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MINNPOST

Sequestration, deficit, debt? Our real problem is the future 'fiscal gap'

By [Louis D. Johnston](#) | 04/04/13

Here's a quick quiz: Which of these numbers is most relevant to arguments about the federal budget?

- a. \$110 billion
- b. \$1.4 trillion
- c. \$16.7 trillion
- d. \$211 trillion

(a) is the amount by which federal government spending is being reduced annually over the next 10 years through **sequestration**, (b) is the federal government's **budget deficit** in fiscal year 2012 and (c) is the current **public debt** of the United States. If you've followed the recent debates about sequestration, debt ceilings and fiscal cliffs, you've probably seen these figures lobbed by one side at another like hand grenades.

So what about (d)?

My guess is you haven't seen that one, but according to Boston University economist **Laurence Kotlikoff**, it's the most important number of them all. The \$211 trillion figure is the fiscal gap — the total amount we are committed to spend now and in the future under current law minus the total amount we are committed to collect now and in the future in net taxes. (To be precise: The fiscal gap is the difference between the present value of current and future spending and the present value of current and future net taxes, where net taxes are the difference between taxes collected and transfer payments.)

Clashing generations

Kotlikoff sets out the case in his 2012 book, "The Clash of Generations." In particular, to close the fiscal gap we must permanently increase current and future tax revenue by 64 percent, cut non-



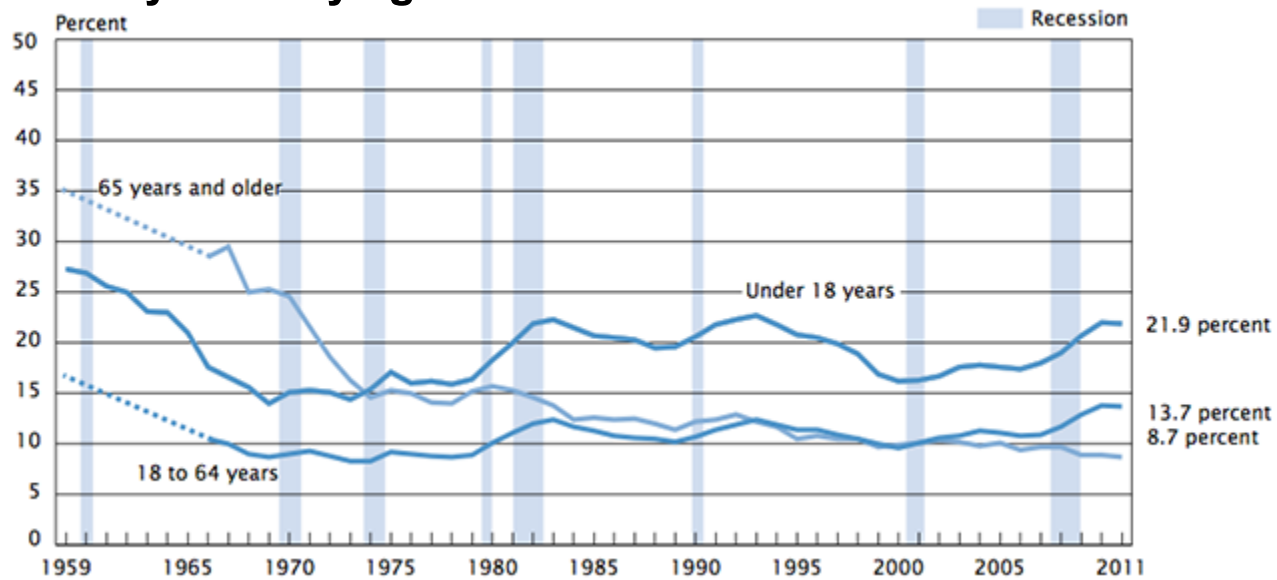
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To close the fiscal gap we must permanently increase current and future tax revenue by 64 percent, cut non-interest spending by 40 percent — or pass a combination of tax increases and spending cuts in this range.

interest spending by 40 percent — or pass a combination of tax increases and spending cuts in this range. And the longer we wait, the greater the pain of tax increases and spending cuts will be.

How did this happen? Two sets of policies opened the fiscal gap. First, we successfully reduced old-age poverty through Social Security and, especially, Medicare. The chart below tells the story:

Poverty rates by age: 1959 to 2011



Source: U.S. Census Bureau, Current Population Survey, 1960 to 2012 Annual Social and Economic Supplements.

Note: The data points are placed at the midpoints of the respective years.

Poverty rates for over-65 people fell by 50 percent from 1965 to 1975 and have remained below 15 percent since then. (By contrast, child poverty and working-age poverty fell until 1970, rose in the early 1980s, and have since fluctuated with the business cycle.)

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Second, we fought the Cold War and the war on terror by devoting roughly two-thirds of all federal spending on goods and services to defense and homeland security. The Soviet threat disappeared between 1989 and 1991, but we are still fighting Al Qaeda.

You may not have noticed, but both of these policies were financed identically: by taxing current workers.

In the case of Social Security and Medicare, the taxes were transferred directly to retirees with the promise that when current workers retired, they would get transfers from younger workers. With regard to defense,

we did not collect enough taxes to cover defense spending so the government borrowed what it needed on the financial markets and then serviced the debt by... taxing future workers.

Same policy, with one called “transfers” and the other called “borrowing.”

Built-in imbalance

The result is a system that has a built-in imbalance between what we have promised in terms of spending (both in defense and transfers) and taxes. A \$211 trillion imbalance.

The arguments about sequestration, fiscal cliffs and the like won't change this, nor will the budget proposals offered by the House, Senate or president. And Kotlikoff demonstrates that we cannot solve our problems by increasing economic growth, encouraging immigration or any of the other nostrums peddled by pundits from the right to the left. The simple fact remains that we have committed to spend more in the future than we have promised to tax ourselves.

So where do we go from here? Kotlikoff has a series of proposals called “**the purple plans.**” (Get it? Red and blue blend to make purple...) The gist of these plans is to encourage households and government to save more and consume less, and to target government transfers towards those who need them most.

I think there is a larger point to be drawn from the \$211 trillion fiscal gap. The threats of old-age poverty and the Cold War have passed, yet we still have a fiscal policy fashioned to meet these enemies. We need to recognize new challenges, such as childhood poverty and threats from non-state actors, then formulate sustainable fiscal policies that will shrink the fiscal gap and meet our children's needs. It's the least we can do for them.

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