Retirement Income
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A Debt Straitjacket? Or a Misdiagnosed Disease?

By Eugene Steuerle *Wed, Nov 22, 2017*

With public and private debt so high across the developed world, International Economy magazine asked a group of economists, including this RIJ guest columnist: "Has the world been fitted with a debt straitjacket?" Here's his response.

A straitjacket, yes, but debt defines its features poorly. Debt is merely one symptom of a disease that has vastly restricted the ability of developed nations to respond to new needs, emergencies, opportunities, and voter interests.

The disease: the extraordinary degree to which past policymakers have attempted to control the future—building automatic growth or growing public expectations into existing spending and tax subsidy programs while refusing to collect the corresponding revenues required to pay for them.

In *Dead Men Ruling*, I show how this leads to a "decline in fiscal democracy"—the sense by officials and voters alike that they have lost control over their fiscal destiny. Though the degree and nature of the problem varies by type of government and culture, research so far in the U.S. and Germany, two countries with greater fiscal space than most other developed countries, confirms this historic shift.

We must understand how we got here if we ever expect to get a cure, since defining the problem by the debt symptom has led mainly to periodic deficit-cutting that leaves the same long-term bind, frustrating voters and officials alike while increasing the appeal of anarchists and populists.

For most of history, nations with even modest economic growth wore no long-term fiscal straitjacket. Even with the debt levels left at the end of World War II, economic growth led to rising revenues, while most spending grew only through newly legislated programs or features added to programs.

Typically, existing programs were expected to decline in cost, e.g., as a defense need was met or construction was completed. Until recent decades, budget offices did no long-term projection. If they had, they would have revealed massive future surpluses over time even when a current year revealed an excessive deficit. Year-after-year profligacy was still a danger, but it wasn't built into what in the U.S. is referred to as "current law."

Today, rising spending expectations are built into the law through features such as retirement benefits that rise with wages, expectations that health care spending will automatically pay for new innovations, and failure to adjust for declining birth rates and the corresponding hit on spending, employment and revenues. At the same time, officials fail to raise the revenues required to meet, much less fund, those laws or voter expectations.

A rising debt level relative to GDP is merely one symptom. Reduced ability to respond to the next recession or emergency is another, while the increasing share of government spending on consumption and interest crimps programs oriented toward work, investment, saving, human capital formation, and mobility. Politically the chief budget job of elected officials turns from giveaways (to avoid growing surpluses) to takeaways (that renege on what the public believes is promised to them).

Economic populists, fiscal hawks and doves alike, don't help when their fights over short-run austerity ignore the fundamental long-term disease. The bottom line: flexibility, not merely sustainable debt, is required for any institution—business, household, or government—to thrive.

The full range of responses given by other economists to the question of debt can be found here.