A Plan to Restore America's Finances

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TMS Scholarship Essay
July 17, 2015

Introduction

In recent years, the debate over how to address the budget crisis has become a politically polarizing issue. Congressional disagreement over how to approach the nation's finances has resulted in government shutdowns and fears of America defaulting on its debt. Both Democrats and Republicans concur that the ever-increasing debt is worrisome, but their proposed methods for reducing it are vastly different. In order to rein in deficit spending, the federal government must enact reforms to Social Security, Medicare, and means-tested welfare programs and grow the economy by lowering the income tax rates on individuals and businesses.

Since the dramatic economic collapse that signalled the beginning of the Great Depression, the federal budget has been characterized by deficit spending. Each year, with the exception of a brief budget surplus in 1960 and for four consecutive years beginning in 1998, the federal government has spent far more money than it has received in each fiscal year. In 2014 alone, the government spending exceeded revenues by $448 billion, increasing the national debt to almost $17 trillion.[1]

The Great Depression marked the beginning of a new era of American economics. President Roosevelt's recovery efforts, known as the New Deal, established a national welfare system, intended to be a safety net for the neediest of Americans. The New Deal vastly expanded the scope of the federal government, granting it authority in creating employment and providing income insurance for the needy and elderly. The Social Security Act of 1935 included provisions that outlined federal spending to assist struggling American families, retired persons, and the millions of Americans who found themselves without work when the economy collapsed in 1929.[2]

The government grew exponentially throughout the twentieth century, with President Harry Truman expanding on Roosevelt's social programs with his Fair Deal legislation, and President Lyndon Johnson expanding these programs even further with his Great Society. Most notably, the Great Society legislation established the Medicare system that is still in place today.

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[1] "The Historical U.S. Federal Budget," InsideGov, http://federal-budget.insidegov.com/.

[2] "Welfare Reform," *American Government*, accessed July 6, 2015, http://americangovernment.abc-clio.com/Search/Display/200926?terms=social%20welfare&webSiteCode=SLN_AMGOV&returnToPage=%2fSearch%2fDisplay%2f200926%3fterms%3dsocial+welfare&token=97CB9DC3158D7B58F6D9701EEA2533E5&casError=False.

Johnson's ambitious legislation also led to expansions of Medicaid, a government-sponsored, means-tested health care program established in the Social Security Act. The benefits were extended to all families eligible for Assistance to Families with Dependent Children (AFDC).[3]

Prior to the most recent recession, deficit spending resulted in little, if any, significant public backlash. Despite the enormous debts accrued during this time, few people considered America's credit rating to be in danger. In December of 2010, members of the National Commission on Fiscal Responsibility and Reform, a bipartisan presidential commission, warned against the potentially dire economic consequences that waited if Congress did not act to drastically reduce the deficit. The commission warned that the national debt would soon surpass the nation's annual GDP, and interest payments would increase from 1.2 percent to almost four percent of the GDP over the next ten years. In August of 2011, Standard & Poor's downgraded the United States' credit rating from its long-held "triple-A" status to "double-A" status.[4]

The most accurate measurement of how the federal budget has evolved since the Great Depression is the measurement of the total surplus or deficit as a percentage of the Gross Domestic Product (GDP) for that fiscal year. This measurement eliminates the necessary conditions to be made for inflation adjustments, and provides the clearest evidence of a trend within government spending. In 1935, President Roosevelt signed the Social Security Act into law. America was in the depths of the Great Depression, and the federal government had taken nearly complete control of the withering economy. In 1935, the deficit was four percent of the total GDP. The percentage continued to rise over the following years, as America sunk deeper into the Depression and then entered World War II, eventually reaching a height of 29.6 percent in 1946. In 2009, the deficit accounted for nearly ten percent of the GDP.

Social Security and Medicare Reform

Social Security and Medicare reform must be a part of any budget reform that Congress enacts in order to keep the programs operating into the future. In his proposed budget for the 2015 fiscal year, President Obama proposed allocating thirty-three percent of the $3.97 trillion

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[3] "Great Society," *American History*, accessed July 8, 2015, http://online.infobase.com/HRC/Search/Details/168834?q=great%20society.

[4] James Q. Wilson, *American Government: Institutions and Policies* (n.p.: Cengage Learning, 2013), 493.

budget toward Social Security, unemployment benefits, and labor, with another twenty-seven percent being allocated to Medicare and other health care programs. Social Security benefits comprise fifty percent of the $2.6 billion of mandatory spending predicted in the proposed budget.[5] Because the programs paid for through the mandatory spending portion of the budget are given to all eligible applicants, their specific dollar amounts are not debated on the Congressional floor. Two-thirds of the entire federal budget is untouchable, and is thus able to grow without restriction by Congress.

When Roosevelt signed the Social Security Act, the minimum age for beneficiaries was sixty-five. At that time, retired persons could begin receiving the benefits that they paid for through taxes on their income. The benefits would be proportional to the beneficiary's input, and would be distributed on a monthly basis.[6] The Social Security Amendments of 1965, signed by President Johnson as part of his Great Society, also set the minimum age requirement to receive old-age health benefits, known as Medicare, at sixty-five.[7]

The minimum age requirement for these two costly programs has never been adjusted to meet new life expectancy standards, meaning those who receive Social Security and Medicare benefits today receive them for far longer than those who received them at the time of their respective inceptions. The average remaining life expectancy for those who reached sixty-five in 1940 was 12.7 and 14.7 years for men and women, respectively. By 1990, the remaining life expectancy for men and women who reached 65 was 15.3 and 19.6 years, respectively.[8] In order for Social Security and Medicare to remain intact for younger generations, adjustments must be made as life expectancy averages continue to rise. As the largest generation in American history, known as the "baby-boomers" -- those who were born between 1946 and 1964 -- begin to retire, the much less populous generations that follow are charged with the task of supporting these baby-boomers through their lengthy retirement.

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[5] Jasmine Tucker, "President's 2015 Budget in Pictures," National Priorites, last modified March 19, 2014, accessed July 7, 2015, https://www.nationalpriorities.org/analysis/2014/presidents-2015-budget-in-pictures/.

[6] Social Security Act of 1935, 1 U.S.C. § 2.

[7] "Social Security Act Amendments (1965)," Our Documents, accessed July 7, 2015, http://www.ourdocuments.gov/doc.php?flash=true&doc=99.

[8] "Life Expectancy for Social Security," Social Security Administration, accessed July 6, 2015, http://www.ssa.gov/history/lifeexpect.html.

In a 2000 report funded in part by the American Association of Retired Persons, analysts hypothesized the potential effects of raising the age of eligibility for Social Security and Medicare programs. The analysts based their hypotheses on two legislative initiatives: the first to raise the age of eligibility to sixty-seven by 2022, and the second to raise the age to seventy by 2040. According to their predictions, the 2022 adjustments would lead to a net-savings of $23.2 billion and cause an 11.1 percent decrease in Medicare enrollment, while the 2040 adjustments would save $67.3 billion annually, with a 16.8 percent decrease in Medicare enrollment.[9] These adjustments would decrease the deficit in a twofold manner, as less people would be collecting the benefits, and those collecting benefits would be supported by a larger tax base. The net-savings recorded in the aforementioned report do not account for the increased revenue of a large tax base made up of citizens who are working longer before collecting their benefits. The combination of the decrease in beneficiaries, the reduction in the length of their receipt of Social Security and Medicare benefits, and the increase in the size of the tax base would help to reduce the portion of the budget allocated to these two costly programs.

Welfare Reform

Means-tested welfare programs also represent a large portion of the budget, and because of this, Congress should take the steps necessary to reduce spending on these programs in ways that do not decrease their efficacy. Such programs include the Supplemental Nutrition Assistance Program (SNAP, or, more commonly, "food stamps"), unemployment benefits, Medicaid, and Temporary Assistance to Needy Families (TANF, formerly AFDC). In total, there are 185 federal means-tested welfare programs, and the estimated combined cost of all of these for the federal government was $700 billion in 2010, up twenty-five percent from just two years prior.[10] In 2013, total welfare spending by the federal government alone topped $949 billion.[11]

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[9] David C. Wittenberg, David C. Stapleton, and Scott B. Scrivner, *How Raising the Age of Eligibility for Social Security and Medicare Might Affect the Disability Insurance and Medicare Programs* (n.p.: American Association of Retired Persons, 2000), 5.

[10] Peter Ferrara, "America's Ever Expanding Welfare Empire," Forbes, last modified April 22, 2011, accessed July 8, 2015, http://www.forbes.com/sites/peterferrara/2011/04/22/americas-ever-expanding-welfare-empire/.

[11] "Total Welfare Spending Reaches $949 Billion," Heritage Foundation, last modified December 4, 2014, accessed July 8, 2015, http://www.heritage.org/multimedia/infographic/2014/12/total-welfare-spending-reaches-949-billion.

In order to enact effective change to the welfare programs, Congress must first examine the efficacy of these programs. In her speech before the House Ways and Means Committee in 1996, LaDonna Pavetti spoke of the increasing tendency of those who receive welfare benefits for a period of time to return to the programs. Speaking of the then-AFDC, Pavetti said, "about half [of recipients] leave within a year; 70 percent within two years and almost 90 percent within five years. But many return almost as quickly as they left -- about 45 percent return within a year and 70 percent return by the end of five years".[12] This overwhelming tendency of former welfare recipients to return to the program within a few years of their departure denotes a flawed system. Welfare programs were originally intended to provide short-term assistance for the neediest Americans while they were trying to get back on their feet. However, many Americans find themselves on a never-ending cycle of dependency on these programs.

Pavetti went on to provide suggestions for reform to the then-AFDC by citing successful reform efforts in Utah. The Utah program she cited emphasized swift reentry into the workforce, while also supplying those transitioning with services to aid them in ensuring their transition back into the workforce is as seamless as possible.[13] As a welfare recipient's time on the program increases, their odds of returning to the workforce dramatically decrease. Those who spend years collecting the government aid are often those who lack the basic skills necessary to secure a job in the workforce, and thus remain dependent on the programs for an exorbitant period of time. If, rather than simply serving as a program that doles out monthly payments to needy Americans, welfare programs were reformed to include skills training, much like the Utah reforms Pavetti spoke of, the welfare retention rate would decrease, and thus, the portion of the federal budget needed to cover welfare costs would decrease.

In 1996, Congress made sweeping reforms to the welfare system, with President Clinton dubbing the efforts as the end of "welfare as we know it". AFDC was reformed and rebranded as TANF. These reforms meant that the federal government would be lending a capped amount of funding to the states, rather than matching the states' funding as was done under AFDC. The program would also impose a five-year limit upon benefits, and would encourage beneficiaries to

[12] LaDonna Pavetti, "Time on Welfare and Welfare Dependency," speech presented at House Ways and Means Committee, Subcommittee on Human Resources, May 23, 1996, Urban Institute, http://webarchive.urban.org/publications/900288.html.

[13] Pavetti, "Time on Welfare and Welfare," speech.

find work and become self-sufficient. Despite being heralded as the final solution to the welfare woes, the reforms did little to curb entitlement spending. TANF spending has remained relatively stagnant since its inception in 1996, but overall spending for means-tested entitlement programs has doubled.[14]

The five-year limits to benefits had a minimal impact on reducing costs, as many of those who termed out simply reapplied and returned to the government dole. The second major reform, capping the federal dollars given to the states, made a more significant impact on the costs to the federal government. Funding for AFDC was determined purely by caseload -- the federal government matched whatever the states spent in order to keep up with demands. The change to a block grant meant the individual states were given a specific amount of federal funding each year, and were free to spend it as they felt necessary. This reform allowed the federal government to take a backseat role in the business of providing welfare. The final major reform was the most impactful: mandatory work requirements. The bill specified who was required to work, what was considered acceptable work, and how much they were required to work. The mandatory work requirements successfully weeded out applicants who applied because the government was offering a free handout, while continuing to help applicants find employment and lift themselves out of poverty.

The so-called "workfare" wasn't wholly popular, though, and many efforts were made to repeal the provision. In 2012, opponents were successful in repealing the mandatory work provision of TANF. The new policy, issued by the Department of Health and Human Services, would allow states to waive the work requirements. The legal requirement that thirty to forty percent of each state's beneficiaries participate in specified work-related activities for twenty to thirty hours per week was changed to allow the entire state's caseload to participate in vaguely defined work for one hour each week.[15] Workfare needs to be restored, not only to TANF, but across other entitlement programs as well. Food stamps are the second most costly means-tested entitlement program behind TANF, and participation continues to rise. Able-bodied recipients

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[14] Robert Rector and Jennifer A. Marshall, "The Unfinished Work of Welfare Reform," Heritage Foundation, last modified January 22, 2013, accessed July 8, 2015, http://www.heritage.org/research/reports/2013/01/the-unfinished-work-of-welfare-reform.

[15] Rector and Marshall, "The Unfinished Work of Welfare."

should be required, at the very least, to prove that they are doing all they can to find work in order to retain their position on the taxpayer's bill.

Tax Reform

The need for tax reform is widely agreed upon across party lines, but Republicans and Democrats are bitterly divided on how the system should be reformed. Mike Patton, a contributor to Forbes, used data from 1913 (the year of the ratification of the Sixteenth Amendment, which legalized a federal income tax on both individuals and businesses), and compared the tax rates to tax revenues. Not surprisingly, the data suggested that when federal income taxes were lower, revenues were higher, and vice versa.[16]

In 1974, Arthur Laffer, a former chief economist at the Office of Management and Budget (OMB), presented a radical new theory of taxation. On a napkin, he drew a curve representing his theory that as tax rates increase, tax revenues decrease, and vice versa, an illustration that has now been dubbed the Laffer Curve. At the time, the highest federal income tax rate was seventy percent, which Laffer claimed was strangling the economy. He believed that the problem did not lie in a lack of demand, but rather high taxes and regulations that were impeding production.[17] The theory runs off of the general truth that revenue is exactly zero at two points: a zero percent rate and a one hundred percent rate. There is a point at which revenues are maximized, and all rates above and below that point produce less than optimal revenue. While the Laffer Curve is predominantly supported by fiscal conservatives, liberals effectively acknowledge its truth when they support higher tax rates on tobacco products and carbon emissions to discourage smoking and curb the effects of global warming. If the cigarettes become too expensive, people will quit purchasing them. If the federal government claims too high a percentage of a person's income, that person will be less inclined to grow his or her business.

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[16] Mike Patton, "Do Tax Cuts Increase Government Revenue?," Forbes, last modified October 15, 2012, accessed July 9, 2015, http://www.forbes.com/sites/mikepatton/2012/10/15/do-tax-cuts-increase-government-revenue/.

[17] Stephen Moore, "The Laffer Curve Turns 40: The Legacy of a Controversial Idea," Washington Post, last modified December 26, 2014, accessed July 9, 2015, http://www.washingtonpost.com/opinions/the-laffer-curve-at-40-still-looks-good/2014/12/26/4cded164-853d-11e4-a702-fa31ff4ae98e_story.html.

While it is true that raising taxes does not always result in higher tax revenue, the converse is true as well. Cutting tax rates only results in an immediate, easily calculable increase in revenue when the rate is exorbitantly high. However, proponents of the Laffer Curve argue that the lowering of tax rates, no matter from what rate, results in an economic stimulus. When corporations are able to pocket more of their earnings, rather than paying them to the government, they can use this increased profit to hire more workers. This in turn creates a larger tax base, and a larger tax base creates more tax revenue.

President Reagan was a firm believer in supply-side economics and the Laffer Curve. On August 13, 1981, Reagan signed the Economic Recovery Tax Act (ERTA, or the Kemp-Roth Act), a sweeping reform on the tax code that set the tone for his entire eight year administration and economic policy, which came to be popularly referred to as "Reaganomics". The law included a twenty-five percent decrease in marginal tax rates (the tax rate on the last dollar earned) for individuals, which were to be phased in over a period of three years. ERTA, along with the Tax Reform Act of 1986, reduced income tax rates for the wealthiest individuals from seventy to thirty percent during the course of Reagan's presidency.[18]

In 1980, the final year of Jimmy Carter's presidency, the income tax rate for the highest bracket was seventy percent, gleaning a total income tax revenue of $460 billion. By the end of Reagan's presidency, which included a drastic income tax reduction from seventy to thirty percent, total federal income tax revenue had risen to $583 billion.[19] The Reagan Era was also a time of significant economic expansion. Between 1983 and 1990, the GDP grew 35.7 percent, with an annual average rate of growth of 4.1 percent. Industrial production grew 26.8 percent, the economy gained 19.9 million jobs, and the Dow Jones Industrial average grew 14.9 percent.[20] These statistics prove that supply-side economics work, and lowering income taxes on individuals and corporations encourages economic expansion, which in turn, results in a growth

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[18] "Reagan signs Economic Recovery Tax Act (ERTA)," History, last modified August 13, 2014, accessed July 9, 2015, http://www.history.com/this-day-in-history/reagan-signs-economic-recovery-tax-act-erta.

[19] Internal Revenue Service, "2014 Internal Revenue Service Data Book," last modified 2014, PDF.

[20] Peter B. Sperry, "The Real Reagan Economic Record: Responsible and Successful Fiscal Policy," Heritage Foundation, last modified March 1, 2001, accessed July 11, 2015, http://www.heritage.org/research/reports/2001/03/the-real-reagan-economic-record.

in federal revenue. The key to reducing the deficit is to grow the economy, and offering tax breaks to those who make economic growth possible is a tried and true strategy.

Conclusion

The debt crisis, and the manner in which we address it, will affect this country for generations to come. The Social Security and Medicare programs will fail within the next few years without significant reform, which must include adjustments to the age of eligibility. Welfare Reform was successfully implemented in the 1990s, but the current administration has, unfortunately, eliminated the work requirements that made the reforms successful. The most certain way to address the debt crisis is to grow the economy. The government could do so immediately by lowering the income tax burden on corporations and individuals, the parties that have the power to create jobs and stimulate the economy. These reforms would result in long-term relief by return the country to a capitalist system, rather than providing temporary relief through increased government spending on stimulus packages that only exacerbate the debt crisis.

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