

## ISSUES IN PERSPECTIVE

Dr. James P. Eckman, President Emeritus  
Grace University, Omaha, Nebraska  
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### *The Fiscal Cliff Deal: A Study in Leadership Failure*

The deal to avert the fiscal cliff has been made, averting for the short term another fiscal crisis for America. But there is little doubt that this deal represents one of the greatest failures of leadership in recent years. It is nothing to be proud of. Let me explain.

- First the deal itself. The deal leaves income tax rates where they were for 99% of households while raising them sharply for the top 1 %. It did nothing to arrest the escalating national debt. The Bush tax rates of 2001 and 2003 are thereby made a permanent part of the tax code, except for those making \$400,000 for singles and \$450,000 for couples, with the rate rising to 39.9% from 35%. Rates on capital gains and dividends will rise to 20% from 15%. The deal also raises estate taxes. The alternative minimum tax, a supplemental tax for the wealthy, has been presently fixed. The deal cuts \$737 billion from deficits over the coming decade, primarily because of the higher tax rates on the rich and the resulting interest savings. But that barely dents the \$10 trillion in deficits the US was already on track to add to its already huge debt of \$16.4 trillion. For those who are intellectually honest, this is an abysmal deal! Our leaders did not approve a deal that balances taxes and spending cuts. As columnist David Brooks correctly observes, “It doesn’t involve a single hard decision. It does nothing to control spending. It abandons all of the entitlement reform ideas that have been thrown around. It locks in lower taxes on families making less than \$400,000; it is simply impossible to avert catastrophe unless tax increases go below that line. . . It sentences the country to another few years of trench warfare.” Our leaders once again avoided making a single difficult decision that calls for anyone to sacrifice or anyone to come to terms with the cataclysmic future we face as a nation. That is not leadership. That is a failure of leadership—and both the president and the Congress must accept that responsibility.
- Second, the deal ignores completely the absolute need for the US to reform its entitlement programs. Permit me to review some basic facts about our future as a nation: In 1900, 1 in 25 Americans was over the age of 65, but in 2030, 1 in 5 will be over 65. As columnist Fareed Zakaria says, “we will be a nation that looks like Florida.” In 1960 there were five working Americans for every retiree, but by 2025, there will be just over two workers for every retiree. In 1975 Social Security, Medicare and Medicaid made up 25% of federal spending, while today they add up to 40%. Within a decade, they will take up over half of all federal outlays. To deal with this dilemma, our leaders have taken the amazing step of postponing the problem by borrowing heavily for three decades, with our debt approaching 100% of GDP. [In 30 years it will be a cataclysmic 247% of GDP. By 2025, entitlement spending and debt payments are projected to suck up all federal revenue.] Thus, federal spending on everything other than entitlements and defense has been steadily shrinking for decades. Furthermore, the federal program of Medicaid is an enormous burden to the states. Zakaria points out that a recent report from the National Governors Association demonstrates

that Medicaid is now the single largest item in state budgets and has grown by over 20% each of the past two years. Thus, spending on everything else from police to poverty programs and public education is being slashed. For the foreseeable future, this trend will not end!! Zakaria asks this poignant series of questions: “The left must ask itself why it is tethered to a philosophy that insists that government’s overwhelming responsibility is for pensions and health care even when, as an inevitable consequence, this starves other vital functions of the state. Is insurance for the elderly the only important function of government? Above education? Above scientific research? Above investments in infrastructure and energy? Above poverty alleviation? And yet that is where we are headed.”

- Third, we must ask this hard question as well: Are the American people to blame in any way for this mess? As difficult as this is, I believe the America voter must accept some responsibility. Brooks comments: “Ultimately, we should blame the American voters. The average Medicare couple pays \$109,000 into the program and gets \$343,000 in benefits out, according to the Urban Institute. This is \$234,000 in free money. Many voters have decided they like spending a lot on themselves and pushing costs onto their children and grandchildren. They have decided they like borrowing up to \$1 trillion a year for tax credits, disability payments, defense contracts and the rest. They have found that the original Keynesian rationale for these deficits provides a perfect cover for permanent deficit-living. They have made it clear that they will destroy any politician who tries to stop them from cost-shifting in this way. . . The country either doesn’t know or doesn’t care about the burdens we are placing on our children. No coalition of leaders has successfully confronted the voters, and made them heedful of the ruin they are bringing upon the nation.” Neither the current President of the United States nor any major Democratic leader has proposed any significant benefits cut or reform of either Social Security or Medicare. As Republicans refuse to consider raising taxes, Democrats refuse to consider cutting spending. We are looking at a colossal failure of leadership in this nation! No matter how significant the accomplishments of President Obama, history will consider his presidency a titanic failure if he does not lead the nation through this crisis. As president, he must present a plan for long-term solvency of the United States. At a minimum, he must do three things immediately: (1) He must lead his own party in meaningful and very serious reform of the entitlement programs, specifically Social Security, Medicare and Medicaid. (2) He must champion a clear plan for fiscal reform of this nation. (3) He must lead the nation by telling the American citizens the truth. This nation is in a crisis and everyone, including the elderly, must sacrifice. We must stop borrowing from our children and grandchildren. This nation can no longer follow the perilous path it is on. Only the president can and must lead us. Currently, he is not leading and consequently history will be devastating in evaluating his lack of leadership on fiscal, tax and entitlement reform. That will be his legacy!
- Finally, on what issues should he lead the nation? What should be the elements of leading the nation out of this morass? Most thoughtful economists agree that at least four major initiatives should characterize meaningful reform. Harvard Business School’s Michael Porter and Jan Rivkin offer a sensible approach:
  1. Simplify the tax code. The US has the highest tax rate among industrialized nations, but actual tax revenue is low. Part of this is due to corporations seeking offshore tax havens

and locating jobs abroad. The US needs a system with a much lower rate but without loopholes. This will then generate more revenue than we do today.

2. Create a sustainable federal budget, which includes both revenue increases and spending reductions. This mandates that the US address entitlement reform—Social Security, Medicare and Medicaid. As the above points have shown, the US is on a path toward insolvency. We simply cannot meet future Social Security, Medicare and Medicaid commitments. There must be reductions in benefits and/or changing qualifications for these benefits. The president must be honest with the American people about this—that is a mark of leadership.
3. Simplify regulation. Reliable surveys of American business indicate that the greatest impediment to investing and creating jobs is regulation. The priority is not to necessarily lower standards but to regulate more intelligently by focusing on outcomes, rather than compliance methods and employing rigorous cost-benefit analysis.
4. Enact a multi-year program to improve infrastructure. America's roads, ports, telecoms and energy infrastructure fail to match the world's best. A new federal policy should allocate funds based on what will most boost economic growth. If we are to remain competitive in this global economy, this cannot be ignored. Unless we deal with entitlement reform and tax reform, there will simply not be sufficient funds to deal with this infrastructure need.

As this *Perspective* has argued, the United States needs strong, bold and determined leaders, and this includes both the president and Congress. We do not have much time and our leaders must be brutally honest and forthright in presenting all of this to the American public. If our leaders do not do this soon, history will judge them harshly. May we pray that God gives them the temerity and courage to act—and act now!

See Porter and Rivkin's article in *The Economist: The World in 2013*, p. 50; David Ignatius in the *Washington Post* (2 January 2013); David Brooks in the *New York Times* (1 January 2013); Fareed Zakaria in *Time* (24 December 2012); and *The Economist* (5 January 2013), p. 21.