Welfare and Debt: A Moynihanian Assessment[1]

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"The Moral Dimensions of a Two Trillion Dollar Debt" is the title of an address delivered a third of a century ago, by Senator Daniel Patrick Moynihan, on January 27, 1986, at St. Paul's Episcopal Church in Rochester, New York. Pat began with the theological ambivalence toward the activity of lending, investment, and accumulation that we now call capitalism. The Hebrew Bible's injunction pointed one way—*Thou shalt not give [thy brother] thy money upon interest, not give him thy victuals upon increase*. The New Testament's parable of the talents pointed another—"the good servant puts his capital to work and it increases." The Catholic Church, he observed, no doubt with a twinkle in his eye, had tended to view capitalism as a "Protestant heresy." On this point, Pat sided with the heretics assembled before him: Christianity teaches the virtue of self-denial and "warns against the terrible cost of discounting future rewards in favor of present ones."

The same was true of public borrowing—up to a point. The City of Rochester blossomed in the 1820s on heavy borrowing by New York State to finance the digging of the Erie Canal. In 1986, the city continued to thrive on public and private credit for "projects of indisputable virtue and reasonable prospects" (and he let it slip that some of those loans were provided by federal agencies through the good offices of Senator Moynihan). Nevertheless, Pat said,

> … there can be no doubt that public debt is much more problematic. This arises from the obvious fact that the people who do the borrowing, which is to say elected officials, are not the ones who will do the repaying. The temptation is real to use debt not as a form of investment, but a means of consumption. Far from the denial of gratification, it can, and frequently does, reflect just the opposite.

Whereupon he delivered a nutshell history of American public finance—in his telling, centuries of resisting temptation followed by five years of dissolute debauchery. The federal government had run deficits many times in the nineteenth century, but only during wars and recessions—and "the debts were paid off with great promptness once there was a change in

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[1] This is the text of an address delivered at a conference, "'But Not Your Own Facts'—Daniel Patrick Moynihan, Evidence and Public Policy," held at the Daniel Patrick Moynihan Center for Scholarship and Statesmanship, Assumption College, Worchester, Massachusetts, on April 5, 2019. The Moynihan addresses discussed in the text are unpublished; they are available from the author. The author worked for Mr. Moynihan in the Nixon White House in 1969–1970.

the particular circumstances that had given rise to them." During the Great Depression, Keynesian economics had had "little if any influence on the New Deal." But it did introduce a new way of thinking about deficits—not just as an unfortunate side-effect of economic hard-times and falling tax revenues, but as a deliberate policy to sustain incomes and demand until the economy recovered. This led eventually to a variety of innovations such as, during the Nixon Administration in the early 1970s, the "Full Employment Budget"—with deficits equal to the tax revenues that would have come in from the currently unemployed if they had had paying jobs. Pat called this counterfactual budget balancing "a euphemism of sorts."

And then, with the arrival of Ronald Reagan in 1981, came dissolution. Supply-siders claimed that cutting tax rates would generate so much economic growth that tax revenues would hold steady or even increase at the lower rates. Libertarian spending-cutters doubted that would happen—but they thought the ensuing deficits might accomplish what they had failed to do directly. Friedrich Hayek had summarized the starve-the-beast strategy following a recent visit to the West Wing: "[I]t is impossible to persuade Congress that expenditures must be reduced, unless one creates deficits so large that absolutely everyone becomes convinced that no more money can be spent."

But both Reagan camps had been wrong. Deficits had ballooned following the 1981 tax cuts, without inducing the least sense of spending restraint in Congress. The national debt had doubled from $1 trillion to $2 trillion by the time Pat spoke in 1986. "This," he said, "has the makings of a crisis of the regime. I don't think it will come to that; but it might." Without a reversal of the 1981 tax cuts, either the currency would need to be debauched through inflation, or else critical defense and domestic programs would need to be cut "in a wholly indiscriminate and destructive manner."

"The largest debtor nation with a declining defense program," Pat concluded, "is not likely to remain for long *the* symbol of successful government." In another lecture later that year, he put the matter even more colorfully: The Reagan Administration "borrowed a trillion dollars from the Japanese and gave a party."[2]

Today, with thirty-three years of hindsight and experience, we can see that Senator Moynihan got some things right and some things wrong in his Rochester address. But on one big thing he was stunningly perspicacious. This thing was not, as far as I know, seen by

[2] "The 'New Science of Politics' Vindicated, or, The Founders Rediscovered," Britannica Distinguished Lecture, The Woodrow Wilson Center, Smithsonian Institution, Washington, D.C., Sept. 12, 1986. Unpublished paper available from the author.

anyone else in 1986; and indeed few people see it even today. But before I tell you what it was, I first need to lay the groundwork by revising and extending Pat's remarks.

Pat was exactly right that federal deficits were episodic throughout the nineteenth century. We may put the matter positively: From 1789 through the 1960s, the federal government followed a *balanced-budget policy*, where annual spending on regular operations was held to annual tax revenues. Borrowing was reserved for emergencies and investments—wars, recessions, natural disasters, and territorial development from the Louisiana Purchase to canals and railroads and highways. And the debts were paid down in businesslike fashion, out of economic growth and government surpluses. This was a bipartisan consensus. Alexander Hamilton and Thomas Jefferson agreed on the point. Andrew Jackson—the founder of Pat's beloved Democratic Party, the frontier populist whose portrait now hangs in the Oval Office—was particularly emphatic. The War of 1812 had propelled the national debt to $127 million, and its subsequent retirement had been complicated by a succession of recessions and financial panics. It remained at $55 million in 1829 when Jackson took office; he resolved to pay it down to zero—and succeeded by the end of 1834 through vigorous administration, ample use of his veto pen, and a booming economy.

This history presents a great conundrum. The government that held to a balanced-budget norm for nearly two centuries was, structurally, the same one we have today. Congress possessed unlimited borrowing power. Taxes had to originate in the House, whose members faced the voters every two years. Presidents were prone to expensive visions and projects. What on Earth were they thinking? Why wasn't their policy *borrow, spend, and elect*?

Two considerations seem to have been at work. First was Pat's "moral dimensions"—the Old Testament admonition, plus the secular obligations not to burden future generations and to keep the powder dry for whatever troubles lay certainly ahead. The second was intensely practical—to police against corruption and mission-creep in the distant national capital. Most citizens had little interest or ability to keep track of what the politicians were up to in Washington. What they did know was that they and their neighbors were highly averse to paying taxes. *Voila*: holding spending to tax revenues was a natural device for limiting the opportunities for mischief. Budget balancing was more than an elite consensus—it was a popular consensus that practicing politicians were constrained to follow.

The dogma lived loudly in FDR. His fiscal policies shifted this way and that, but his budgets always cabined off deficits for spending on Depression relief and Depression recovery; and he insisted that Social Security be financed by its own tax revenues. Pat nailed

Keynes, whose practical influence worked in slow motion. Amity Shlaes, in *The Forgotten Man*, notes that FDR found Keynes baffling and mathematical.

Keynes, too, was a budget-balancer, but over the period of the business cycle rather than the calendar year. He constructed a positive theory for the age-old expedient of running deficits during hard times and paying them off when things improved. In so doing, however, he introduced the idea that deliberate government borrowing need not be limited to public investments and wars. It was also legitimate, and economically smart, to borrow for private consumption—the technical term was "aggregate demand management." After all, reputable private citizens borrow not just for business investments but also to calibrate their personal consumption and income. A young couple borrows against future earnings to purchase a house and station wagon while the kids are still young. They were doing so en masse in the postwar decades when Keynesianism finally began to sink in.

Moreover, public officials and their economic advisers came to interpret Keynes expansively. Government budgets were no longer mere bean-counting exercises, balancing current revenues and expenses. Now they were to balance the needs of the known present against the resources of an imagined future. But the present is always cluttered with problems and difficulties, while the future is an abstraction. The future is also, in the American mind, a happier, more prosperous place—especially if we can just get ourselves through today's pressing exigencies. This manner of thinking was evident in the Kennedy and Nixon administrations' budget proposals. Their deficits were minuscule by today's standards, but they were the first ones justified not on grounds of necessity but rather of planning—of fine-tuning a peacetime, prosperous economy. This was a turning point.

When Pat got up to the immediate moment of Reaganomics, he got many things wrong. The Administration had not claimed the 1981 tax cuts would pay for themselves. It had said they would spur economic growth—job number one following the miserable stagflation of the 1970s. It thought the revived growth might compensate for 20 percent of the tax revenue that would otherwise be lost. Deficits ballooned in the mid-1980s mainly because Paul Volker's Federal Reserve reduced inflation faster than anyone had anticipated. We were not bound for a recession by decade's end, as Pat predicted, but rather for a decade-and-a-half of strong economic growth interrupted by only a brief, mild recession in the early 1990s. That growth compensated the Treasury for 80 percent—not just 20 percent—of the Reagan tax-rate reductions.

Last but not least, much of the mid-1980s borrowing was devoted to a military buildup that, we now know, demoralized and then overwhelmed the Soviet Union—a high-return investment. The party was yet to come, held at the Brandenburg Gate on December 22, 1989.

Now, Moynihan at Rochester was a practicing politician, in the arena, interpreting an unfolding economic drama. The facts were in conflict; opinion was inescapable. Greg Weiner and Shep Melnick quote Pat the scholar-statesman: scholars "enter the realm of speculation" at their peril—"but that is not a choice available in politics. Speculate or perish." But statesmanship, too, had its demands: In the months following his address, Senator Moynihan was a leading author of the Tax Reform Act of 1986, which cut individual rates even further, while eliminating many shelters and loopholes.

Pat did have two incontestable facts on his side. First, debt and deficits had skyrocketed to levels never seen in peacetime. Second, this had not caused Congress, or the Administration, or the public, to demand, or even consider, significant reductions in expenditures. The obdurate, age-old balanced-budget consensus had simply vanished. It had vanished at a time of prosperity and good-feelings ("Morning in America" was Reagan's landslide reelection slogan). Keynes was nowhere in sight—liberal demand management had been replaced by conservative supply management. Another turning point, and another puzzlement.

And here was Pat's big, singular insight. Listen again to his strange admonition which seemed to come out of the blue: "The temptation is real to use debt not as a form of investment, but a means of consumption. Far from the denial of gratification, it can, and frequently does, reflect just the opposite." *Frequently does*—he is not expounding Leviticus. And now consider his sally about borrowing a trillion and throwing a party. Pat was well aware of Reagan's robust military buildup; he supported it and wanted it to continue. But he saw that something else was afoot. The public was not restive but festive. It was, he emphasized, getting what <u>it</u> wanted.

What was afoot was a transformation of the political economy of the federal government. From the founding until very recently, it had been primarily a provider of public goods for the nation—defense and diplomacy; courts and justice; development and infrastructure; latterly, support for basic research and schooling. Now it was becoming something quite different—primarily a provider of private consumption by individuals, through the medium of writing checks for Social Security and Medicare and a variety of means-tested welfare benefits. In 1960, public goods had accounted for about 75 percent of

federal outlays net of interest payments on the debt, while "payments for individuals" were the other 25 percent. By 1970, payments for individuals had grown to 35 percent. In 1986 when Pat spoke, payments for individuals had become dominant at 55 percent. Today they are 75 percent and still growing; public goods are now the residual 25 percent of our national government and shrinking.[3]

We are accustomed to hearing that federal spending has been commandeered by middle-class entitlements—pensions and medical care for the booming, politically alert cohorts of older citizens of all incomes. That is a half-truth, or at most a two-thirds truth. Means-tested welfare—cash (including refunded tax credits) plus medical, food, and housing assistance—has grown at about the same pace as entitlements, amounting to about one-third of payments for individuals throughout the period since Medicaid came onstream in the late 1960s. The Welfare Reform Act of 1996 interrupted the growth of non-Medicaid welfare spending only briefly. If we include the recent expansion of state Medicaid spending induced by the Affordable Care Act of 2010 (ObamaCare), means-tested welfare is now nearly 40 percent of payments for individuals. Moreover, Social Security and Medicare are themselves redistributive, with benefit structures skewed toward those of lower income.

Pat mentioned none of these developments in his Rochester address, but he was well aware of them. Indeed, he had been present at the creation—at the moment of our first tentative turn toward routine deficit spending. When he was crafting the Family Assistance Plan (FAP) in the Nixon White House in 1969, everyone assumed that its added expenditures, perhaps $5 billion a year, would be covered by tax revenues. The government was then running a surplus. With the expected unwinding of hostilities in Vietnam, the Budget Bureau was projecting an "annual peace-and-growth dividend" of $7–8 billion in the coming years. In the internal White House debates over FAP, one of Pat's most effective arguments was that a big initiative would preempt Congress's natural inclination to fritter away the surplus. Memo to the President: "Once you have proposed it, you can resist the pressures endlessly to add marginal funds to already doubtful programs." When President Nixon unveiled FAP in a television address on August 8, 1969, the White House was cheered by this incoming telegram: "TWO UPPER MIDDLE CLASS REPUBLICANS WHO WILL PAY FOR THE PROGRAM SAY BRAVO."[4]

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[3] Figures calculated from OMB Historical Table 6.1.

[4] The figures and quotations in this paragraph are from Daniel P. Moynihan, *The Politics of a Guaranteed Income: The Nixon Administration and the Family Assistance Plan* (1993), pp. 176–179, 233, 251.

But the peace-and-growth dividend was not to be. It was preemptively consumed, not by congressional spendthrifts but by automatic spending growth in established programs. Pat announced the discovery himself, that very August, using a fine simile that made the evening news. Speaking to the press outside the Western White House, he said, "I'm afraid the peace dividend tends to become evanescent, like the morning clouds around San Clemente." The Administration temporized for a time with the "Full Employment Budget." But federal payments for individuals *nearly doubled* in the early 1970s. Beginning in 1975—the first year such payments exceeded half of non-interest spending—annual deficits became large and continuous, defying any attempt at rationalization. Deficits became much larger in the 1980s, as we have noted, and continued so through most of the 1990s.

Still, America prospered. In 1989, Jonathan Rauch wrote in *The Atlantic*, "We have learned in this decade that we throw away the balanced-budget rule at great peril to our machinery of governance and our national conscience, but we have also learned that the economy is unlikely to stop us." Indeed, the economy gave us four surplus years at the end of the 1990s, an unanticipated gift of the dot.com wealth bubble. Then the bubble burst … and then the Twin Towers burst. Routine deficits resumed their upward trajectory, reaching a peak in 2009, the year following the financial collapse. Altogether, through good times and bad, deficit spending and payments for individuals have grown in tandem for nearly fifty years. In the nine years since 2009, the Treasury has had to borrow on average 4.8 percent of America's entire Gross Domestic Product to pay the bills for 22.3 percent of federal spending. We are now conjuring with the moral dimensions of $1 trillion *annual deficits.*

These developments are no longer the work of anyone's economic theory, not of Keynes or the supply-siders, not of Paul Krugman or Lawrence Summers. They reflect the emergence of a new budget norm—*the borrowed-benefits norm*—that is every bit as populist as the balanced-budget norm it replaced. This I believe is what Pat noticed. Voters and public officials were forging a new political compact: for the government to pay out benefits considerably in excess of what it collects in taxes, and to borrow the difference from nonvoting future generations. The benefits are fine in principle; Pat devoted much of his career to promoting them, and to attempting to calibrate them to support rather than undermine family and community. But however worthy, necessary, or urgent they may be, they are mainly present consumption and are not going to generate returns to pay off the borrowed funds. Continuous large scale public borrowing for private consumption leads to immoderation now, immiseration down the road, all the while corrupting democratic self-government. When Pat put his hand to Social Security reform in 1998, his first principle was

that it be returned to pay-as-you-go funding—lower payroll taxes, smaller defined benefits, and personal investment accounts.

If Pat Moynihan were still with us today, trying to make sense of what has become of our national life, I am certain that he would be impressed by our comprehensive rejection of constraint—not only in public finance but in politics, in constitutional structure, in rhetoric, and in culture. There was no more consistent theme of his thought and action than the reality of constraint in human endeavor, and the necessity to acknowledging it, and accommodate it, if one is to make any kind of progress. This, to me, is the deep takeaway of his celebrated distinction between having one's own opinions and having one's own facts. But Pat also recognized that opinions themselves can be constraining—so that defining problems incorrectly can make politics "the art of the impossible" (the title of a Moynihan essay).

Let me suggest that these are the circumstances of the contemporary American welfare state. It is too little constrained by the objective facts of sustainable public finance, which we are either pretending do not apply to us or are simply ignoring. This is a thoroughly bipartisan delusion. At the same time, it is too much constrained by subjective opinions that are confusing debate and complicating reform. This is a specialty of the politicians of the progressive Left. They maintain that our welfare state is too small and miserly. It ought to be vastly extended with Medicare For All, and a guaranteed income for all, and a green energy economy while we're at it. All to be paid for with sharply higher taxes on corporations, on capital investments, and, especially, on the rich—*"Every Billionaire is a Policy Failure."* In these endeavors, we are advised to follow the example of Sweden.

To be sure, we are dealing here with profuse with errors of fact. Sweden's taxes are higher than America's but, unlike ours and unlike those now being proposed, Sweden's fall mainly on the middle class. Its income tax is relatively flat beyond moderate incomes—as compared to America's, which is the most progressive of all the developed economies. Sweden taxes corporate and capital income relatively lightly. Along with Europe's other large welfare states, it relies heavily on taxes on consumption, especially the Value Added Tax, that are regressive. Sweden has more billionaires per capita than the United States.

These fun facts are, however, largely beside the point. Sweden is a tidy country with a population equal to Michigan, smaller than Georgia or North Carolina. It is (or was until quite recently) highly homogeneous and communitarian. It can hardly be a model for a sprawling, diverse, fractious nation of immigrants, thirty-two times its size. But Sweden is not really being offered for empirical support. Rather it is a Valhalla—the idealization of an

aspiration. And that aspiration is thoroughly homegrown. In my own home, around the breakfast table, I may rail that the Democrats have been taken over by a gaggle of little Leninists and one ancient Stalinist. But, on the points we are considering, they are giving voice to venerable domestic sentiments that run back to the source of our problems with welfare finance.

America's system of income and capital taxation was constructed during the Progressive Era, in the late nineteenth century and early twentieth. It was extraordinarily progressive by international standards—Thomas Piketty, the French economist and high-tax advocate, notes that "very high taxes on the very rich" were "invented in the United States." It has remained so ever since; tax rates on the highest earners have come down in recent decades, but so have rates on the middle class, and growing numbers of citizens have been removed from the tax rolls altogether. Today a substantial proportion of the adult population, more than 40 percent, pays no income tax at all. High progressivity has generated innumerable statutory preferences and exclusions and private strategies of income manipulation. Compared to those of the other advanced economies, the U.S. tax system is outstandingly progressive, outstandingly complex, and outstandingly meagre in revenue production. It is this longstanding tradition that set the stage for the debt-financed welfare state.

A few scholars on the academic Left understand the problem. Sociologist Monica Prasad of Northwestern University writes that "America has greater poverty [than any other developed economy] because a set of progressive interventions backfired … progressive taxation and reliance on consumer credit undermined political support for the welfare state." Her argument is complex, but is nicely adumbrated in the title of her 2012 book I have quoted from, *The Land of Too Much* (a phrase coined by Huey Long). Precisely because the American economy, beginning with the farm economy, has been so spectacularly abundant and productive, our political attentions have focused on sharing the great wealth in our midst and maintaining widespread purchasing power in the face of glut. Tax specialist Edward D. Kleinbard, of the University of Southern California Law School, makes a complementary argument in a 2014 *New York Times* op-ed entitled "Don't Soak the Rich." Social equality, he argues, is best promoted by public spending—on food stamps and other means-tested welfare, on Social Security and Medicare with their progressive benefit schedules, and on highways and defense and other public goods which are inherently egalitarian. They all depend on large, broadly based revenue systems, which we have denied ourselves through misdirected progressivism.

But academic arguments such have these have had as much influence on the political Left as Keynes had on FDR. During his first presidential campaign in 2008, Barack Obama was asked whether he would favor raising taxes on capital income even if that would suppress investment and reduce government revenues. He answered that yes, he would, because that would be more fair. Pat Moynihan would not have made that mistake. The pursuit of redistribution among the more-or-less well-off is a distraction from the noble aims of the welfare state as Pat conceived them—to alleviate real poverty and hardship, to strengthen the family, and to sustain community and nation. But there it is: a constraint, no less so for being subjective opinion, and we shall have to cope with it.