for fiscal policy, supporting rapid trend (long-run) growth and providing a financially viable social safety net. It does not envision Congress and the administration responding to future booms and busts with reactive, discretionary tax and spending actions. That was the policy regime in the 1960s and 1970s and it failed miserably. In the final 20 years of the 20th century, those business cycle issues were left to the Federal Reserve (which is much nimbler) and fiscal policy focused on growth.

For reasons that defy easy description, this discipline went away in the first two decades of the 21st century. It is time to get it back and the AAF plan reflects this. It is also true that if one focuses on growth, then other policy areas are addressed in ways that impeded growth as little as possible. In this case, emissions of greenhouse gases are addressed with a comprehensive, upstream carbon tax that harnesses market forces to minimize the cost of the climate policy.

The recipe is not magic. Do a comprehensive tax reform to be as pro-growth as possible and

rely on a broad, consumption-oriented base to bring in additional revenue. On the spending side, undertake serious but thoughtful reforms to entitlements - especially Social Security and Medicare - to slow the growth of spending. And recognize that the world is not a safer place, so spending on national security will have to increase.

The upshot is summarized in the table below. Notice that debt held by the public is reduced to 67 percent of GDP in 30 years. It is not enough to simply hold the line at current levels. Indeed, debt was 30 percent of GDP at the start of the 21st century; it would be fairer to the future to get it back to that level and have current generations foot the bill for their largesse.

Summary of Budget Projections Under Current Law and AAF Plan

Percent of GDP	Current Law		AAF Plan	
	2034	2054	2034	2054
Revenue	17.9%	18.8%	18.4%	19.7%
Spending	24.1%	27.3%	21.3%	20.1%
Deficit	6.1%	8.5%	2.9%	0.4%
Debt Held by the Public	116%	166%	95%	67%

Sources: CBO and AAF.

The debt issue is often framed in terms of crisis and sovereign debt meltdowns. While having a crisis is a clear failure, not having a crisis is not success. The AAF plan produces a better fiscal policy that will result in higher standards of living and greater security in the future.