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Edited by David A. Ditch

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INSTITUTE FOR ECONOMIC FREEDOM

About the Editor

David Ditch is Research Associate in the Grover M. Hermann Center for the Federal Budget, of the Institute for Economic Freedom, at The Heritage Foundation.

Contributors

Doug Badger is a Visiting Fellow in Domestic Policy Studies, of the Institute for Family, Community, and Opportunity, at The Heritage Foundation.

Frederico Bartels is Senior Policy Analyst for Defense Budgeting in the Center for National Defense, of the Kathryn and Shelby Cullom Davis Institute for National Security and Foreign Policy, at The Heritage Foundation.

Justin Bogie is Senior Policy Analyst in Fiscal Affairs in the Hermann Center.

Marie Fishpaw is Director of Domestic Policy Studies, of the Institute for Family, Community, and Opportunity.

Rachel Greszler is Research Fellow in Economics, the Budget, and Entitlements in the Hermann Center.

Adam N. Michel, PhD, is Senior Analyst for Fiscal Policy in the Hermann Center.

Robert E. Moffit, PhD, is Senior Fellow in Domestic Policy Studies.

Nina Owcharenko Schaefer is Senior Research Fellow in Domestic Policy Studies.

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The Heritage Foundation | 214 Massachusetts Avenue, NE | Washington, DC 20002 | (202) 546-4400 | heritage.org

Digging Out of the Hole: A Blueprint for a Responsible Post-COVID-19 Budget

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The federal government has added $3 trillion to the national debt in the wake of the COVID-19 pandemic. This comes on the heels of legislators choosing to overspend during the years of strong economic growth prior to 2020. Looking ahead, mounting unfunded liabilities for programs such as Social Security and Medicare threaten to push the national debt to unprecedented levels even after the economy recovers. To maintain a strong national defense and a pro-growth tax code, officials must act quickly to rein in unsustainable programs and put the federal government on a path toward balance.

The federal budget is at a crossroads. Where the President and Congress go from here could fundamentally redefine what America is and will be. Once the country re-emerges from the COVID-19 public health crisis, lawmakers and the Administration must pursue policies to dig the budget and the economy out of the hole.

The public health crisis and its economic fallout have shortened the timeline that Washington has during which it can correct structural problems that are driving federal finances toward a fiscal crisis. Lawmakers should learn critical lessons from the crisis about the importance of prioritizing essential federal functions, respecting the boundaries of federalism, and reining in "scope creep" that leaves agencies unprepared to respond effectively to crises that require a national focus.

Federal spending was already unsustainable before the outbreak of COVID-19 and its economic fallout. The public health crisis, its economic and societal ramifications, legislative relief packages, and extended lockdowns of entire communities and industries have driven federal spending, deficits, and debt to levels not seen since World War II.

The crisis also uncovered several weaknesses in how Congress manages federal finances, including a failure to prioritize proper national functions to ensure that federal government agencies meet the most pressing national needs, including responding effectively to a public health crisis of global proportion. Lawmakers have overextended the federal government, allowing mission creep to distract from essential governmental functions as agency budgets grew to accommodate mission-tangential and unrelated initiatives in response to political considerations.

Before the pandemic hit, America's gross debt was already more than 23 trillion,[1] nominal federal spending was at an all-time high,[2] and the threat of a debt-driven financial crisis was looming.

But few Americans, and even fewer Members of Congress, were taking it seriously. The stock market soared to record highs, and the national unemployment rate was at a 50-year low.[3] American wages were up, and take-home wages were on the rise for most workers.

In a matter of days, that all changed. Within five weeks, 39 million Americans filed for unemployment.[4] In March 2020, the stock market completed its worst first quarter in history.[5]

In response to the COVID-19 crisis, lawmakers have thus far enacted four legislative relief bills, generating at least $2.4 trillion in deficits in a matter of months.[6] Some of this spending and tax relief is warranted to provide a floor for individuals and businesses struck by this massive and unexpected shock, especially as a result of governmental social-distancing orders and economic shutdowns.

Little consideration has been given to the long-term fiscal effects, however. The expansion of existing mandatory programs coupled with the creation of new entitlements could not only boost short-term spending but could mean more federal spending for decades to come.

Moreover, to the extent that lawmakers delayed inevitable entitlement reforms that are driving the federal government's fiscal unsustainability by growing at a much faster pace than the economy, the public health crisis's fiscal impact has accelerated the timeline for pursuing structural reforms to health care and old-age entitlements.

Once the country moves past the immediate and most severe impacts of the COVID-19 pandemic, it will be critical for Congress and the Administration to act on a responsible budget plan that significantly reduces the growth in federal spending and stabilizes the national debt without impeding the economic recovery.

Lawmakers should also not miss this critical opportunity to prepare for future public health emergencies, which requires that they learn lessons from their response to the present pandemic. The federal government should closely evaluate the use of resources, prioritize funding, and revise the regulatory environment. Lawmakers should further recognize the nature and limits of the federal role, the constitutional authority of state and local officials, and the indispensable role played by the private sector in combating pandemics.

A strong and sustainable economic recovery can reduce outlays and increase revenues. To facilitate a robust recovery, Congress should stop impending automatic tax increases, which would raise the cost for Americans returning to work. The budget should also advance pro-growth structural reforms, such as full expensing, to ensure a predictable environment for post-coronavirus investment.

The next federal budget should continue rebuilding America's military and make progress on meeting the requirements of the National Defense Strategy, supporting the shift toward great-power competition, which has only intensified since the onset of the global coronavirus pandemic.

> The expansion of existing mandatory programs coupled with the creation of new entitlements could mean more federal spending for decades to come.

The coronavirus crisis demonstrates the importance of maintaining a sustainable budget. Congress missed numerous opportunities over the past several years to right-size federal spending, prioritize essential functions, and stabilize the debt. During prosperous times, the federal government should live within a balanced budget and build up surpluses to establish cushions to weather revenue shortfalls from contractions of the economy and unexpected expenditures from emergencies, such as a public health crisis.

In order to preserve individual liberty and enable opportunity and prosperity for all Americans, it is critical that Congress and the Administration finally take the federal budget's unsustainability and ineffectiveness seriously and put the nation on a stronger fiscal path. America can re-emerge from the pandemic stronger, with better fiscal health contributing to both economic and public health.

The Fiscal State of the Nation

Congress' response to the COVID-19 pandemic has significantly impacted the nation's fiscal state. Before the outbreak, the U.S. economy was performing well with sustained growth, unemployment rates at decades lows, and most Americans taking home more money each week.[7]

However, problems did exist. Those problems have been compounded in the wake of the COVID-19 pandemic and by the federal government's response to the health crisis. Before the pandemic swept the nation, the federal budget was already on pace to have a deficit of more than $1 trillion. The Congressional Budget Office (CBO) now projects that the fiscal year (FY) 2020 deficit will be over three times higher than its March projections.[8] Further, the national debt held by the public has risen to more than 100 percent of 2020 gross domestic product (GDP), which is 20 percent of GDP higher than the March estimates.[9]

While debt in and of itself is an insufficient measure of whether a government's underlying fiscal policies are sustainable, high levels of debt carry the risk of stifling economic activity, prosperity, and opportunity, making it harder for many Americans to live their version of the American dream.[10]

The fiscal impact of COVID-19 and legislative responses have accelerated the need for Congress to take control of spending, and thereby control the growth in the debt. Not only should the federal government prepare to better manage the challenges posed by the next national emergency, natural disaster, or economic downturn, it should also change its overall budgeting approach to reduce spending and maintain sustainable levels of debt over the long term.

The Federal Budget Before the COVID-19 Pandemic. While the economy was doing well before the COVID-19 outbreak, the federal budget was continuing down an unsustainable path, nearly unobstructed, as it had been for the past decade. At the start of February 2020, the gross federal debt was $23.2 trillion, exceeding the size of the U.S. economy.[11]

In March, the CBO released budget and economic projections for FY 2020 to FY 2030. It did not incorporate impacts from legislative actions taken in response to COVID-19 or potential changes in economic factors (such as unemployment and projected economic growth) that are affected by the outbreak.

Nevertheless, the federal government was already on a dangerous budget course that could lead to a spending crisis and debt-driven economic crisis.[12] The March CBO projections showed the federal government crossing the trillion-dollar deficit threshold in FY 2020, and a cumulative deficit of more than $13 trillion from FY 2021 through FY 2030. As a percentage of GDP, debt held by the public was projected to rise to 97.8 percent.[13]

The September update to the CBO's projections revealed the impact of COVID-19 on the nation's finances: The deficit in 2020 had risen from $1 trillion to $3.3 trillion. Further, despite a reduction in projected interest payments of $2.2 trillion from FY 2021 through FY 2030, the 10-year deficit is still expected to be $13 trillion.[14]

The CBO estimates that by the end of 2024, debt held by the public will rise to 107.1 percent of GDP, 20.3 percentage points higher than its pre-COVID-19 projections, and surpassing the previous high reached just after World War II.[15]

This latest CBO projection includes an average spending level of 22.5 percent of GDP over the next 10 years, about 2 percent of GDP higher than the 50-year average. In contrast, the revenue projection of 17.5 percent of GDP over the next decade is in line with the 50-year average. The federal government's mounting debt problem is clearly a matter of too much spending, not a lack of tax dollars coming into the Treasury.[16]

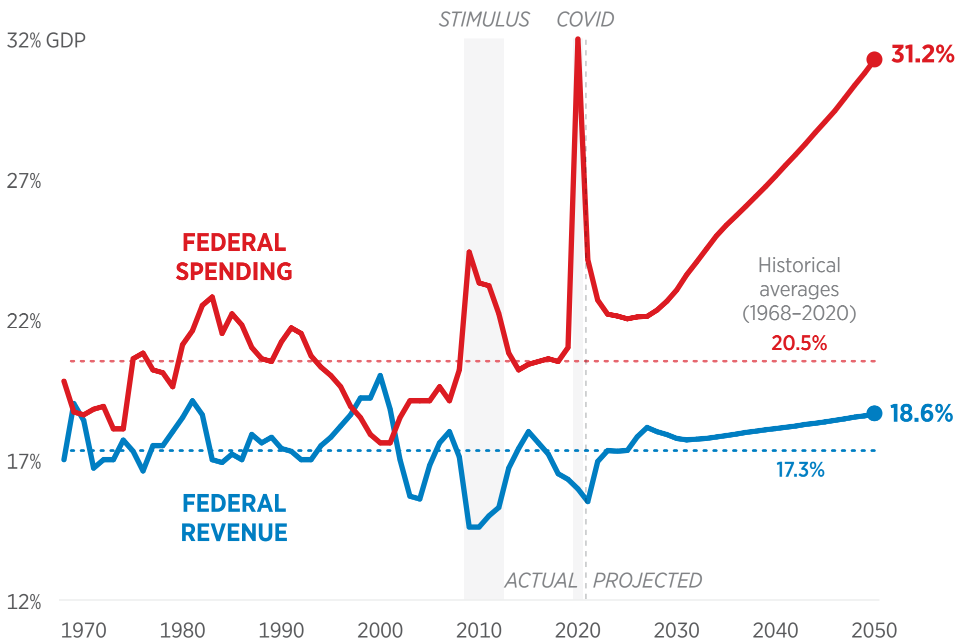
> The main drivers of federal spending growth continue to be three sources: Social Security, health care entitlements, and interest on the national debt.

The main drivers of federal spending growth continue to be three sources: Social Security, health care entitlements, and interest payments on the national debt. The CBO projects that by the end of the next decade, federal health care spending, Social Security, and interest will consume 90 percent of all revenues.[17] The largest single component of spending growth, and the underlying fiscal unsustainability that it is causing, is health care.[18]

Without reforms, both Social Security and Medicare are on a path to insolvency within the next 11 years to 15 years,[19] meaning that at some point, all recipients could face benefit cuts. The longer Congress waits to take action to reform entitlement programs, the more drastic the spending cuts or tax increases will have to be. Lawmakers must get back into the business of budgeting, period. But more important, they must produce fiscally responsible budgets that address the key drivers of spending growth as well as reforming programs that fall outside the federal government's proper role.

CHART 1

Growing Spending Is the Problem



SOURCE: Congressional Budget Office, "The 2020 Long-Term Budget Outlook," September 21, 2020, https://www.cbo.gov/publication/56516 (accessed October 7, 2020).

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Impacts of COVID-19 on Economic Projections. Before the COVID-19 pandemic struck, spending and debt projections were already heading in a disastrous direction. Pandemic response efforts and their economic impacts have made the fiscal state of the nation substantially worse.

In July 2020, the CBO projected that in the fourth quarter of 2020, real GDP growth will be 5.9 percent lower than during the fourth quarter of 2019, with a yearly decline of 5.8 percent. For FY 2021, the CBO estimates that the economy will rebound, growing at an annual rate of 4 percent.[20]

The CBO's preliminary projections estimate that unemployment will average 10.6 percent in the fourth quarter of 2020, a 6.9 percentage point increase compared to the year before. Into 2021, the CBO expected a hiring rebound that would lower the unemployment rate to 8.4 percent by the end of December (in fact, it was already at 7.9 percent in September), about 4.9 percentage points higher than the CBO's January projections.[21]

The CBO's projections reflect a best-case scenario, assuming the economy continues to recover in the second half of 2020, and that the federal government does not enact additional stimulus legislation. The estimates also assume that some form of social distancing continues through the third quarter of 2021. The outlook could be significantly worse depending on legislative and public health actions taken by federal, state, and local governments in the coming months.

Where Do Lawmakers Go from Here? The cumulative and long-term economic and fiscal impacts of the COVID-19 pandemic are still unknown. Until the economy recovers fully, lawmakers will continue to face challenging budget circumstances. That should not mean that lawmakers continue to neglect making progress on reducing spending and controlling the national debt as a share of the economy.

While the current deficit and levels of debt are instructive, they are an insufficient measure of whether a government's finances are sustainable. Determining the sustainability of a government's fiscal position depends on future growth in spending and revenues.[22]

This means that even with no, or relatively low, levels of debt as a share of the economy, the budget can be unsustainable. At the same time, a budget could be sustainable even with high levels of debt.[23]

The U.S. government has borrowed substantial sums of money to minimize the economic effects of the COVID-19 pandemic. Entitlement spending—especially on health care—has contributed to systemic fiscal imbalances. Without structural reform, the rate of spending on these entitlements will continue to grow into the future.[24]

In previous national crises, such as war, debt spiked for a period and then fell relative to the economy once the crisis had passed. That has not been the case in the 21st century. Since 2007, debt has increased steadily through both economically prosperous and recessive times, more than doubling by 2019.[25]

A number of federal programs were already unsustainable before the crisis. What is not clear is whether the coronavirus will meaningfully change the growth in spending for these programs, or for those that were sustainable pre-crisis. If the crisis increases long-term health costs, there is a significant chance that the overall fiscal outlook will become more sustainable.[26]

Stabilizing growing entitlement spending, particularly on health care, is a key metric that Congress and the President should strive to achieve. Reforms are necessary to stabilize debt growth and avert a possible fiscal crisis.

The President's FY 2021 budget reduces debt to GDP from 81 percent in FY 2021 to 66.1 percent in FY 2030 through reforms, saving more than $4.6

trillion.[27] This level of debt is still higher than the 50-year average of 60.4 percent of GDP,[28] but much lower than current-law projections.

Though the starting point has shifted, the debt-reduction targets laid out in the President's FY 2021 budget remain a worthwhile goal that Congress should strive to meet in its next budget resolution.

However, there is a flaw in the President's budget that the Administration and Congress cannot afford to make again. The budget relies on robust economic growth and low interest-rate assumptions to stabilize the debt. The Administration's assumed 3 percent growth rate is significantly higher than the CBO's projected 1.7 percent rate before the economic shock created by COVID-19.[29]

> There are outside variables that are beyond any government's control. Relying on optimistic growth to balance the budget presents real risks.

Prior to the COVID-19 pandemic, the President's growth assumptions were near the upper bound of pro-growth estimates. As the COVID-19 crisis has shown in countries around the world, consistent growth does not automatically mean good policy. There are outside variables that are beyond any government's control. Relying on optimistic growth to balance the budget presents real risks.[30]

Even in the wake of COVID-19, shrinking the size of government and reducing the debt-to-GDP ratio is possible, but it will take bold leadership and a strong commitment to fiscal discipline from lawmakers, the Administration, and the public.

Congress should pursue reforms to the health care and Social Security entitlement programs, refocus federal spending on constitutional priorities, and leave other policy areas to state and local governments as well as the private sector.

Reforming the Main Drivers of Spending Growth. Entitlement program spending (Social Security, Medicare, Medicaid, and other health care programs) and soaring interest payments on the national debt are the main drivers of the federal government's long-term spending growth. By the end of the next decade, these programs and interest are projected to consume 90 percent of every dollar that comes into the United States Treasury.[31]

For the past several years, The Heritage Foundation's *Blueprint for Balance* has contained proposals for entitlement reforms that would not only make workers and retirees better off, but would also solve each program's economic shortfalls.[32] The savings for taxpayers would be nearly $2.5 trillion in the next decade, at a minimum.

Reforming Health Care Programs. The primary problem with the budget is that there is a small subset of programs that are growing at unsustainable levels. These programs are large and comprise more than 60 percent of total federal spending. They are the government-funded health care programs, including Medicare, Medicaid, and the health care exchanges (also known as Obamacare). These pose the most significant challenges to the budget's sustainability. While other entitlement programs also pose significant challenges, without reforms that align spending growth with that of the economy over the business cycle, health care spending is the elephant in the room.[33]

The 2020 *Blueprint for Balance* contains several recommendations to streamline the Medicare system, update the financing of the Medicaid program, and reform other health care spending, saving the federal government at least $1.5 trillion over 10 years.[34]

Medicare, which currently covers 63 million people at a total annual cost of $836 billion,[35] is clearly the biggest and most difficult challenge. Given the impact of the COVID-19 pandemic, including massive job losses, projected revenue declines, and huge increases in deficit spending, Medicare's already dire financial condition can only worsen, making the necessary reforms even more urgent. According to the latest report by the Medicare Trustees, the Medicare Hospitalization Insurance (HI) program will be insolvent in 2026, if not sooner, and Medicare's rapid overall spending growth is projected to impose enormous financial pressures on beneficiaries and taxpayers, as well as on other priorities in the federal budget.[36] The long-term unfunded obligations of the Medicare program amount to $45.7 trillion—that is the difference between what the program is expected to pay out and what it will take in from dedicated revenues from payroll taxes and premiums over 75 years.[37]

Medicare reform is necessary for providing a financially stable and dependable program of high-quality medical care for current and future beneficiaries. Reform is also necessary for helping to relieve current and future taxpayers, particularly younger working families, of the continually mounting burden of federal entitlement deficits and debt. A failure to enact rational reforms in a timely fashion will likely result in the imposition of ever-more severe Medicare payment reductions, jeopardizing beneficiaries' access to high-quality care, or even heavier taxation on working families, or an undesirable combination of both. To sustain the program for current and future Medicare beneficiaries, lawmakers must act, the sooner the better, to preserve and improve the program for current and future generations.

Medicaid—the program traditionally serving poor women and children, and the elderly and disabled—has expanded significantly due to Obamacare's creation of a new class of beneficiaries. Costs of the Medicaid program, combined with Obamacare spending, also continue to skyrocket. Combined federal and state Medicaid spending is expected to reach $1 trillion by 2027, and Obamacare spending is expected to reach $200 billion by 2029.[38]

To address these issues, Congress should:

- **Simplify traditional Medicare** to unify Medicare's hospital and physician programs, streamline cost sharing, and add a catastrophic benefit.

- **Establish "site neutrality" in Medicare payment.** Under current law, Medicare reimburses medical services delivered by hospitals at a higher rate than the Medicare rates paid to physicians and clinics providing the very same services outside the hospital setting. By establishing the same payment rate for medical services, regardless of the site of delivery, including payment for post-acute care and hospice, taxpayers would secure major savings. Such a reform would not only provide Medicare beneficiaries with a broader range of care options, it would also create a more level playing field for competition between hospital and non-hospital care-delivery systems.[39]

- **Update Medicare premiums by gradually increasing them from 25 percent to 35 percent over 10 years.** This gradual increase would allow all beneficiaries to benefit from Medicare's enhanced solvency and improved financial condition.

- **Reduce taxpayer subsidies for wealthy Medicare recipients** to relieve cost pressure on taxpayers and slightly reduce the overall Part B and Part D premium costs for middle-income beneficiaries.

- **Harmonize Medicare's and Social Security's ages of eligibility and then index the eligibility age for both programs to life expectancy.** This is a commonsense reform, given the significant increase in life expectancies and work capacity, and would reduce the negative impact of current government policies that encourage older Americans to end their productive careers earlier than they otherwise would.

- **Base Medicare Advantage (Part C) payments on straight market competition** instead of the current cumbersome combination of competitive bidding and Medicare's administrative pricing.

- **Transform the entire Medicare program into a defined contribution ("premium support") system** to create competition between traditional Medicare and a wide range of private health plans, including employer-sponsored plans and health savings accounts.

- **Replace the Medicaid program's open-ended federal financing with more predictable and accountable budgeting** based on core eligibility groups and the administrative flexibility to target those resources more effectively. Short of a full restructuring, the termination of Obamacare's enhanced federal funding for the law's Medicaid expansion would stop the inequitable treatment of Medicaid enrollees by removing the financial incentive for the states to divert taxpayers' resources from the traditional enrollees to the newly eligible enrollees.

- **Repeal the Obamacare federal-entitlement-financing structure and replace it with a formula grant to the states** with new flexibility for the states and consumers. The proposal would repeal the mandatory federal insurance subsidies and the Medicaid expansion and replace them with discretionary formula grants. In addition, the proposal would extend new regulatory flexibility to the states and guarantee individuals the option to choose a private health care arrangement of their choice.

Reforming Social Security. Social Security has drifted far from its original purpose of preventing poverty in old age to being many Americans' primary source of retirement income. In large part, that is because the program's growth, from 2 percent of workers' paychecks at its inception to over 12 percent today, makes it hard for individuals—particularly lower-income workers—to save on their own. Moreover, because Social Security is already running cash-flow deficits and every dollar collected in taxes goes to pay current benefits, the program strips workers of the chance to earn a positive return over time. Moreover, the disability insurance program's structural flaws and inefficiencies, work disincentives, and widespread fraud and misuse prevent the program from effectively serving the needs of individuals with disabilities.

The 2020 *Blueprint for Balance* contains recommended reforms to the Social Security Old-Age and Survivors Insurance (OASI) and Disability Insurance programs that would save a projected $972 billion over 10 years, while also making the programs solvent over the long term and reducing the payroll tax rate.

For the OASI program, Congress should:

- **Increase Social Security's retirement age and index it to life expectancy** so that Social Security's eligibility age would automatically adjust to reflect individuals' longer life spans and additional work capacity.

- **Shift toward a flat antipoverty benefit** so that the program could better align its resources with individuals' needs and help to prevent more elderly people from living in poverty.

- **Modernize the program's spousal benefit** to account for the fact that most women earn Social Security benefits based on their own work history.

- **Use the chained consumer price index (CPI) for Social Security's benefit calculations** to provide a more accurate adjustment for inflation.

- For the Social Security Disability Insurance (SSDI) program, Congress should:

- **Implement a flat antipoverty benefit** to achieve the program's goals of preventing poverty and directing resources to those with the greatest need.

- **Provide a need-based benefit period** consistent with the program's expectation that individuals return to work if they recover.

- **Eliminate the grid factors that improperly allow up to half of all individuals who receive disability insurance benefits to do so based on non-medical factors**, such as age, education, and work experience.

- **Provide an optional private disability insurance component through a partial payroll tax credit** to provide workers with a more timely and efficient determination process as well as significantly greater employment support services.

- **End direct payment to SSDI representatives so that individuals have control of their own money** and representatives do not have an incentive to work against their clients' interests by delaying decisions.

- **Improve program integrity policies, such as allowing social media to be used in eligibility determinations,** applying the judicial code of conduct to administrative law judges (ALJs), conducting reviews of outlier judges, and strengthening clinical data repositories (CDRs), including eliminating the Medical Improvement Review standard in CDRs.

- **Improve program efficiency through such policies as eliminating the reconsideration stage,** updating the official list of jobs available in the national economy, and reducing target caseloads for ALJs.

- **Correct unintended benefit payments by ending double-dipping into both SSDI and unemployment insurance benefits,** limiting retroactive benefits to six months, and including unearned income in the measure of substantial gainful activity.

With each delay in addressing rising entitlement program shortfalls, the more expensive it becomes to resolve programmatic deficits. Entitlement costs grow every day and the COVID-19 health pandemic will significantly exacerbate the insolvency of Social Security and Medicare. The longer lawmakers wait to enact reforms, the more costly those changes will need to be. The sooner lawmakers adopt entitlement reforms, the lower the costs on each individual and family will be as unfunded liabilities are reduced for younger and future generations.

Reforming the Federal Safety Net. The federal safety net includes 89 different means-tested programs at a cost of over $1.1 trillion a year, spanning numerous federal agencies, that provide cash, food, housing, medical care, and social services to poor and low-income Americans. America's federal welfare system includes programs such as public housing and food stamps, and direct cash benefits through the earned-income tax credit and the Temporary Assistance for Needy Families (TANF).[40]

As Heritage Foundation Visiting Fellow Leslie Ford notes,

> Federal leaders confronted with a global pandemic used the federal safety net as tool to support Americans suddenly thrust into an economic downturn. The federal safety net was temporarily bolstered to include unprecedented unemployment cash benefits, expanded Medicaid eligibility, and increased food stamp benefits. With these safety-net programs, many Americans were able to weather the temporarily closed economy without which many would have been unable to afford basic necessities.

While the first stage of the coronavirus response was arguably necessary for controlling the initial spread of the virus and minimizing the economic consequences of the shutdowns, in the next stage, policymakers will have to balance contending with an ongoing pandemic with supporting an economic recovery. Policymakers must ensure that these safety-net programs—particularly for health care—continue to be available for those who truly need them, while ensuring that they do not become a way of life after the economic recovery. As states begin to re-open the doors of businesses, schools, and society in general, the focus of federal leaders must be on supporting the economic recovery and avoiding policies that could have harmful long-term consequences for workers and society.[41]

From a fiscal perspective, it is important to ensure that safety-net programs continue to be available. When this crisis passes and the economy recovers, Congress should focus on long-term reforms to improve the safety net and better serve Americans who rely on it.[42] Congress should:

- **Return financial responsibility for housing programs for non-elderly, non-disabled recipients to the states.** The federal government currently pays over 90 percent of the cost of subsidized housing for poor and low-income persons. Housing needs, availability, and costs vary significantly across states and localities, as does the level of needed and available assistance. Instead of merely perpetuating federally funded programs that often provide substantial benefits for some while leaving others in similar circumstances with nothing, the federal government should begin to transfer responsibility for the administration and costs of low-income housing programs to the states, which are better equipped to assess and meet the needs of their unique populations. The fiscal responsibility of paying for their housing programs would give states the incentive to run these programs much more efficiently and effectively.

Federal funding for means-tested housing programs should be phased out at a rate of 10 percent per year, reaching zero funding at the end of a decade. Each state should be allowed to determine how, and to what extent, it replaces federal housing programs with alternative programs designed and funded by state and local authorities.

- **Eliminate the "heat and eat" loophole in the food stamp program.** Using a loophole known as "heat and eat," states can artificially boost a household's food stamp benefit. The amount of food stamps a household receives is based on its "countable" income (income minus certain deductions). Households that receive benefits from the Low-Income Heat and Energy Assistance Program (LIHEAP) are eligible for a larger utility deduction. In order to make households eligible for the higher deduction, and thus for greater food stamp benefits, states have distributed LIHEAP checks for amounts as small as $1 to food stamp recipients.

  Although the 2014 farm bill tightened this loophole by requiring that a household must receive more than $20 annually in LIHEAP payments in order to be eligible for the larger utility deduction and subsequently higher food stamp benefits, some states have continued to use it by simply paying more than $20 per year.

  At the end of 2019, the U.S. Department of Agriculture (USDA) proposed a rule that would revise Supplemental Nutrition Assistance Program (SNAP) regulations to standardize the methodology for calculating standard utility allowances.[43] Policymakers should finalize this rule and eliminate this loophole.

- **Eliminate Supplemental Security Income (SSI) Benefits for Children.** The original intent of SSI was to provide cash assistance to adults who are unable to support themselves because of a disability and to the low-income elderly. But SSI has also long provided cash assistance to low-income households with children who are functionally disabled. Today, about 15 percent of SSI recipients are children. SSI should be reformed to serve its originally intended population by ending benefits for children.

  Low-income parents with a disabled child are eligible for cash assistance from the TANF program, as well as for benefits from other means-tested welfare programs, such as Medicaid and food stamps. Any medical expenses arising from a child's disability that are not covered by another program, such as Medicaid, should be provided by SSI.

- **Require counting of income from non-citizens, who are ineligible, when calculating food stamp benefits.** Food stamp benefits are based on a household's "countable" income. The lower a household's countable income, the higher its eligible benefits. Although USDA guidance says that "all of the ineligible non-citizens' resources are countable for SNAP purposes," not all states actually count these resources.

  There is no reason why the income of a household member should not be counted when it comes to determining food stamp eligibility for the household, even if that member is ineligible for food stamps himself. Although food stamps are ostensibly limited to eligible recipients, they are used to purchase food for the entire household. Therefore, policymakers should require that the income of non-citizens be counted when determining household eligibility.

- **Eliminate funding for the Low-Income Home Energy Assistance Program.** LIHEAP is one of several welfare block grants created in the 1980s. Despite over $120 billion in inflation-adjusted spending, LIHEAP has never served as a vehicle of reform. States and localities are better positioned to address the needs of their target populations that are not already addressed by other federal means-tested programs. In fact, state policy changes in recent decades have rendered LIHEAP unnecessary. Additionally, endemic fraud and abuse undermine the program's integrity. Policymakers should end LIHEAP, devolve responsibility for its goals back to the states, and restore real federalism to the welfare system.

- **Eliminate funding for the Social Services Block Grant (SSBG).** The SSBG is one of several welfare block grants created in the 1980s. Despite more than $180 billion in inflation-adjusted spending, the SSBG has never served as a vehicle of reform. The services offered through the SSBG are ineffective because they are duplicative, poorly targeted, and not funded on the basis of measured performance outcomes. States and localities are better positioned to address the needs of their target populations that are not already addressed by other federal means-tested programs. Policymakers should end the SSBG, devolve responsibility for its goals back to the states, and restore real federalism to the welfare system.

- **Eliminate funding for the Community Services Block Grant (CSBG).** The CSBG is one of several welfare block grants created in the 1980s. Despite more than $25 billion in inflation-adjusted spending, the CSBG has never served as a vehicle of reform. CSBG funds are poorly targeted and not directly linked to measured performance outcomes. States and localities are better positioned to address the needs of their target populations that are not already addressed by other federal means-tested programs. Policymakers should end the CSBG, devolve responsibility for its goals back to the states, and restore real federalism to the welfare system.

- **Eliminate the Community Development Block Grant (CDBG).** In the 1980s, President Ronald Reagan created the CDBG along with several other welfare block grants. Operated by U.S. Department of Housing and Urban Development, the CDBG was intended to provide housing assistance for low-income families, but its funds have often been funneled to high-income communities and to wasteful pork-barrel projects. Despite nearly $200 billion in inflation-adjusted spending, there is little measurable evidence that this program works as intended. Policymakers should therefore end federal funding for the CDBG.

Fiscal Reforms to Reduce Spending and Achieve Sustainability

As a result of the COVID-19 pandemic, America's fiscal state has worsened significantly in a short period of time. The sudden surge in spending, decline in revenues, and the resulting increases in the annual federal budget deficit and national debt should compel Congress to better prepare for the next national emergency. One critical step in that preparation should be to put the federal government's fiscal house in order.

To achieve fiscal sustainability, Congress and President Donald Trump should work together to implement reforms of the entitlement programs driving the majority of spending growth, particularly health care programs; prioritize federal spending on enumerated constitutional responsibilities; adopt and enforce an accountable and responsible budget process; return to the Founding Fathers' view of federalism; eliminate corporate welfare and wasteful and duplicative programs; and create an independent commission to develop a comprehensive government re-organization plan.

If Congress continues to ignore budget problems and fails to act, current and future generations will be left with a far more uncertain (and likely worse) economic future than previous generations enjoyed. The future opportunity and prosperity of the American people are at stake.

Reforming Entitlement Programs. Spending on Social Security, Medicare, Medicaid, and other health care programs is driving the federal budget to the edge of a cliff. There is no revenue-generating system in the world that would, in the long run, be able to finance entitlement programs that are by their design growing faster than the economy.

Pre-COVID-19, the CBO projected that by the end of the next decade, federal health care spending, Social Security, and interest payments on the national debt will consume 76 percent of all revenues.[44] The expansion of health care spending has expanded, and will almost certainly continue to expand, beyond CBO projections in the short term. Absent reforms, Congress might be forced to implement massive tax increases to fund other federal priorities, such as national defense.

It will be impossible for America to return to a sustainable spending and debt path without addressing entitlement spending. Lawmakers should reform entitlement programs to be more affordable and fiscally sustainable while better meeting the needs of the American public by returning control over health and retirement decisions to the people.[45] This *Special Report* provides a comprehensive list of key reforms under "The Fiscal State of the Nation" section above.

Prioritizing Spending on the Set of Functions Enumerated in the Constitution. Congress should cede most spending on highway, education, justice, and other domestic programs to private entities and state and local governments, which are best able to manage such activities effectively and efficiently. Effective management requires having the freedom to target local programs to specific local needs and to serve those who need these services most.

Government control of business activities crowds out private-sector funding and innovation and increases the likelihood that shielded entities will take unnecessary risks. After promising a healthy return on investment, government-owned and government-subsidized businesses are frequently in the red, calling on taxpayers to bail them out repeatedly by way of more deficit spending.

Any federal government function that can easily be provided by state and local jurisdictions or businesses should be devolved to those governments or the private sector, respectively, saving federal taxpayer money and providing Americans with better, more responsive, and more innovative services. A government that does too many things that are outside its proper scope will ultimately fail at providing the essential services for which it is squarely responsible.

Adopting and Enforcing an Accountable, Responsible, and Transparent Budget Process. The Congressional Budget Act of 1974 requires Congress to adopt a concurrent budget resolution by April 15 of each year. Meeting that deadline is a crucial step in the budget process because it enables the House and Senate Appropriations Committees to begin drafting the federal government's annual spending bills.

Congress often fails to pass a budget before April 15, if it passes a budget resolution at all. Since 1975, Congress has only approved a budget resolution by the statutory deadline six times. Over the past decade, only three budget resolutions have been adopted, and those resolutions served more as vehicles for other legislation rather than as governing documents. No budget resolution has been brought to the House or Senate floor for debate since 2017.[46]

Missing the budget resolution deadline puts the appropriations process behind as well, leading to the likelihood that continuing resolutions and massive omnibus spending bills will be needed to fund the government beyond September 30 of each fiscal year. FY 2020 was the 23rd consecutive year that a continuing resolution has been in place for at least part of the federal government. Congress has not completed all of its appropriations work before the start of a new fiscal year since the mid-1990s.[47]

Congress has no will and little incentive to follow the budget process. The rules intended to keep the process running smoothly are weak and all but ignored by both parties.[48]

Creating a better functioning budget process cannot resolve every issue, nor can the budget process adequately determine how the overall fiscal choices fit within the larger economic policy goals of the country. Fiscal targets should be established up front and debated in a similar manner to other policy. Congress and the Administration already have a general process in place to conduct such an exercise through the annual preparation and consideration of the *Economic Report of the President*. Once transparently established, that economic policy can be used to inform the development of the fiscal policy reflected in the budget documents.[49]

Returning to True Federalism. A highly centralized government is a poor fit for a country as large and diverse as America. Federalism should allow 50 different models of governance suited to the needs of the nation's individual states. Within the confines of the Constitution, states should be free to enact policies that best serve the needs of their citizens. Properly understood, federalism serves not the states, but the American people who reside in the states. It also fosters competition among the states, creating incentives for them to enact policies that retain and attract residents and businesses.

To revive true federalism, Congress should focus on its core constitutional responsibilities. Laws that go beyond the federal government's enumerated powers and pre-empt state authority should be repealed. Congress should leave to the states any program that does not carry out a constitutional function of the federal government or that otherwise ought to be handled at the state level. As a general principle, the government closest to a problem should be the one addressing it.

Short of doing that, Congress should focus on reforming how it disburses federal dollars to the states in order to serve the American people more effectively. What this means will vary case by case. In certain areas, such as transportation, Congress should give the states much more latitude in spending the federal dollars they receive than it now does. In other areas, like means-tested welfare or public housing, Congress should ensure that federal dollars do not undermine work, family, or community. As long as Congress is funding these programs, it is appropriate that it take steps to curb dependence on them (for example, through work requirements). The ultimate goal, of course, remains to have the state governments not only operate public assistance programs, but also pay for them with state revenues.

Eliminating Corporate Welfare Programs. Over the years, Congress has implemented numerous policies to subsidize the production or consumption of one energy source over another, including through direct cash grants, special tax treatment, taxpayer-backed loans and loan guarantees, socialized risk through insurance programs, and mandates to produce biofuels, tariffs, and energy sales at below-market costs. Whichever shape such favoritism takes, the results are always the same: The government delivers benefits to a small, select group and spreads the costs among families and businesses. Government handouts take choices away from consumers and distort the flow of investments.

The government's picking of winners and losers does more harm to energy innovation than good. Instead of relying on a process that rewards competition, taxpayer subsidies prevent a company from innovating to make a technology cost competitive. Subsidies also promote dependence on preferential treatment from the government and encourage programs that are meant to last only a few years to become permanent fixtures because of the special interests that benefit from them. Congress should eliminate preferential treatment for every energy source and technology and let competition and consumer choice drive energy innovation forward.

Eliminating Waste, Fraud, and Duplication in the Federal Budget. Given that federal spending has ballooned to more than $4 trillion annually, there is undoubtedly a great deal of waste, duplication, and inefficiency in the federal budget. If Congress were to follow the budget process and perform its essential oversight function, it would go a long way toward eliminating wasteful spending.

In order to allow Congress to conduct proper oversight, however, the overall size of the government must be reduced. The government has simply grown too big for Members of Congress to keep pace with their oversight responsibilities. Case in point: The federal government has grown so large that it is unclear how many individual programs exist.[50]

The Government Accountability Office (GAO) releases an annual report detailing duplication among federal government agencies, along with recommendations on how to fix the problem. Congressional oversight can tie agency funding to improvements in the management of taxpayer resources. Other GAO-identified actions require congressional authorization, such as preventing individuals from double-dipping into unemployment and disability benefits.[51] From 2011 to 2018, just over half of the GAO's recommendations to Congress were implemented, saving the federal government $216 billion so far. Adopting new and existing GAO recommendations could save taxpayers hundreds of billions of dollars more.[52]

> The federal government has grown so large that it is unclear how many individual programs exist.

Moreover, reducing improper payments through better oversight and management could save additional billions every year. The federal government wasted an estimated $175 billion in 2019 alone by making improper payments. Improper payments include actions such as sending checks to people who should not receive them or who lack proper documentation, overpaying for medical equipment or paying for goods and services that were never delivered, as well as paying benefits to dead people.[53] The bulk of improper payments happens in federal health care programs, where government intervention has grown rapidly.

Eliminating waste, fraud, and abuse, as well as inefficient federal programs, will streamline the federal government and save billions of taxpayer dollars each year.

Implementing an Independent Commission to Produce a Plan for Re-organizing the Federal Government and Giving the Commission's Recommendations an Easy Path to Enactment. Building on the GAO's recommendation, Congress should create an independent commission tasked with developing plans to re-organize the federal government to reduce overlap and fragmentation.[54] Presidents of both parties have introduced such plans in the past, including President Trump, who released the "Delivering Government Solutions in the 21st Century" plan in 2018.[55]

The newly developed commission's mission would be to draw up a comprehensive proposal for re-organizing the federal government in ways that would cut waste and duplication, establish logical lines of jurisdiction, limit the government's role to its constitutional responsibilities, achieve long-term savings for taxpayers, and streamline the bureaucracy.

The plan agreed to by the commission would then receive special consideration before Congress, moving to each chamber with an up-or-down vote and without amendments being offered. Rather that potentially getting bogged down over individual provisions, it would be up to Congress to decide only whether the package overall will make for a better, more efficient government than what exists now.

A similar commission-style approach, the military's Base Realignment Closure, has been successfully used in closing outdated and unnecessary military facilities and consolidating operations for improved efficiency.[56]

By extending this method to all levels of the federal government, Congress could reduce spending, refocus government on its core responsibilities, and create a more efficient and accountable federal bureaucracy.

By adopting these and other fiscal reforms Congress and the Administration can achieve budget sustainability, which is conducive to preserving individual liberty, economic freedom, and a strong civil society in the United States.

Restructuring and Refocusing Federal Pandemic Preparedness

The federal government's response to the COVID-19 pandemic was slow, sometimes inept, and often ineffectual. Despite years of pandemic preparedness exercises, multiple lines of authority within and across agencies, and tens of billions of dollars in funding, the federal response to COVID-19 fell short.

The New York Times captured the failures of one of the leading federal public health agencies, the Centers for Disease Control and Prevention (CDC), in a single headline: "The CDC Waited Its Entire Existence for This Moment. What Went Wrong?"[57] The article chronicles how the agency impeded the availability of tests early in the pandemic, operated an antiquated data system that left the agency and others fighting the disease with blind spots, was encumbered by a sclerotic bureaucratic culture that hampered innovation and adaptation to new information, clashed politically with the White House, and issued confusing guidance to doctors, nurses, and state and local public health officials.[58]

The CDC was not alone in its failures. The Assistant Secretary for Preparedness and Response (ASPR), a position created by Congress in 2006 to coordinate federal efforts to combat infectious disease outbreaks, also failed to provide needed direction. The Food and Drug Administration (FDA) shared in the CDC's early stumbles on COVID-19 testing.[59]

These problems derive in part from the fact that the responsibility for the federal response to pandemics is scattered among several agencies, with a multiplicity of funding sources and lines of authority.

The Heritage Foundation's National Coronavirus Recovery Commission described this chaotic arrangement:

> Over the past two decades, Congress has significantly increased the amount of funding that is available for federal, local and international public health emergencies. Both the CDC and NIH [National Institutes of Health] budgets have more than doubled in nominal values since 2000, while holding fairly steady as a share of the economy. A significant amount of funding has also moved to emergency preparedness, including support for laboratories to test known and novel diseases. This also includes support for local public health departments through the Public Health Emergency Preparedness program (PHEP), which provides resources for both identifying and establishing surveillance systems for infectious diseases.

> In addition, Congress has consistently funded a number of other programs that were intended to improve the response to any public health situation, including pandemics. ...
>
> This demonstrates the political tendency to address crises by building additional government programs on top of the infrastructure that already exists without first evaluating what is working and what is not.[60]

Preparing for future public health emergencies requires that the country learn lessons from its response to the present pandemic. That requires government to evaluate the use of resources, prioritize funding, and revise the regulatory environment. It also entails the recognition of the nature and limits of the federal role, the constitutional authority of state and local officials, and the indispensable role played by the private sector in combating future pandemics.

A Top-Down Assessment of Federal Actions During the Pandemic. The National Coronavirus Recovery Commission drew a useful distinction between *protecting* public health and *promoting* public health.[61] The former focuses on controlling the spread of infectious diseases, while the latter has more to do with public education on reducing risks of diseases with behavioral components (such as diabetes, heart disease, and obesity). Over time, the mission of the CDC in particular has blurred this distinction, with increasing resources devoted to nutritional education and discouraging smoking and other risky behaviors. That compromised the agency's ability to carry out its core mission in response to the pandemic. A top-down assessment would identify areas of success, failure, and weakness and result in an after-action report that refocuses the agencies on more effective pandemic response. Among changes that Congress should consider are:

- **Realignment and re-organization of agency responsibilities with the Department of Health and Human Services (HHS).** The roles of various agencies and Secretaries with stakes in pandemic response—the CDC, the FDA, the NIH, the ASPR, and the Assistant Secretary of HHS—should be more precisely delineated to assure the most efficient response to future pandemics.

- **Return of the CDC to its core mission.** The assessment should determine whether the CDC needs to be more focused on core functions required for dealing with a pandemic, leaving other public-health-related activities to other entities within the HHS.

- **Re-evaluation of the role of the ASPR.** Established by Congress to coordinate the federal response to pandemics, the ASPR was hampered by the diffusion of responsibilities across several federal agencies. The Administration should consider expanding the ASPR's role to include oversight over other agencies.

- **Better coordination within the federal government.** There are hundreds of different budget accounts for biopreparedness, with the HHS, the Department of Homeland Security (DHS), and the Pentagon all having congressionally funded programs.[62] This creates redundancies and gaps that do not become obvious until a crisis occurs. The Administration should put together a plan to better consolidate and coordinate these various funding streams and, where appropriate, ask Congress to streamline them. As a start, the Office of Management and Budget (OMB) should produce a budget exhibit that shows these various accounts.

- **Decision on whether a national stockpile is appropriate.** The national stockpile proved to be of dubious value during the pandemic. Despite grave concerns early on about the shortage of ventilators and the decision to have a U.S. manufacturer produce a supply of them for the stockpile, the President's Council of Economic Advisers found that the existing supply of ventilators was sufficient to meet medical demand and that the stockpiled ventilators were likely unnecessary.[63] If the Administration concludes that the federal government should maintain a national stockpile, it should develop metrics for determining adequate supply and include provisions for releasing medical supplies before their expiration.

- **Better coordination with state and local authorities.** The Constitution limits the federal government's role, while vesting extensive police powers in state and local authorities.[64] An assessment of the COVID-19 response should include recommendations for better coordination among the various levels of government.

- **Regular table-top pandemic exercises coordinated by the White House.** The President, Vice President, or a surrogate should conduct these exercises regularly and should include federal, state, and local government participants. Such exercises can help to identify gaps, redundancies, and areas of poor coordination and can help in the formulation of a pandemic response plan that has the buy-in of all the major players.

- **Improved data collection and dissemination.** The CDC data collection system is antiquated and unreliable. Federal, state, and local officials did not have access to the real-time data necessary to optimize their response to the pandemic. Data was sporadic in such critical areas as hospitalization, mortality, excess deaths, age, and comorbidities (and the overlap between these categories), nursing home residence, total active cases, and the identification of existing and emerging hotspots. A revamped public health data collection system must collect in real time to the extent possible, and by electronic form (not by fax, as in much of the current system). That may require the development of standardized forms. To the extent it does, the government should rely on the private sector to establish the standards, rather than centrally devising such a system.

An Executive Order Tasking Cabinet Officials with Developing Recommendations for Pandemic Preparedness.[65] Cabinet officials should undertake:

- A joint HHS–State Department assessment on the adequacy of international disease surveillance and the factors that led to the World Health Organization's inadequate response to the pandemic.

- A joint HHS–DHS examination and revision of Federal Emergency Management Agency (FEMA) resources for quicker and more adaptable pandemic response.

- A joint HHS–Director of National Intelligence assessment of the intelligence agencies' capacity to provide the necessary early warning of emerging infectious diseases.

- A joint HHS–Pentagon report on the appropriate role of the Defense Department and National Guard in responding to pandemics.

Budgeting for the Next Emergency Before It Strikes

The next federal budget must ensure that the nation is prepared to respond to the next emergency.

The U.S. Congress and the President were unprepared, both operationally and financially, to respond to the demands that a large-scale public health pandemic—of the scope and scale of COVID-19—requires. They were unprepared because lawmakers failed to prioritize essential national functions to ensure that federal government agencies are able to meet the most pressing public needs, including responding effectively to a public health crisis of global proportion and practicing sustainable fiscal management during economically good times in order to build up resource reserves on which to draw during a crisis.

Even if the federal government had been better prepared, wide-scale intervention would most likely still have been required. No government could have fully prepared for a crisis of the magnitude of COVID-19. However, by better prioritizing public health and other health care spending, by building emergency reserves, and by adopting a transparent method to account and pay for emergency spending, the federal government's response would have been more effective, targeted, and fiscally responsible.

> As the country navigates ongoing challenges and recovers from the pandemic physically and financially, lawmakers must ensure that the nation is better prepared when (not if) the next disaster strikes.

Not all national emergencies are or will be on the scale of COVID-19. Every year the federal government responds to emergencies and national disasters of varying degrees, whether tornadoes, regional flooding, wildfires, or hurricanes.

Regardless of the scope, the federal government does little to prepare for any disaster or emergency, budgeting only for events with a cost of $500 million or less per occurrence.[66] Since 2012, the federal government has authorized an estimated $240 billion in non-defense disaster and emergency designated spending.[67] For disasters falling under the $500 million threshold, FEMA spent an average of $123 million in disaster relief funds on each of 101 declared disasters in 2019.[68]

As the country navigates ongoing challenges and recovers from the COVID-19 pandemic physically and financially, lawmakers must act—now—to ensure that the nation is better prepared when (not if) the next disaster or emergency strikes.

Budgeting for Recurring Disaster and Emergency Requirements Within Base Agency Budgets. FEMA is the federal government's primary response unit for natural disasters. Annual disaster response activity is funded through FEMA's disaster relief fund. By statute, the disaster relief fund can only be used to pay for disasters that cause less than $500 million in total damages. In the FY 2020 consolidated appropriations act, FEMA's disaster relief fund received a total base appropriation of $511 million, meaning that responding to one declared disaster could wipe out the fund's entire base budget.[69] The disaster relief fund is ill-equipped to respond to anything beyond minor natural disasters.

Moreover, instead of fully funding the disaster relief fund budget, Congress has relied on Budget Control Act disaster-cap adjustments to boost FEMA's spending. The cap adjustments allow lawmakers to provide monies without having to prioritize within existing budget limits by making cuts to other parts of the federal budget. In 2020, the disaster relief fund received a cap adjustment of nearly $17.4 billion above the fund's base budget.[70] Over the past five years, FEMA's disaster relief fund has received an annual average annual cap adjustment of $10.03 billion.[71]

Congress appropriated more than $10 billion in additional annual disaster funding over the past five years. Regularly recurring disaster and emergency expenditures are mostly predictable. Lawmakers know that the nation will face some level of natural disasters every year. Congress should budget for them accordingly instead of adding more deficit spending.[72]

Senators Mitt Romney (R–UT), Mike Lee (R–UT), Mike Braun (R–IN), and Pat Toomey (R–PA) introduced a bill in 2019 that would require disaster spending to be budgeted within the CBO's baseline budget projections.[73] This would serve as a good first step toward limiting the abuse of the disaster spending designation, especially in combination with broader reforms to disaster and emergency spending, such as reducing FEMA's cost share for small-scale disasters and providing a mechanism to pay for future emergency spending through emergency measures accounts.

Establishing Emergency Measures Accounts. While budgeting for emergencies and disasters ahead of time is fiscally prudent, Congress will at times be faced with sudden truly unforeseen events that require an urgent response. Establishing emergency measure accounts to account for deficit spending to respond to unforeseen, large-scale events, like the COVID-19 pandemic, allows for extra spending while confronting lawmakers with future trade-offs to limit spending to what is necessary and prudent.

Before the next national emergency hits, the federal government should have a plan in place to pay for it. Under emergency measures accounts, any time Congress passes a bill with emergency appropriations, direct spending, or revenue measures, a process would be triggered to make Congress pay for the new spending in the future. Once the emergency legislation passes, lawmakers would have two years to develop a plan to pay for the entire cost of the emergency bill, within the 10-year budget window.

The repayment plan should offset all emergency deficits within 10 years of passage of the emergency legislation, including estimated interest. If Congress is unable to agree to reforms equal to the costs of the emergency spending package, an across-the-board sequestration could be applied to all federal non-interest spending as a last resort.

Empowering State and Local Governments to Engage Actively in Disaster Response. One reason that disaster response and recovery has become so costly for the federal government is that the current system does little to encourage state and local governments to participate in disaster preparedness and response.

The growth in federal disaster relief funding is largely due to the spike in the number of federal disaster declarations, which is a direct result of changes in policy and regulation under the Stafford Act. The act shifts at least 75 percent of disaster-response costs to the federal government. This creates a cycle as states respond to increased federalization of disasters by preparing less than they should. As a result, states are less prepared for disasters, they request more federal help, perpetuating a downward cycle.

For a state to receive a 75 percent federal cost share, damages must exceed $1 million or $1.46 per capita, whichever is greater.[74] Sixteen states have a $5 million minimum threshold.[75] By becoming entangled in numerous small-scale events, FEMA is less able to respond to catastrophic events when its involvement is most critical. Prioritization and focus matter in staging an effective response.

FEMA should reduce the federal share of disaster costs to 25 percent for most declared disasters. Higher cost shares should be reserved for catastrophic events, which FEMA's National Response Framework describes as "any natural or manmade incident, including terrorism, that results in extraordinary levels of mass casualties, damage, or disruption severely affecting the population, infrastructure, environment, economy, national morale, and/or government functions."[76] By limiting disaster declarations and limiting cost sharing, FEMA will be able to put more resources and focus toward responding to catastrophic disasters, which is when federal disaster assistance is most needed.[77]

Such reform is not only good for disaster response, but also strengthens the principles of federalism. Better prepared and invested state and local governments will improve overall disaster preparedness and response. Greater state and local involvement also improves fairness. Taxpayers in states that do not have many disasters, or that do a better job preparing for them, subsidize high-disaster-risk and low-preparedness states through the current federal model.

Keeping Taxes Low to Ensure a Robust Recovery

The next federal budget must be both pro-growth and deficit conscious. A responsible budget must not hinder the critical economic recovery as the public health threat abates. It must not increase taxes and should acknowledge that now is not the time for tax cuts that do not directly aid the economic recovery. Revenues will likely remain depressed as the economy begins to recover, with incomes and payrolls remaining below their pre-crisis highs for some time. This will make balancing the budget that much more challenging.

> The next federal budget must not increase taxes and should acknowledge that now is not the time for tax cuts that do not directly aid the economic recovery.

However, a strong and sustainable economic recovery can reduce outlays and increase revenues. To facilitate a robust recovery, Congress must ensure that tax rates do not rise above their current levels by preventing impending automatic tax increases. Tax increases would raise the cost for Americans returning to work through higher and more complicated income taxes and higher taxes on the types of business investments necessary for creating new jobs and raising wages. The budget should advance pro-growth structural reforms, such as full expensing, to ensure a predictable environment for post-coronavirus investment. When individuals and businesses are uncertain about their future tax liabilities they work less and delay or cancel new purchases; low and predictable taxes allow more robust planning during the recovery.

Preventing Future Tax Increases. Significant parts of the Tax Cuts and Jobs Act (TCJA) of 2017 are temporary, forcing large tax increases on American workers and employers beginning in 2022, followed by the most significant tax increases in 2026. Congress must keep taxes low by making the 2017 tax cuts permanent, ensuring that individuals and businesses are allowed to keep more of their own earnings, which will support the economic recovery.

The TCJA reduced federal income tax rates, increased the standard deduction, doubled the child tax credit, repealed the personal and dependent exemptions, and capped the deduction for state and local taxes (SALT), among many other changes. Each of these major changes for individual taxpayers expires at the end of 2025. In 2026, taxes will automatically increase for most Americans.[78]

For businesses, the lower corporate tax rate is permanent, but the 2017 law's adjustments to cost-recovery rules are temporary and bring equally critical economic benefits, which will be especially important during the economic recovery.[79] The pre-TCJA U.S. tax system made businesses wait to deduct the cost of their investments from their taxable income. This delay between paying for an investment and being able to write off the cost against taxable income amplifies the negative effect of the corporate income tax by raising the after-tax cost of investment and thus shrinking the U.S. capital stock.

The TCJA reformed the cost-recovery system by allowing businesses to write off new short-lived investments (cost recovery periods of 20 years or less) immediately—often referred to as full or immediate expensing. The TCJA's expensing provision begins phasing down after the end of 2022, reducing 20 percentage points each year for four years. Research and development expenses will also not be eligible for full expensing starting in 2022. Additionally, the international tax system includes automatic tax increases, most of which kick in after 2025.[80]

Following the uncertainty of the coronavirus crisis, Congress must protect Americans from facing new, higher taxes, especially during the economic recovery. Uncertainty about future taxes could further delay necessary business re-openings and continued investment.

Expanding Full Expensing to Structures. Tax reform for the economic recovery should extend the benefits of full expensing to all investments, including physical structures. Structures (cost-recovery periods of 27.5 and 39 years), such as new manufacturing floor space, storefronts, and residential buildings, still must use the costly and complicated pre-TCJA system. Among other benefits, expensing for structures would remove a current disincentive that raises costs for American businesses that might be looking to repatriate foreign manufacturing and supply chains in the post-coronavirus economy.

Permanent expensing for structures can be accomplished in two different ways. First, Congress could simply allow full and immediate write-offs, similar to those available to other investments. While more straightforward, this option would move 39 years of tax deductions into the 10-year budget window, increasing the *perceived* revenue reduction of the policy. However, this timing shift means that during the years outside the budget window the Treasury will benefit from higher revenues, significantly decreasing the total revenue losses. Otherwise, Congress could create a system of neutral cost recovery, which would allow businesses to index their deductions for inflation and the time value of money, resulting in a system similar to that of full expensing.[81] Neutral cost recovery could significantly reduce the budget-window cost of expensing for structures.

Enacting Universal Savings Accounts (USAs) as Personal Rainy-Day Funds. USAs are all-purpose savings accounts, which would allow Americans to build a personal rainy-day fund to better weather the risks of a future economic downturn, health crisis, or simply save for other life priorities. USAs reduce taxes on savings for all Americans and help families build their own financial security through a single, simple, and flexible account. Individuals should be allowed to contribute at least $10,000 in post-tax earnings to their USA each year, and all withdrawals should be excluded from taxable income so that all accrued earning would be tax-free. Simple and flexible accounts allow more Americans at all income levels to save more of their earnings with fewer restrictions on where and when they can spend their own money.[82]

In future economic downturns, USAs would be particularly helpful for the lower-income workers who are often most affected by business closures and layoffs. USAs would help more Americans to build a financial cushion to weather income losses and the inevitable delays of government-provided assistance, such as with rebate checks or unemployment processing.

Ensuring Adequate Access to Offsetting Tax Losses. In years when businesses are not profitable, the tax code allows net operating losses (NOLs) or negative profits to be carried forward to future years and used to offset subsequent taxable profits. These NOLs are helpful for start-ups that might see losses in the first few years of operation, and they also function as an important safety valve for businesses that lose money in an economic downturn. NOLs simply allow taxable profits to be averaged over time, rather than assessed in arbitrary annual installments.

Under current law, businesses are generally prohibited from carrying NOLs back to previous tax years (claiming a deduction against past years' positive profits and thus receiving a current-year tax refund). For c-corporations, NOL carryforwards are limited to 80 percent of net income. For many privately owned pass-through businesses whose owners pay taxes as individuals, NOLs are limited to as little as $250,000 a year. The Coronavirus Aid, Recovery and Economic Security (CARES) Act expands access to NOLs by allowing losses from tax years 2018, 2019, and 2020 to be carried back five years and suspends the 80 percent and $250,000 limitation for tax years beginning before January 1, 2021.

Full access to NOLs should be a permanent policy. Congress should permanently remove restrictions on NOL carryforwards and allow ongoing five-year NOL carrybacks for all firms.

Rationalizing Taxation of Interest for Businesses and Individuals. The current treatment of interest in the tax code is neither uniform nor ideal. Interest costs are partially deductible for businesses, and interest income is taxable as ordinary income to the lender. Many forms of interest expenses are not deductible for the individual and can often escape taxation when distributed to international or other tax-preferred entities. If interest income is taxable, then interest expense should be deductible. If interest expense is not deductible, then interest income should not be taxable.[83]

The business interest deduction is limited to 30 percent of "earnings before interest, taxes, depreciation, and amortization" (EBITDA), a measure of profitability, through the end of 2021. In 2022, the 30 percent limitation will be based on a narrower definition of operating income, "earnings before interest and taxes" (EBIT). The CARES Act temporarily increased the 30 percent limitation to 50 percent for 2019 and 2020. Congress should allow the temporary increase to a 50 percent limitation to expire, but should not limit the business interest deduction to a narrower definition of earnings by blocking the scheduled shift from EBITDA to the more limiting EBIT.

However, Congress should consider reforming the tax treatment of interest more fundamentally by denying the deductibility of new interest expenses for all taxpayers while eliminating interest income from taxable income. Among many benefits, this shift would help to remove future tax incentives to use debt rather than equity to finance future investments, strengthening corporate balance sheets for future downturns. The reform could both increase the economic efficiency of the tax code and raise revenue to help to offset the revenue losses from making the 2017 tax cuts permanent.[84]

Repealing Distortionary Tax Subsidies. There are about $650 billion worth of narrowly targeted tax credit subsides with few economic benefits and high economic and budgetary costs that lawmakers should eliminate from the tax code. These include credits for low-income housing, green energy investment, orphan drug research, energy production, and biodiesel producers, among more than 25 others detailed in the 2020 *Blueprint for*

Balance.[85] Congress should also allow the temporary 20 percent pass-through business deduction to expire, and apply the $10,000 individual SALT deduction cap to corporate taxpayers.

Protecting American Businesses from Out-of-State Sales Taxes. Congress should protect vulnerable online retailers by codifying a physical-presence test for tax collection. In 2018, the Supreme Court of the United States overturned previous protections when it upheld a South Dakota law that requires out-of-state businesses to collect the state's sales taxes on goods sold to customers in the state, even if the business has no physical connection—or political recourse—in the customers' state.[86] Every small business that sells online now can be subject to the more than 10,000 different taxing jurisdictions around the country—each with varying rates of tax and rules about what is taxable. Getting hit by the high cost of regulatory compliance and tax assessments from unknown and out-of-state revenue collectors was threatening to bankrupt many small retailers before the COVID-19 crisis.[87] These rules are now prohibiting small distributors from retooling to ship new products during the crisis for fear of regulatory entanglement.

The recommendations above will help to set the United States up for a strong economic recovery and a successful return to responsible federal budgeting. Congress can help to ensure stable policy that is conducive to working, hiring, and investing by protecting Americans from scheduled tax increases and expanding the most pro-growth parts of the 2017 tax cuts, such as full expensing. A robust recovery, paired with appropriate spending reforms, will also help to return the budget to balance, as fewer people draw on federal benefits and more people earn taxable income in good economic times.

A Strong National Defense Enables a Stronger America

The next federal budget should continue rebuilding America's military and meeting the challenges of the National Defense Strategy (NDS). The Trump Administration brought a strong focus on restoring the military readiness that was eroded by years of underinvesting and overuse.[88] Additionally, the Administration issued a new NDS in early 2018, indicating that the main threat to national security is great-power competition, rather than terrorism.[89] Implementing the changes outlined by the NDS is not a simple or a fast task. It will take years to be fully implemented, especially against adversaries that have been consistently dedicating more resources to their military.[90] The coming budget needs to continue to support the change toward great-power competition, which has only intensified after the start of the global coronavirus pandemic.[91]

Congress should:

- **Enable Army modernization.** The Army Future Command has started a process to change how the Army modernizes its platforms and prepares for its future.[92] It is a process that will necessarily lead to some bumps and challenges, such as the current failures and reconsiderations of the Optionally Manned Fighting Vehicle (OMFV). The Army is a service that is transforming how it prepares for the future, in order to adapt to the demands of the NDS. In this regard, the "Army must remain flexible enough to deal with unforeseen challenges, including preserving hard-learned counterinsurgency capabilities."[93]

- **Increase the size of the Navy fleet.** The Navy is in the midst of a process of re-evaluating its future fleet architecture and how the Navy will support the NDS and the Marine Corps transformation.[94] However, there is little question that the country will require a bigger Navy.[95] Secretary of Defense Mark Esper even remarked that the current goal of a 355-ship Navy is likely too small.[96] Naval programs require long-term planning and it takes at least two years from the moment that Congress appropriates resources for a new ship to the time the ship starts to be built. The Navy is currently experimenting with unmanned ships that will likely be part of the fleet in the future.[97] These are important efforts that need to be supported in the budget, with a focus on shipbuilding and experimentation.

- **Enable the Marine Corps' transformation into a force able to operate within the enemy's weapons engagement zone.** The Commandant of the Marine Corps, General David Berger, has made a compelling case for adjusting the Marine Corps to be more relevant to changing operational and threat environments, specifically those in littoral regions defended by area denial systems.[98] This will also require changes to the Corps' acquisition programs. The budget needs to support these choices by allowing the service to divest from platforms like tanks, tube artillery, and bridging, while emphasizing experimentation and exercises, and capabilities that enable close-range operations, such as the F-35B. Building a Marine Corps that is "smaller, mobile, and low signature will be essential to success on future battlefields of all sorts, especially when operating within range of large numbers of enemy sensors and precision weapons."[99]

- **Support a more capable Air Force.** The budget needs to support the Air Force's plan to increase its fleet size to the "The Air Force We Need."[100] The emphasis of the budget should be on acquiring seven additional fighter squadrons, five additional bomber squadrons, and 14 additional tanker squadrons. The budget needs to accelerate the acquisition of the most modern and deployable weapons systems currently available.[101] In this regard, the Air Force's budget should "not delay acquisition of fieldable systems in the belief that revolutionary changes in the acquisition timeline can deliver game-changing technology in time to fight a peer competitor in the next 20 years."[102]

- **Transfer space assets to the Space Force from other services.** In the budget request for FY 2021, the only Department of Defense assets and personnel that were transferred to the Space Force were from the Air Force. This needs to change for FY 2022, and the Space Force needs to incorporate assets from the other military departments.[103] There are an estimated 21,200 space professionals dispersed throughout the Army and the Navy that ought to be incorporated into the Space Force.[104] The Secretary of Defense is able to reduce bureaucracy, streamline the U.S. space enterprise across the Defense Department, and give the Chief of Space Operations the ability to organize, train, and equip the preponderance of U.S. military space assets, only if all the space assets can be brought under the new service.

- **Continue to modernize the nuclear arsenal.** U.S. nuclear delivery platforms are old and need to be replaced without further delay in order to avoid gaps in the U.S. strategic deterrent as the threats to the United States become increasingly complex. The budget must fund the Ground-Based Strategic Deterrent (GBSD), the B-21 bomber, the Long-Range Standoff Weapon, and the *Columbia*-class submarine.[105] These programs have been supported by the previous two Administrations and thoroughly evaluated, and need to move forward.

- **Promote deeper integration with allies.** The strategy outlined in the 2018 NDS is unachievable if the United States acts alone in the world. This is why strengthening alliances and attracting new partners is indeed the second pillar of the NDS.[106] The budget needs to support the European Deterrence Initiative and fold it into its regular base planning.[107]

- **Implement pending defense-wide reforms.** The Department of Defense was able to alleviate some of the budgetary pressure through its defense-wide budget review.[108] In the review, based on Secretary Esper's similar efforts in the Army,[109] the department was able to save more than $5 billion and reinvest those resources in higher-priority areas. The process is planned to continue in all areas of the department, from the military services to the combatant commands and other organizations under the control of the Secretary. It is a very laudable effort to perform this type of review, and it should indeed continue.[110]

- **Avoid magical technological thinking.** The Armed Services spent years developing a series of weapons and platforms that incorporated leap-ahead, game-changing technology with little result.[111] The investment in immature technology might have had value for moving forward American science and technology, however, it did not yield much meaningful military capability. Future platforms ought to incorporate incremental improvements with mature technologies, with room for experimentation in their use and applicability. In this regard, the budget should emphasize the platforms and capabilities that are currently available and will be in the joint force for decades to come. Further, technology is not likely to change the fundamental character of warfare, in which violence is used to impose one's political will on an adversary. In this sense, the "character of warfare evolves continuously on the edges, but its fundamental nature remains true to its immutable core."[112]

- **Clarify biodefense efforts.** The National Biodefense Strategy was released in 2018 and follows a line of multiple federal government strategies since the turn of the century.[113] The implementation of those strategies has consistently been challenged by the need to harmonize more than 22 different government entities. Understanding the total amount of money that is dedicated to the effort across the federal government ought to be an important step. Congress and the OMB need to work together on better labelling the biodefense programs so that they are visible. Right now, the best estimates on how much is spent on biodefense come from academia.[114]

- **Improve budgetary data and congressional reporting.** The current defense budget is capable of answering a narrow set of questions, such as how much the Defense Department is planning on spending on F-35s in 2023, or how much the construction project at Eglin Air Force Base costs. It fails to answer common congressional questions, such as how much is allocated to deterrence in the Indo–Pacific theater, or how much is dedicated to cyber warfare.[115] While Congress mandates that the Defense Department write hundreds of different reports every year, they are of limited distribution inside Congress, even when they are unclassified.[116] Congress and the executive branch need to work together to improve the distribution of data and information flows between them. This joint effort would avoid duplication of work and would also help both branches of government to speak from the same set of ground truths.

- **Close excess bases.** The Department of Defense is carrying more than 19 percent in excess infrastructure that would be reduced through a round of base realignment and closure (BRAC).[117] The excess capacity burdens taxpayers and the department with unnecessary costs that would be better allocated elsewhere in the budget. A new round of BRAC should set a target reduction goal to reduce the infrastructure by a percentage determined by Congress. There are multiple ways in which Congress can change how a BRAC round develops to answer questions and alleviate doubts that lawmakers might have.[118] Furthermore, a new round of BRAC would serve to assess how the current infrastructure is adapted to the goals of the NDS.[119]

A Strong Defense for a Strong America. The initial time period after the coronavirus pandemic ends will provide opportunities for the United States to mold the future of the international order. For decades, the U.S. military has served as the basis for peace and prosperity in America and in the world. Future defense budgets need to build on that basis and shape it for future needs.

America Needs a Stronger Post-Crisis Budget

The COVID-19 pandemic deepened the severity of America's fiscal situation, accelerating the timeline for lawmakers, the Administration, and the public to seek structural reforms to stabilize spending and debt, prioritize essential federal functions, and prepare for future crises. The pandemic also revealed fundamental weaknesses in how Washington budgets and governs, leading up to, and during, crises that require national attention.

The pandemic and its fiscal and economic repercussions should serve as a wake-up call for lawmakers to work with the Administration to put America on a sustainable fiscal track. The most effective way to do this is by addressing spending growth in health care and other entitlement programs, the key drivers of deficits and debt, and by learning critical lessons and preparing to respond better to the next crisis. Washington should also have the concurrent goal of continuing to rebuild America's defense without impeding the economic recovery, which is best accomplished by pursuing pro-growth policies and keeping taxes low. As the nation emerges from the most severe shocks brought on by COVID-19, lawmakers must seize the moment to correct the federal government's fiscal course in order to preserve individual liberty, economic opportunity, and prosperity in America.

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