ROBERT D. REISCHAUER

1

The Dawning of a New Era

THE DEBATE OVER national priorities at the century's end is occurring in an environment markedly different from that of the past twenty years. The nation's economy is unusually strong and surprisingly resilient in the face of considerable weakness and instability abroad. Partly because of the strong economy, the overall federal budget is in surplus after almost three decades of large and intractable deficits. Projections by both the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) suggest that surpluses will continue for at least the next two decades if current tax and spending policies are not significantly changed. Furthermore, many of the issues that dominated past policy debates—such as the deficit, the cold war, and welfare—have receded or disappeared.

This new environment should promote both a reexamination of current national priorities and debate on an agenda for the nation's future. With neither major political party having a lock on the Senate, the House of Representatives, or the White House, and a presidential election without an incumbent up for reelection only months away, a full and open discussion of national priorities is needed. The dawn of a new century—which the United States enters as the world's preeminent economic, military, intellectual, and cultural power—underscores the importance of this debate.

The Economy

The performance of the U.S. economy as of the summer of 1999 is superlative in almost every way. Since the 1990–91 recession, real output has expanded at an annual rate of 3.1 percent. Rather than slowing, growth picked up as this expansion, the longest of the century during peacetime, has matured. Between the first quarter of 1997 and the second quarter of 1999, economic growth has averaged 3.9 percent. Productivity growth, which slowed markedly after 1972, has accelerated modestly during the second half of the 1990s. Just as the reasons for the earlier slowdown are not well understood even now, the causes and permanence of the recent pickup in productivity growth remain matters of debate. Increased investment in plant and equipment, improved worker training, the cumulative experience of a maturing labor force, relentless efforts of management to promote efficiency, and new computer and communications technologies are among the possible explanations for the improvement in productivity.[1]

To the envy of the rest of the world, the U.S. economy has been a job creation machine. Some 133 million Americans were employed in June 1999, up 16 million from a decade earlier. The fraction of the adult population with jobs—67 percent during the first half of 1999—was the highest of the post–World War II period. The overall unemployment rate, which has been below 4.5 percent since November 1998, is lower than at any time in three decades. African American unemployment, which was over 14 percent in 1992, had fallen to 7.3 percent in June 1999, still far higher than the white rate, but lower than it has been since separate rates were first tabulated in 1972.

With labor markets tight, the fruits of economic prosperity have begun to be shared broadly. From the mid-1970s until the mid-1990s, many types of workers—men without a college education and younger and minority workers in particular—experienced fairly steady declines in their real earnings. Women and highly educated men held their own during periods of economic slack and did modestly well when the econ-

1. A portion of the improvement is attributable to refinements that have been made in the methodology used to measure inflation. For an evaluation of the increase in productivity see Gordon (1999).

omy was strong. After the 1990–91 recession, the incomes of those at the top of the distribution began to grow rapidly. Real median family incomes began to rise after 1993 and by 1997 had surpassed, for the first time, the previous peak reached in 1989. The fraction of the population classified as poor fell from 15.1 percent in 1993 to 13.3 percent in 1997—a marked improvement, although well above the 11.1 percent low point reached in 1973.

Inflation has dropped to levels not seen on a sustained basis since the first half of the 1960s. Modest increases in hourly compensation, faster productivity growth, fiercely competitive markets awash in inexpensive imports, and improvements in the measurement of consumer prices have all helped keep inflation low. Since 1991, the consumer price index (CPI) has risen at an average annual rate of 2.8 percent and, for the two years ending in June 1999, it rose at an annual rate of under 2 percent. For all practical purposes, inflation as of mid-1999 was not a concern of consumers, workers, or businesses.

The Budget

For two successive years the unified budget—the "off-budget" accounts of social security and the U.S. Postal Service plus the government's other or "on-budget" accounts—has been in surplus. These fiscal 1998 and 1999 surpluses are the first back-to-back surpluses since 1956–57. The 1999 surplus—at over 1 percent of GDP—was the largest relative to the size of the economy since 1951. Both OMB and CBO project that, if spending and tax policies are not changed, the surpluses will grow to exceed 3 percent of GDP—more than $400 billion—by 2009. While the surpluses to date have been attributable to an excess of social security receipts over that program's expenditures, growing surpluses are projected to emerge in the rest of the budget over the next few years.

How Was the Deficit Dragon Slain?

The speed and extent to which persistent deficits have morphed into projected surpluses have left policymakers, economists, and an incredulous public scratching their heads and searching for explanations. Among the more important is a decade of sensible fiscal policy. Congress passed, and two presidents signed three major multiyear

deficit reduction packages—in October 1990, August 1993, and August 1997. When enacted, these omnibus bills were estimated to reduce deficits during the first five years after implementation by $482 billion, $433 billion, and $118 billion. The first two packages balanced tax increases with spending reductions. Tax increases made up 49 percent of the combined deficit reduction of these two packages, reductions in spending the balance.[2] The Taxpayer Relief Act of 1997 (TRA97), a component of the 1997 deficit reduction package, reduced revenues by $92 billion over the 1998–2002 period, but the Balanced Budget Act of 1997 (BBA97), another element of the package, more than offset this revenue loss with $210 billion in spending reductions.[3]

In addition to provisions affecting taxes and spending, the three deficit reduction packages erected procedural barriers to future deficit-increasing spending and tax legislation. The Budget Enforcement Act of 1990 (BEA), a component of the 1990 deficit reduction package, established caps or limits on so-called discretionary spending for fiscal years 1991–95.[4] If Congress appropriated more than these caps allowed, the law required OMB to bring spending down to the limit by proportionately reducing or "sequestering" spending authority in each discretionary account.

To impose fiscal discipline on tax and mandatory spending legislation, the BEA created the pay-as-you-go (PAYGO) mechanism. Under it, the sum of the fiscal impacts of all tax and mandatory legislation enacted since the deficit reduction package was approved could not increase the deficit for any fiscal year. If, at the start of the fiscal year, the PAYGO scorecard—as the tally sheet is called—indicated a transgression, OMB was required to offset the breach by sequestering a handful of mandatory programs according to a complex set of rules.

2. This division excludes debt service savings, which should be prorated proportionately between tax increases and spending reductions.

3. The refundable portion of the EITC and child tax credit are included in the estimate given for reduced revenues as is the revenue increase associated with the boost in cigarette taxes that was included in the BBA97.

4. The term "discretionary spending" refers to budgetary resources provided through the appropriation process. Direct, mandatory, and entitlement spending refers to activities in which the authority to commit budgetary resources is controlled by authorizing, rather than appropriation, legislation. General Accounting Office (1993).

To accommodate unforeseen developments, the BEA provided that the spending caps and PAYGO scorecard would be automatically adjusted to reflect any spending increase or revenue loss associated with legislation that both Congress and the president designated as "emergency" in nature. The 1993 and 1997 packages extended the discretionary spending caps to cover fiscal years 1996–98 and 1999–2002; rebased the PAYGO scorecard, and modified, in minor ways, the procedures governing the discretionary spending limits and the PAYGO mechanism.

The discretionary spending caps and the PAYGO restraint proved remarkably effective. Between 1990 and 1998, real (inflation adjusted) discretionary spending was reduced by 11 percent. Concerned about triggering a PAYGO sequester, lawmakers took care to offset revenue losses and increases in mandatory spending in the legislation they approved by enacting cuts in other mandatory spending programs and increases in revenues. While Congress approved "emergency" spending or tax cut legislation each year, the amounts were modest and responded to genuine exigencies such as floods, earthquakes, hurricanes, terrorism, and military and humanitarian crises like Bosnia and Kosovo. Although free to place the "emergency" designation on any spending or tax legislation, lawmakers did not significantly abuse this authority until 1999 when they confronted the unrealistically tight fiscal spending caps established by the 1997 deficit reduction package.

The strong economy is a second important reason why large budget deficits have given way to growing surpluses. The Federal Reserve deserves much praise for its deft handling of monetary policy, which has played an important role in sustaining the economic expansion. Chairman Alan Greenspan convinced financial markets early in the 1990s that the Fed would act quickly to squelch any renewed inflationary pressures. He also implied that the central bank would offset the fiscal restraint inherent in Congress's deficit reduction packages with easier monetary policy if an economic slowdown threatened, a development he considered unlikely. Having gained the confidence of financial markets and lawmakers, the Fed's actual monetary policy allowed the economy to expand well beyond the limits that the central bank, in its official statements, suggested were consistent with price stability. In

the mid-1990s, the Fed, along with most public and private sector economists, said that inflationary pressures could be expected to build if the unemployment rate fell much below 6 percent. But with inflation low and stable, the central bank allowed the expansion to continue and did not boost interest rates even though the unemployment rate fell, first below 5 percent and then below 4.5 percent.

Numerous other factors contributed to the economy's good performance. The distortions and imbalances that had characterized the economy during the late 1980s and early 1990s—for example, overbuilding in the real estate sector, weakness in the savings and loan and banking industries, sectoral adjustments caused by defense downsizing, exploding health care costs, and growing budget deficits—had worked themselves out by the mid-1990s. Low inflation created a more predictable environment for business decisionmaking. A strengthened dollar reduced import prices, which pushed U.S. companies to seek greater efficiencies. Burgeoning investment opportunities in the communications, biotechnology, and computer industries also helped to energize the economy.

It would be difficult to overstate the contribution of the strong economy to the improved budget outlook. In January 1993, CBO projected that GDP for 1999 would be $8,275 billion; by July 1999 its estimate for that year had grown to $8,964 billion. With a bit over one-quarter of increases in GDP accruing to the government as higher revenues, the $689 billion GDP improvement boosted revenues. So have unexpected changes in the composition of GDP. Corporate profits and wage and salary disbursements—two relatively highly taxed components of national income—grew over the 1990s as a fraction of GDP, rather than remaining roughly the same as most forecasters had predicted.[5] The strong economy also held down spending for such programs as unemployment insurance and welfare.

Lady Luck also contributed to the dramatic turnaround in the budget outlook. Just as virtually all unexpected developments during the

5. In January 1993, CBO projected that the growth of economic profits and wage and salary disbursements would average 5.7 and 4.8 percent, respectively, over the 1992–99 period. Its July 1999 projections estimate the growth rates of these two components over this period were 10.1 percent and 5.7 percent.

previous two decades had unfortunate fiscal repercussions, almost everything broke right from a budget perspective during the 1990s. The peaceful collapse of the Soviet empire justified significant reductions in the defense budget and made the painful consequences of defense downsizing politically acceptable. Without this downsizing, compliance with the discretionary spending caps would probably have been impossible because policymakers, in fact, showed no consistent ability to cut domestic discretionary spending. Defense spending fell 26 percent between 1990 and 1999 while discretionary spending devoted to domestic programs rose 24 percent.[6] Only in the 1996 budget—the first approved after Republicans gained control of both houses of Congress—did real spending on domestic programs fall.

The slowdown in the growth of employer health care costs, which began in the early 1990s, was a second serendipitous development with budgetary consequences. After more than two decades of double-digit increases, the growth of employers' health care costs slowed to a crawl as benefit managers energetically shifted workers into managed care plans that bargained aggressively with providers for lower fees and increased employee premiums and cost sharing. With a lag, these savings contributed to higher profits and wages, which boosted federal revenues because both are taxable while employer-paid health care premiums are not.

The concentration of the income gains among those with high incomes during the first half of the 1990s, while unfortunate from the majority's perspective, was another bit of budgetary good fortune that boosted government revenues and lowered deficits. Over the 1989 to 1995 period, 61 percent of the aggregate increase in income accrued to the richest tenth of households. Because the wealthy face higher-than-average tax rates and the 1990 and 1993 deficit reduction packages boosted those rates, the revenue gain realized by the government was greater than it would have been if the income gains had been more equally distributed.

6. Real discretionary spending for international programs fell 19 percent over the 1990–99 period. *Budget of the United States Government, Fiscal Year 2000, Historical Tables*, table 8.2.

The soaring stock market also helped lower the deficit. Equity prices rose far more than the improved outlook for corporate earnings and the reductions in inflation and interest rates could justify.[7] Whether this run-up turns out to have been a speculative bubble or a sustainable revaluation of equities, it has unexpectedly boosted tax collections. Tax payments on realized capital gains, which averaged $29 billion a year between 1990 and 1993, shot up to an estimated $78 billion a year from 1997 through 1999. Furthermore, the soaring stock market has encouraged many to exercise stock options, which during the 1990s have become an increasingly important form of compensation, particularly in the high-tech sectors of the economy. Income realized from exercising options is mostly taxed at ordinary rates, not at lower capital gains rates, providing another unexpected boon to federal revenues.

The dark clouds that have filled the economic skies of Japan, most of Europe, Korea, Southeast Asia, and much of Latin America in recent years have had a silver lining for the United States. With excess industrial capacity and weak currencies, foreign producers supplied the American market with inexpensive imports that helped hold down U.S. prices. Economic weakness abroad also depressed demand for many raw materials and basic commodities, helping to keep prices low and the Fed's inflationary concerns in check despite the U.S. boom. The price of oil, in particular, fell from $20 a barrel in 1990 to $8 in December 1998.

Finally, an unexpectedly sharp slowdown in the growth of medicare and medicaid spending has helped the budget outlook. Medicare spending grew 11.3 percent a year and medicaid outlays expanded at theannual pace of 17.1 percent between 1989 and 1995. The slowdown in private sector health care cost growth, together with legislative changes, particularly those enacted in the BBA97 reduced projections of the growth of medicare and medicaid spending to an estimated 5.2 and 6.1 percent, respectively, over the 1997–99 period. In fact, medicare spending barely rose, climbing less than 0.5 percent annually over this period. Aggressive efforts of the Health Care Financing Administra-

7. Between January 2, 1990, and July 1, 1999, the Dow Jones average rose 294 percent, the Standard and Poors 500 index by 284 percent, the Wilshire 5000 by 264 percent, and the New York Stock Exchange index by 229 percent.

tion to root out inappropriate and fraudulent charges, lower inflation, and underestimates of the severity of the BBA97 cuts may explain the sharper-than-expected slowdown. Medicaid spending growth slowed to an estimated 5.7 percent rate over the 1997–99 period. One explanation for this unanticipated slowdown is that the number of welfare recipients who are categorically eligible for medicaid has fallen more than was expected in the wake of the 1996 welfare reform act.[8] The rolls of the Temporary Assistance for Needy Families (TANF) program, which replaced Aid to Families with Dependent Children (AFDC), declined 40 percent and medicaid rolls fell by 14 percent between 1996, when the welfare bill was signed, and December 1998.

How Likely Are the Projected Surpluses?

Clearly, many factors—some attributable to policy decisions, others to luck—have transformed the gloomy budget outlook that prevailed in 1990 into the bright projections of 1999. But how realistic are these projections? Should discussions of future priorities assume that growing surpluses will be available to support new spending, tax cuts, or reductions in federal debt?

In the summer of 1999, OMB and CBO both projected that unified budget surpluses would cumulate to $2.9 trillion over the fiscal 2000–09 period if current policies were not changed (table 1-1). These projected surpluses would be significantly larger than the deficits accumulated over the 1988–97 period ($1,840 billion) but a bit less than the sum of the deficits incurred over the 1980–97 period ($3,097 billion). Just under two-thirds of the surpluses—about $1.9 trillion—projected for the next decade would be contributed by the social security program in the so called off-budget accounts. The surpluses in the balance of the budget—the on-budget accounts—would amount to about $1 trillion over the decade.

All such projections depend critically on assumptions about the performance of the future economy, the course of spending and tax legislation, and myriad noneconomic factors that affect the budget,

8. Most of those leaving the welfare rolls or not seeking welfare under the reformed system are thought to be eligible for medicaid benefits but, for a variety of reasons, do not enroll. For a discussion of this issue see Mann (1999).

Table 1-1. *Summer 1999 Budget Projections for Fiscal Years 1999–2009*
Billions of dollars

Budget review	*Fiscal year projections*			
OMB June 1999 mid-session review	1999	2000	2009	2000–09
Baseline total surplus[a]	$99	$142	$473	$2,926
On budget	–25	5	240	1,083
Off budget	124	137	233	1,843
CBO July 1999 budget update	1999	2000	2009	2000–09
Baseline total surplus[a]	$120	$161	$413	$2,896
On budget	–4	14	178	996
Off budget	125	147	235	1,901
Baseline assuming discretionary spending grows with inflation				
Total surplus	$120	$128	$274	$1,947
On budget	–4	–19	39	46
Off budget	125	147	235	1,901

Sources: OMB (1999); CBO (1999b); Crippen (1999).
a. Assumes that discretionary spending through 2002 does not exceed the caps established by the BBA97 and that after 2002 discretionary spending increases with inflation.

including such seemingly remote developments as state medicaid policy decisions and college tuition adjustments that would affect the revenue loss from the Hope and Lifetime Learning tax credits created by the TRA97.

Projecting the course of the economy two years out, let alone a decade into the future, is hazardous. Fortunately, accurate forecasts of the precise pattern of future business cycles are not essential if all one is seeking is a rough estimate of the likely budget situation over the course of a decade. If the average rates of economic growth, inflation, unemployment, and interest prove close to those assumed, the impact of the economy on the overall budget situation will be pretty much as projected.[9] In this respect, the economic assumptions used by OMB and

9. CBO estimates that after a decade (by 2009) a 0.1 percentage point lower annual rate of economic growth would reduce the projected surplus by $40 billion, a 1 percentage point higher inflation rate would increase the projected surplus by $117 billion, and a 1 percentage point higher interest rate would reduce the projected surplus by $20 billion. CBO (1999a, appendix C).

CBO seem reasonable.[10] While uncertain, they are similar to the consensus view of private sector economic forecasters. The projections of large and growing budget surpluses are, therefore, not the product of unduly rosy economic assumptions.

The same cannot be said, however, of the assumptions that the budget offices have made about the likely course of spending and tax policy. In accordance with the conventions of budget projections, the budget offices assume that tax policy and mandatory spending programs remain unchanged. This assumption is reasonable because the tax code and these programs do not have to be reauthorized periodically.

In the case of discretionary spending, which must be appropriated each year, the conventions of budget projections assume that such spending will stay within the legislated caps and will grow at the rate of inflation after the spending limits established in the BBA97 expire at the end of 2002. These assumptions are highly unrealistic. For them to be realized, Congress and the president would have to reduce real discretionary spending over the 2000–02 period by an average of 8 percent below the amount required to maintain 1999 levels of discretionary spending.[11] By 2002 spending would be almost 12 percent below the amount needed to maintain discretionary programs at their 1999 levels in the face of inflation. To maintain current real per capita discretionary spending would require 19 percent more discretionary spending in 2009 than the budget projections assume will be provided.

Faced with budget surpluses, neither Congress nor the president is likely to enforce such restraint on discretionary spending. Recent actions of lawmakers give no reason to question this judgment. Confronted by stringent discretionary spending caps for 1999, lawmakers broke the limits by designating some $21 billion as “emergency” discre-

10. Over the 1999–2009 period, CBO expects economic growth, inflation, unemployment, and interest rates to average 2.4, 2.5,5.2, and 5.5 percent, respectively. The comparable assumptions underlying the OMB projections are 2.4, 2.5, 5.1, and 5.6 percent.

11. This represents a comparison of the discretionary spending caps with the 1999 spending level, including emergency spending, adjusted for inflation. Crippen (1999).

tionary spending.[12] To be sure, real discretionary spending was reduced some 11 percent between 1990 and 1998, but as noted previously, all of this reduction was in the defense accounts. Currently, the administration and most members of Congress from both parties now support increased real defense spending. If defense spending were just maintained at the 1999 real levels, nondefense discretionary spending would have to be reduced 18 percent below 1999 levels by 2002 to comply with the spending caps.

Achieving the much less ambitious goal of holding the growth of total discretionary spending roughly to the rate of inflation would reduce from $996 billion to a mere $46 billion the cumulative surplus projected by CBO for the non-social security portion of the budget over the 2000–09 period, and unified budget surpluses over this period would shrink from $2.9 trillion to $1.9 trillion (table 1-1). Meeting even this goal will be hard enough given population growth, expectations raised by budget surpluses, spending pressures built up from a decade of fiscal restraint, and the expiration of the spending caps after 2002.

The New Fiscal Policy Goal

Whether the cumulative non-social security surpluses over the next decade are close to $1 trillion or less than $50 billion is very important for discussions about national priorities. Between January 1998 and July 1999 a profound, but little noticed, shift occurred in the focus of fiscal policy. From 1969 until the president's 1998 state of the union address, lawmakers were primarily concerned with balance—or lack thereof— in the *unified* budget.[13] Merely achieving

12. If the supplemental appropriation approved in the spring of 1999 (P.L.106-31) and the 1999 outlay effects of the emergency appropriations for 1998 (P.L. 105-174) are added to the emergency appropriations contained in P.L. 105-277, the fiscal year 1999 budget contains $34.2 billion in emergency budget authority that will result in $18.9 billion in emergency outlays. Roughly $5 billion of these totals was disaster assistance to farmers, which is normally considered a mandatory, rather than a discretionary, spending.

13. Before 1969 there were separate "administrative" and "trust fund" budgets. Congress paid most attention to the administrative budget which differed from the current unified budget in several respects, the most important being that it excluded the social security program. The unified budget concept came from recommendations presented in the *Report of the President's Commission* (1967).

balance in the unified budget seemed unattainable for most of this period.

When lawmakers enacted the 1997 deficit reduction package, they cherished the hope that it would lead to tiny overall surpluses in 2002 and 2003—$1 billion and $5 billion—and larger ones thereafter. Yet many were skeptical because they considered the deep discretionary spending cuts required by the package to be unlikely, the sharp reductions in medicare's payments to providers to be unsustainable, and the packages's accounting gimmickery to be ephemeral.

Had history unfolded as lawmakers expected, a debate would probably have begun around 2001 concerning the uses to which the projected *unified* budget surplus should be put. But the budget situation quite unexpectedly improved so much that surpluses in the *non-social security accounts* became virtually certain before 2002 if tax and spending policies were left unchanged. Faced with this new budget reality, President Bill Clinton pledged in his 1998 state of the union address to "save social security first," before agreeing to any significant tax cuts or spending increases. Republicans agreed with the need to strengthen social security and, in spring 1999, responded to the president's challenge by offering various mechanisms—so-called lock box proposals—designed to ensure that all of the surpluses generated by social security would be devoted to reducing public debt. The president then endorsed this objective in his June 1999 *Mid-Session Review of the Fiscal 2000 Budget*. The upshot is a new consensus—that fiscal policy should aim to prevent deficits in the non-social security, or *on-budget*, accounts of the government.

If this consensus holds, what happens to discretionary spending will determine how much the nation will have available for cutting taxes, reforming entitlement programs, or reducing public debt below the level that will result if social security surpluses alone are devoted to this purpose. If the very tight lid on discretionary spending assumed in the budget offices' projections were sustained, close to $1 trillion would be available over the next decade to reduce taxes, expand and strengthen social security and medicare, or pay down debt. But such a policy would require significant reductions in discretionary programs, thereby setting priorities in a particular way. If discretionary spending grows at the rate of inflation, "on-budget" surpluses will almost van-

ish. In that case, lawmakers will not be able to cut taxes or strengthen entitlement programs unless they are willing to renege on their commitment to use all of the projected social security surpluses to pay down national debt. Similarly, if aggregate discretionary spending is permitted to grow more rapidly than inflation—say to accommodate increased procurement and readiness needs in defense, to boost funding for health research, or to augment spending on transportation infrastructure—taxes will have to be raised, entitlement programs cut, or social security surpluses diverted from debt repayment.

The Issues

In short, the budget debate *is* the debate on national priorities. The strong economy and arrival of the first budget surpluses since 1969 have transformed the debate. No longer do budget deficits and what to do about them dominate policy discussions. The end of deficits has freed policymakers to address new issues and confront old problems in ways that may cost more than was considered prudent in the lean and hungry deficit years.

The strong economy has reduced the importance of perennial issues involving personal economic security. Tight labor markets have allayed workers' concerns about finding or holding a job. With real wages rising across the board, concern over growing income disparities has abated. Nonetheless, income differences remain large, and the low earnings of the unskilled keep alive the debate about how much to raise the minimum wage. Although relatively low mortgage interest rates and rising incomes have pushed homeownership rates to an all-time high, homelessness remains a significant problem.

Cold war security matters have faded from the agenda, but Russia remains a potent and dangerously unstable nuclear power. New concerns have emerged, including potential threats from North Korea, Iraq, and other rogue states; regional conflicts on the Indian subcontinent and in the Balkans; civil wars in Africa; international terrorism; and economic instability in parts of Asia and Latin America that could affect otherwise sound economies.

Some divisive problems of the 1970s and 1980s have lost salience during the 1990s. Dropping rates of violent and property crime, which

fell in 1998 to the lowest level since the government began collecting such data in 1973, has dulled the partisan and ideological edge of debates over criminal justice policy.[14] Welfare, long known as the Middle East of domestic policy, has become a back burner issue. The Personal Responsibility and Work Opportunity Act of 1996—the welfare reform legislation that replaced the Aid to Families with Dependent Children (AFDC) entitlement program with the Temporary Assistance for Needy Families (TANF) block grant program for states—resolved many of the more controversial matters, at least for a time. The unexpectedly sharp drop in the welfare rolls also helped to defuse the issue. By the end of 1998, the number of AFDC/TANF beneficiaries was down 46 percent from the 1994 peak; the number of food stamp recipients declined 33 percent over this period. In addition, the problem of teen pregnancy, which for years seemed to be unyielding, diminished modestly during the 1990s; between 1990 and 1996, the teen pregnancy rate fell by 17 percent.[15] Finally, the fiscal pressures that for many years led states and localities to beg Washington for federal assistance have eased dramatically. In fact, over the past several years, most states have boosted spending faster than inflation and cut taxes.

To be sure, hardy perennials of past debate remain at the forefront of policy discussions today. The large number of school dropouts and inadequately educated graduates remains troubling for a nation that hopes to lead the world during the twenty-first century. As a result, debate continues over the role the federal government should play in improving schools. The environment is far cleaner than it was a decade or two ago, but global warming, urban congestion, and suburban sprawl have joined pollution on the policy agenda. The number of Americans lacking health insurance continues to grow despite a slowdown in the growth of health premiums and record high employment, which is the source of insurance coverage for most people.

Free for the first time in three decades of the numbing effects of deficits, policymakers have turned their attention to several fundamental questions that will help to define the role of the public sector

14. U.S. Department of Justice (1999).

15. Alan Guttmacher Institute, "Teenage Pregnancy: Overall Trends and State-by-State Information," April 1999 (http//www.agi-usa.org [September 2, 1999]).

in the twenty-first century. Foremost among these is the question of what to do about social security and medicare, which provide income support and medical insurance for the aged and disabled. Action is essential to avoid financial insolvency during the first half of the twenty-first century when the baby boom generation retires. With surpluses projected for the non-social security accounts, a new financing option—adding general revenues to payroll taxes to support these social insurance programs—has emerged. Proposals to "privatize" these programs have also become part of the debate.

Projected surpluses have also revived tax cuts as a politically viable option. This debate is really about the appropriate size and scope of government. Federal receipts are estimated to reach 20.6 percent of GDP in 1999, the highest since the wartime year 1944 when receipts hit 20.9 percent of GDP. For some this is proof that tax burdens are too high and should be reduced. Others disagree, pointing out that the ratio is unusually high because the economy is booming, realized capital gains (which generate tax revenues but are not part of GDP) are soaring, and the nation is running surpluses for the first time in three decades, surpluses that should be used to pay down debt and strengthen the government's ability to meet the fiscal challenges it will face when the baby boom generation retires.

Chapter Summaries

While many of the problems of the previous two decades have dissolved or been reshaped by the nation's newfound prosperity, the new century holds sufficient challenges to test the imagination, creativity, and courage of American leaders to set national priorities for the year 2000 and beyond. The remaining chapters in this volume, which are summarized below, deal with some of the major issues facing policymakers and the nation at the turn of the century. These chapters lay out the dimensions of the problems and the policy options available for addressing them.

National Security and Foreign Aid

Spending on national defense is a smaller fraction of GDP—3 percent—than at any time since the outbreak of World War II. Real defense spend-

ing is about 25 percent below the average of the 1980s. Yet the annual U.S. defense budget of roughly $280 billion accounts for about one-third of global military outlays and is roughly five times larger than that of any other country. Russia and China together account for just over 10 percent of global spending, and the "rogue states" of Iran, Iraq, Libya, Cuba, and North Korea together spend less than 2 percent. However, as Michael O'Hanlon explains in chapter 2, U.S. defense spending is not necessarily excessive. The United States is the only country with major military commitments throughout the world, and its desire to prevail decisively with low casualties requires a substantial edge over potential foes.

After a decade of defense downsizing, most observers call for some increase. The debate is over how much. After a decade of small procurement budgets, the armed forces need to replace weapons and other hardware that are fast wearing out. Personnel cuts, base closures, and other economies may provide some small offsetting savings but with most of the post–cold war downsizing complete, there is little room for further savings in these areas.

While an increase in real defense spending would almost certainly be required to meet current procurement plans, that increase may not materialize if overall discretionary spending is held to the president's proposed fiscal 2000 budget or to the even more stringent congressional budget resolution for fiscal 2000. So the Pentagon may have to find ways to tighten its belt. Modest further cuts in manpower, as well as a partial restructuring of the military to help it handle the strains of frequent peacekeeping and crisis management operations, may be possible if the United States decides to maintain the capability to fight a two-war scenario less demanding than the two nearly simultaneous Desert Storm-like wars built into current plans. Furthermore, O'Hanlon suggests that the increase in procurement costs could be held down if the Pentagon refurbished existing systems or replaced them with similar equipment, rather than upgrading to far more expensive, next-generation weapon systems. In addition, the military should take advantage of the computer and electronics revolutions and purchase better munitions, communications systems, unmanned aerial vehicles, and advanced computer systems.

Like defense, the international affairs accounts have been cut deeply during the 1990s, although the end of the cold war did not measurably

reduce the requirements for diplomacy or foreign aid. O'Hanlon acknowledges that foreign aid is often wasted but notes that recent research has confirmed that aid provided to countries with sound macroeconomic policies demonstrably increases their economic growth and reduces poverty. He suggests that the U.S. aid budget should be restored to roughly 1980s levels—an increase of about $3 billion annually—and focused on countries committed to reform.

International Trade

I. M. Destler notes a paradox in U.S. trade policy. During the 1970s and 1980s, the U.S. economy was troubled by inflation and high budget deficits. Nonetheless Congress gave successive presidents power to continue to negotiate reduced tariffs and liberalized trade rules with other countries under so-called fast-track authority, which required Congress to accept or reject the negotiated agreement without amendment. In the 1990s, by contrast, the economy is extremely robust, with stable prices and high employment. Increased trade and international competition have made large contributions to current U.S. economic strength. Yet Congress has denied President Clinton fast-track authority. It is vital to the future economic health of the United States, Destler argues, that Congress restore this authority.

When President Clinton entered office, the North American Free Trade Agreement (NAFTA) and global trade liberalization under the so-called Uruguay round of the General Agreement on Tariffs and Trade had already been negotiated. He fought hard for and won congressional ratification of both agreements, although the NAFTA success came only after the United States negotiated "side agreements" on labor and environmental issues. But since then, Congress has balked at extending "fast-track authority," thereby making it impossible for the president to bargain effectively with foreign governments, which are unwilling to commit to agreements that the U.S. Congress may subsequently modify. The disagreement derives from conflict between two groups in Congress. One fears that further trade liberalization will produce undesirable side effects—such as pressure on the wages of low-skilled U.S. workers, loss of U.S. employment, or unfair competition by foreigners with low labor or environmental standards. The other is unwilling to "encumber" trade negotiations with such matters, which they see as extraneous.

Meanwhile, the U.S. merchandise trade deficit has ballooned as the U.S. economy has boomed and the economies of its major trading partners have languished. The rising trade deficit has intensified concerns about the linkages among trade, labor standards, and the environment. Destler argues that these "trade and . . ." issues are real and must be addressed to reassure concerned members of Congress that such issues will not be neglected as the nation pursues freer trade.

The continued pursuit of trade liberalization is important because the U.S. economy is enormously flexible and gains much from the specialization that trade abets. It is no coincidence that the United States is exceptionally open and exceptionally rich. Besides making Americans better off, trade negotiations are an important component of U.S. political leadership, particularly in Latin America and China. And trade policy has substantial *domestic* political importance, as it symbolizes American attitudes toward engagement in the global economy.

To break the logjam, Destler calls upon President Clinton to initiate a three-pronged national dialogue. Working groups would be established to identify the specific negotiations to be authorized; to address labor, environmental, and other trade-related issues; and to design ways to help Americans who lose from globalization. The purpose of this effort would be avowedly political. Destler believes that common ground exists for additional trade liberalization, a process that has served the nation well for nearly half a century. Immediate approval of fast-track authority would be useful, but it is not necessary. What is needed urgently, Destler believes, is political leadership to begin the dialogue that will rediscover the currently silent, free trade majority.

The Future of the Family

Despite the nation's prosperity, children are increasingly at risk of growing up in economically or socially impoverished environments, which are associated with poor educational outcomes, high crime rates, and poor life prospects. Isabel V. Sawhill reports that almost one-third of children are born out-of-wedlock. Half of all marriages end in divorce. An estimated 60 percent of all children born in the 1990s will spend some time in a single-parent family. A higher proportion of young children than in the past live in one of two types of families: those started by poor, teenaged, unwed mothers who lack a high school degree and

those headed by relatively affluent, well-educated married parents in their twenties or thirties. This bifurcation in family environments is already contributing to growing income inequality and could cast a dark shadow on the future. The increase of single-parent families has contributed importantly to the growth of child poverty and to escalating public costs for welfare, health care, social services, housing, and other forms of assistance.

Sawhill considers a variety of public policies to strengthen family ties, including changes in tax laws, benefit programs, and divorce laws; child care or other subsidies that might provide additional support to those raising children; and efforts to discourage people from having children before they are ready. She argues for reducing the marriage penalty in the earned income tax credit, for education to prepare people for marriage, for better child support enforcement, and for after school programs to reduce early childbearing.

Because full-time motherhood entails significant economic sacrifices for all but the affluent, child care subsidies can simultaneously improve the lot of single, working mothers and help vulnerable children enter school more ready to learn.

In the end, Sawhill emphasizes that government policies aimed at strengthening families are likely to have modest direct effects. But these direct effects are often amplified by the new messages such policies embody and by the tendency of even small changes in behavior to create their own momentum through a shift in cultural norms. Failure to recognize these indirect effects in the past may have made the tone of the policy debate in this area overly pessimistic about what government and nongovernment efforts can accomplish.

Income Inequality

Economic inequality has increased substantially during the past two decades. Adjusted for inflation, the average income of the one-fifth of families with the lowest incomes actually shrank between 1979 and 1997. But increased income disparities have not been driven solely by falling incomes of those at the bottom or by spectacular gains of those at the top. Rather, inequality has increased throughout the income distribution. Gary Burtless explains that this trend should concern the

nation because growing disparities threaten political and social cohesion and could harm public health.

The sources of the increase in inequality are complex and not fully understood. Burtless estimates that greater earnings disparities, particularly among men, are responsible for roughly one-third of the increased inequality. The declining prevalence of husband-wife families accounts for another one-fifth. About one-eighth is related to the increased tendency of high-earning men and high-earning women to be married to each other. One-third of the increase in inequality is related to miscellaneous factors such as the growing inequalty and importance of nonwage income and a decline in the effectiveness of government assistance for the poor.

As Burtless explains, however, these explanations are mechanical. The underlying causes of growing inequality include technological change and globalization, which have boosted the demand for and wages of skilled and educated workers, and the erosion of family bonds. Why divorce has become more common and out-of-wedlock childbearing has increased remains largely a mystery.

Policy has not stood still in the face of the growing inequality. In recent years, low-income Americans have seen their income tax liabilities reduced or eliminated, and those with earnings have received more generous rebates from the earned income tax credit (EITC). Health insurance coverage for low-income children has been greatly expanded through medicaid and the Children's Health Insurance Program (CHIP). The availability of cash welfare benefits for low-income, working-age persons who are not disabled has been reduced and benefit levels have been cut.

Burtless judges that the United States is more likely than other advanced nations to accept increased inequality. Despite our limited tolerance for public sector action in this area, he urges that more should be done. Jobs paying a wage slightly below the minimum wage should be provided to some long-term unemployed and those being forced off the welfare rolls by time limits. A basic health insurance package should be generated for all children. Since health benefits constitute a significant share of total compensation for low-wage workers in firms that provide their workers with such coverage, this policy should boost the demand for and wages of such workers.

Providing Security for the Elderly and Disabled

Over the next four decades, the U.S. population will age rapidly. The population age 62 and over will double, and that age 85 and over will more than triple. The burden on future workers, from whose production must come the consumption for elderly and nonelderly alike, will increase. The aging population will also strain public budgets, particularly those of the social security and medicare programs.

Social security, which provides pensions to some 44 million elderly and disabled individuals, is enjoying surpluses now that are projected to continue for more than two decades. But the program faces a projected long-run deficit, necessitating some significant reforms before the exhaustion of the trust fund reserves, now anticipated in 2034. The sooner steps are taken to strengthen the program, Henry J. Aaron and Robert D. Reischauer argue, the easier and less disruptive they will be.

The authors examine three broad categories of reform: replacement of the current system in whole or in part with mandatory, individually owned savings accounts modeled on Individual Retirement Accounts (IRA), over which workers would exercise a good deal of control; replacement of the current system in whole or in part with mandatory, individually owned savings accounts modeled on 401(k) accounts, over which workers would have limited control; and strengthening the current system without reliance on individual accounts. They reject the approaches that rely on individual accounts, largely because such accounts cannot ensure basic income to retirees, their spouses, and dependents—the primary purpose of social security. Individual accounts would force workers to bear risks they are poorly positioned to handle and would be expensive to administer.

Projected budget surpluses have led members of both parties to propose using general revenues to strengthen social security. Aaron and Reischauer contrast three plans: President Clinton's proposal to divert surpluses to the social security trust fund and to invest a portion of those revenues in private equities; a proposal crafted by the chairman of the Committee on Ways and Means to use surpluses to finance deposits into individual accounts; and a bipartisan congressional proposal that would use surpluses only to ease the transition to a new system with individual accounts.

Medicare, which provides health insurance for the elderly and disabled, faces projected insolvency in 2015. Although the program has been an unquestioned success, it suffers from several deficiencies. Foremost among these is the program's outdated benefit package, which does not cover outpatient prescription drugs or cap out-of-pocket expenditures.

Three broad approaches have been proposed to reform medicare. The first is to strengthen and modernize medicare by expanding the benefit package, letting market forces rather than administrative mechanisms set the prices for services other than hospitals and physician services, and restraining the growth of hospital and physician fees through traditional mechanisms. A second approach would have government contribute up to a maximum amount toward the purchase of health care from the traditional fee-for-service system or a private health plan. Competitive defined benefits or "premium support," as this approach is called, would introduce competition that its advocates hope will dampen cost growth. Finally, some would like to replace medicare by diverting payroll taxes into savings accounts for each age group. These deposits plus investment earnings would be used to buy health insurance coverage during that age group's retirement.

A majority of the Bipartisan Commission on the Future of Medicare, as well as the president in his July 1999 medicare proposal, endorsed variations on the premium support approach. Both plans would let participants choose a benefit package that covers prescription drugs. The costs of such coverage would be subsidized for many or all participants. As Aaron and Reischauer explain, the plans put forward by the president and the majority of the commission illustrate how difficult it is to both deal with the deficiencies of the current medicare program and take steps to restrain the growth of its costs. They conclude that payroll taxes will almost certainly have to be raised or general fund support increased to sustain the program.

Long-term care is an important and expensive need of many of the elderly and disabled for which medicare provides only limited assistance. Medicaid is the nation's largest single source of support for such care, but only for those with low incomes and assets. Middle-income families must deplete their resources before they are eligible for the program. Substantial inequities exist because the generosity of medicaid's

long-term care services varies significantly from state to state. The authors point out that there are no easy ways to help people pay for long-term care. The social insurance approach would be very costly, while tax subsidies to encourage people to buy long-term care insurance would likely be ineffectual.

Reischauer and Aaron conclude that failing to act soon will cause a problem that is manageable, if difficult today, to become unmanageable and divisive in the future.

Taxes

Despite seemingly endless tinkering over the years, almost everyone concurs that the tax system could be improved. Unfortunately, agreement about the nature and severity of the problems or what to do about them is elusive. After describing why federal taxes are so complex, how tax burdens are distributed, and the ways taxes affect economic growth, Henry J. Aaron, William Gale, and James Sly examine proposals for large tax cuts. They describe several arguments advocates make to justify tax cuts—that the government is taking in excess revenues, that Americans are overtaxed, that tax cuts would effectively reduce the size of government, and that cuts would promote economic growth—and show the weakness of each claim. Nonetheless Congress passed a large tax cut in the summer of 1999, which the president had neither signed nor vetoed as this book went to press. Should the bill become law, it would cut national saving and lavish large tax cuts on the wealthiest households. The authors argue that if taxes are to be cut, there are alternatives that would provide more relief to middle-income households and simplify the tax code more effectively than the proposal passed by Congress.

The chapter describes and evaluates different ways to modify the current tax system. Aaron and Gale focus on the panoply of targeted provisions that narrow and complicate the tax base, require increased rates on routine economic activities, mask true tax burdens and effective tax rates, and rarely achieve their goals. For the most part, the objectives sought through targeted provisions would be better addressed through direct expenditures, a course that would simplify and improve public understanding of the tax code. Better than adding to the menu of such special provisions—an approach that has many supporters in Congress and in the administration—would be curtailing them. For example, it

would be possible to reduce complexity directly by converting deductions to 15 percent tax credits and using the revenue to cut rates or, if taxes are to be cut, by raising the standard deduction. They list other structural simplifications that could relieve many households of the need to file a tax return.

Expansive claims have been made on behalf of various fundamental tax reform plans that would replace the current system with a flat-rate consumption tax, with no credits or deductions. Fundamental reform retains many advocates although its popularity has waned since the mid-1990s. Radical reform would be subject to the same political constraints or trade-offs that currently plague tax policy. In particular, claims that fundamental reform could simplify taxes and spur economic growth are overstated because many superficially appealing simplifications would produce untoward consequences. Curtailing deductions for mortgage interest and charitable contributions, for example, could cause declines in housing prices and charitable donations. Furthermore, complex provisions to ease the transition would be inescapable. As a result, tax rates would be higher than flat tax supporters acknowledge.

Incremental reform is less dramatic but more promising. Specific steps could ease compliance and enforcement, finance rate cuts, and promote economic growth. Because every tax reform creates losers as well as winners, selective tax reductions would help make reform politically palatable. For that reason, as well as for reasons of fiscal prudence, large tax cuts at this time would be unwise. The nation should instead husband its resources—not only to meet problems related to population aging but also to accumulate a down payment on genuine tax reform.

Education

Since the mid-1960s, federal elementary and secondary education policy has aimed to ensure equality of opportunity. It has contributed significantly to the removal of legal barriers based on race, poverty, ethnic origin, and handicap. Yet, Diane Ravitch emphasizes, student performance is quite disappointing. U.S. students lag behind those in most other countries—particularly at the secondary education level—and do not measure up to domestic standards. The performance of black and Hispanic students is particularly disappointing.

A starting point for raising educational achievement is improving the qualifications of teachers, many of whom have neither a major nor a minor in the subject they teach. The federal government should support programs to strengthen teachers' knowledge of their academic field and help states develop instruments to test teachers' subject-matter knowledge.

The governance of education is undergoing major change in response to widespread bureaucratization and poor student performance. One strategy for change is the introduction of competition and market pressures. A prime example is income-tested vouchers—scholarships that poor parents can use to pay for tuition at public or nonpublic schools. Vouchers command headlines and raise blood pressure among advocates and opponents alike. Evidence of the educational outcomes of voucher programs remains a matter of intense dispute. Meanwhile, the proliferation of charter schools is revolutionizing educational governance. Charter schools are public schools that agree to be held accountable for results in exchange for autonomy on how those results are produced, as well as waivers from most regulations other than those governing health, safety, and civil rights. They are popular, in part, because they promise to reduce bureaucratic micromanagement, trim overhead costs, and dedicate a greater proportion of funds to actual instruction. Contract management represents another modification of traditional school governance. The actual effects of each of these innovations in school governance are far from settled.

In this environment, it would be premature for the federal government to promote any one approach to school governance, but the need for experimentation and evaluation is clear. For that reason, Ravitch argues, the federal government should make sure that aid provided under such federal programs as Title I, special education, and bilingual education follow the student, thereby removing any bias in federal policy toward current school governance. The federal government should also streamline regulations that now require costly and burdensome bookkeeping by school districts to comply with federal grants for elementary and secondary education, special education, and handicapped students.

The bilingual education program has been a particular disappointment. It was intended to help students who speak a language other than

English—usually Spanish—make the transition into English language instruction. In fact, it often obstructs acquisition of fluency in English. The drop-out rate of Hispanic students is higher than that of any other major group. Ravitch argues that the federal program should be rechristened as the English-language Literacy Program and that federal grants to states and school districts should emphasize that the primary goal of the program is to help children gain proficiency in English.

Head Start is at once the most popular educational program and, in Ravitch's view, the most poignant lost opportunity. Enrollments are high and growing, and congressional support is overwhelming. The program provides important health, nutrition, social, and psychological services to poor children. But Head Start teachers are not well trained to help children gain an educational head start. Additional Head Start spending, Ravitch maintains, should go to boost teachers' salaries and improve their training rather than to increase enrollment. By setting educational standards for preschool children, the Head Start program could better fulfill the promise of its name.

The major challenge of federal elementary and secondary education policy is to operate effectively within the limitations of the federal role imposed by the fact that federal spending constitutes only 10 percent of the roughly $300 billion spent on such education. Primary responsibility for precollege education under our constitutional system resides with state and local governments. But the federal role, if limited, is nonetheless vital. The issue of testing is illustrative. The federal government cannot and should not set educational standards for hundreds of thousands of schools and tens of millions of students. But it can and should, Ravitch maintains, set achievement standards for those who receive federal financial aid to attend college. In this way, the federal government could send a clear message that "achievement counts" and bolster the efforts of parents and teachers to improve education throughout the United States.

Metropolitan America

The dominant trend in metropolitan America is rapid decentralization. Outer suburbs have attracted population and employment, leaving behind many central cities and their adjoining older suburbs. In recent years, citizens and public officials have come to recognize that these

growth patterns impose high costs—congestion, loss of open space, and school overcrowding in the newer suburbs, and poverty, fiscal distress, and lack of job growth in the older communities—and that a range of federal and state spending, tax, and regulatory policies are contributing to these patterns. Bruce Katz explores the metropolitan agenda that is emerging in reaction to these problems, an agenda the author hopes will reshape urban and suburban growth.

In some areas, new metropolitan coalitions are emerging. These coalitions are pursuing a range of policy reforms at the regional and state levels to curb sprawl and promote reinvestment in older communities. These reforms include the enactment of state growth management statutes, tax and bond initiatives to acquire open space, "smart growth" legislation to steer infrastructure funds toward older communities, pooling of metropolitan resources to promote fiscal equity between jurisdictions, and the creation of new metropolitan entities to govern issues of regional concern.

Katz argues that the federal government should support this new metropolitan agenda in several ways. It should modify existing policies that facilitate sprawl and concentrate poverty. It should instill metropolitan governance or, at a minimum, metropolitan thinking into a wide range of federal programs and policies. The administration of federal transportation, homeownership, affordable housing, and work force programs should reflect the fact that they have metropolitan effects. Finally, the federal government should investigate whether particular parts of metropolitan areas are treated fairly in the allocation of federal resources, particularly those that create wealth and leverage private sector investments.

Crime

Until the 1960s, congressional conservatives, especially those from the South who feared civil rights legislation, stymied active federal involvement in fighting crime. Then, starting in the 1960s, Congress passed not only civil rights legislation but also a lengthy series of bills to fight violent crime, improve information on crime, provide financial assistance to crime-fighting activities in states and localities, control gun sales, build prisons, and establish mandatory sentencing. The reason for this legislation was obvious—crime was on the rise, and the electorate

was frightened and angry. Today crime rates are falling, in part for demographic reasons, in part because of more stringent law enforcement, and in part because of changed social and economic conditions. John DiIulio Jr. argues that it is time for the federal government to take stock of the role it has assumed in fighting crime. Furthermore, he believes that the federal government should not extend the law enforcement initiatives it has adopted in recent years.

One clear success for federal policy has been improvement in the accuracy of crime statistics, although further improvements are possible and desirable. Crime continues to be undercounted, as it always has been. The solution, unsurprisingly, is more money and more public support for data-gathering efforts by the responsible agencies: the Bureau of Justice Statistics and the Federal Bureau of Investigation.

Perhaps the most striking developments in criminal justice in recent years have been the proliferation of prisons (both federal and state), the large increase in the number of inmates, and the increased average duration of incarceration. Contrary to the beliefs of some, violent criminals, not petty drug offenders, make up most of the increased prison population, although even now, many violent offenders never spend time in prison. Growing rates of incarceration have contributed in some measure to the fall in crime rates, for the simple reason that while in prison inmates cannot commit crimes against the general population.

However, with roughly two million people in prison, it is time to recognize that measures other than a further increase in the prison population are in order. Putting violent and habitual offenders behind bars is one thing; insisting that every convicted felon spend every sentenced minute behind bars is quite another. In particular, incarceration of drug offenders without treatment is bad social policy. DiIulio reiterates a recommendation he made in the 1992 edition of *Setting Domestic Priorities*: the federal government should mandate that all state correctional systems provide drug treatment programs similar to those offered prisoners in the federal system, and that the federal government fully pay for these programs. DiIulio also recommends that the federal sentencing grid for drug offenders be replaced by antidrug policies and advisory guidelines that restore a degree of judicial discretion to federal judges in drug cases. The federal government should also provide sup-

port for intensive, coerced, community-based abstinence programs for all probationers—state and federal—with a history of substance abuse.

DiIulio devotes particular attention to the problem of youth crime. While it has diminished in recent years, he is not sanguine about the future. The population in the crime-prone late teens will increase, and crime may also rise. "Getting tough" on juvenile offenders—that is, treating them like adult criminals—has not had a major effect on how young offenders are actually treated, in large part because no state has had the stomach to treat more than a few young people in this fashion. For now, the best federal policy, in DiIulio's view, would be to monitor juvenile crime rates and let states and localities determine how best to deal with juvenile offenders. In the end, DiIulio believes, the nation should acknowledge the ancient wisdom that chronic delinquency usually has its origins in early childhood experiences; that most juveniles who engage in frequent or serious crimes against persons and property usually come from families characterized by violence and dysfunction; that the presence of loving, responsible adults to teach children right from wrong reduces criminal propensities among youth; and that the absence of such adults makes it more likely that children who might otherwise simply be aggressive will become criminals.

The Environment

Paul R. Portney reviews the progress that has been made and the problems that remain in environmental policy thirty years after the creation of the Environmental Protection Agency (EPA) and Council on Environmental Quality and the expansion of the Clean Air Act of 1963. Without question, the quality of the ambient environment has improved. The nation's rivers, lakes, and coastal waters are cleaner now than in the past. As Portney points out, environmental policy owes its successes to broad and consistent public support for environmental protection. Nevertheless, significant problems remain, particularly in nonpoint source pollution, such as runoff from farms and city streets.

As government involvement in regulating the environment has increased, so too has the size and budget of the EPA, the United States' largest regulatory agency. But as Portney explains, most of the cost of environmental regulation is paid not by government but by those who must comply with federal rules and regulations. These costs are large,

difficult to measure, and outside fiscal restraints, but should be balanced against the considerable economic and social benefits of a cleaner environment.

Environmental policy has evolved in several directions that Portney finds promising. It has moved from prescriptive, technology-based regulation to market-oriented approaches that give polluters incentives to clean up. It has increased emphasis on environmental reporting, which has added to public information about emissions. Many businesses have reacted to the disclosure of this information by voluntarily reducing their pollution to show that they are good stewards of the environment. Finally, the EPA is increasingly sharing responsibility for environmental issues with other government departments and with state agencies. Because state regulatory capacity has increased and the nature of many environmental problems are localized, Portney suggests that a thoughtful reappraisal of "who should do what" in the environmental arena is in order.

The complex and controversial issue of global climate change is likely to be a major focus of environmental policy in the coming decades. Portney believes that it will be difficult to persuade Congress to move aggressively because of uncertainty about global warming trends and the high cost of modifying emissions that are thought to promote warming. Nevertheless, the consequences of global warming could be very serious and difficult to reverse. It is therefore urgent to narrow the uncertainty about the size of this problem and the costs of addressing it and to develop a consensus around appropriate remediation.

The Changing Shape of Government

During the past fifteen years, the federal bureaucracy has undergone the most dramatic reshaping in administrative history. Deep cuts have been made in both the civil service and defense contractor work forces. Overall, federal employment has been reduced by almost 400,000 positions. The cuts have been much deeper in the Department of Defense than in the domestic agencies. They also have been deeper at the bottom of the pyramid of government jobs than at the top.

As Paul Light explains, these cuts reflected no administrative strategy other than reducing the total headcount of the federal civil service. For the most part, the work force was downsized through attrition. No

work force planning system existed to enable those responsible for downsizing to identify jobs peripheral to the government's core missions. As a result, the cuts were not targeted on deadwood, inefficiencies, or duplicative activities. By cutting as much muscle as fat, the downsizing may well have undermined the federal government's ability to meet its future missions.

Pressures for further downsizing are likely to reappear following the 2000 presidential election, as candidates vie with one another over who can cut government most. Care is warranted to ensure that additional force reductions do not jeopardize government's ability to provide essential services and reduce even further the public's faith in the public sector.

Restructuring Government

Shortly after taking office, the Clinton administration launched a major effort to "reinvent" the federal government. The administration pledged "a government that works better and costs less." Despite cynical observations of many critics, the administration not only downsized the federal work force but also reshaped the government through tactics ranging from procurement reform to improved customer service.

But, as Donald Kettl points out, substantial work remains undone. The civil service was not reformed because the administration calculated that it stood little chance of moving such legislation through Congress. Instead, the administration concentrated on what it—and millions of federal workers—could do on their own. The result was an incremental strategy in which, according to Kettl, Vice President Al Gore took strong, consistent, and surprisingly personal leadership.

As the "reinventing government" process unfolded, the administration found itself caught in tough political battles over the size of government. While the work force was smaller, government spending continued to grow, and citizens gained little sense that government was "smaller." And while the performance of many government programs unquestionably improved, some agencies, like the Internal Revenue Service (IRS), suffered embarrassing attacks for its poor service. Despite its enormous efforts, the administration won few political kudos, according to Kettl. However, the inescapable pressure to improve the government's productivity—squeezing more services out

of less money—has made reinvention a permanent movement. Indeed, that truth frames the basic dilemma of the reinvention movement: elected officials can expect little political gain, even when progress is clear. Public perceptions may be influenced more dramatically by failures, such as the IRS's abuse of taxpayers, than by the successes, which are rarely flashy or newsworthy. At the same time, politicians have little alternative but to continue the reinvention effort.

Campaign Finance Reform

No aspect of our democracy is subject to more withering criticism than the manner in which election campaigns are financed. Yet few areas of policy seem less amenable to consensus building and legislative resolution. Thomas E. Mann describes the collapse of the comprehensive campaign finance regulation enacted in reaction to the scandals surrounding the 1972 election. By 1996 the money chase was unbridled. The author analyzes the chronic problems with money and politics—politicians' need for money, conflicts of interest, inequities in access and influence, the lack of competition, and weak enforcement—and the more critical ailments associated with soft money and election-oriented issue advocacy.

Mann critically reviews three ambitious proposals for reforming the system—full public financing, complete deregulation, and a jurisprudential alternative to the Supreme Court decision, *Buckley* v. *Valeo*, which ruled that legislated limits on campaign spending were unconstitutional. He then outlines a more incremental agenda that would adjust the current regulatory system rather than replace it. That agenda includes abolishing or strictly limiting soft money, making election-oriented issue advocacy subject to federal regulations regarding contributions and disclosure, raising contribution limits to account for the inflation since the limits were established, freeing political parties to play a more active and constructive role on behalf of their candidates, providing public subsidies to congressional candidates, improving disclosure of contributions and expenditures, and strengthening enforcement of existing laws.

Reformers face daunting political obstacles to enacting new campaign finance law: politicians' self-interest, low public salience, partisanship, potential Senate filibusters, and limits imposed by the courts.

In addition, conflicts among desirable goals produce legitimate disagreement over how best to proceed. Under these circumstances, Mann concludes that the best hope is not a solution to the campaign finance problem but a continuous effort to manage it as well as possible, given the complex constraints, rapidly changing environment, and the other, sometimes competing, goals of the political system.

References

Congressional Budget Office. 1999a. *The Economic and Budget Outlook: Fiscal Years 2000–2009.*

———. 1999b. *The Economic and Budget Outlook: An Update* (July 1).

Crippen, Dan L. 1999. "Statement on the Mid-Session Review of the Fiscal Year 2000 Budget before the Senate Committee on the Budget, July 21." 106 Cong. 1 sess. Government Printing Office.

General Accounting Office. 1993. *A Glossary of Terms Used in the Federal Budget Process*, revised (January).

Gordon, Robert J. 1999. "Has the "New Economy" Rendered the Productivity Slowdown Obsolete?" Paper prepared for the CBO Panel of Economic Advisors meeting (June).

Mann, Cindy. 1999. *Promoting Medicaid Enrollment for Children Who Are Moving In and Out of the TANF System*. Washington: Center on Budget and Policy Priorities (March).

Office of Management and Budget. 1999. *Mid-Session Review, Budget of the United States Government, Fiscal Year 2000* (June 28).

Report of the President's Commission on Budget Concepts. 1967. Government Printing Office (October).

U.S. Department of Justice. 1999. National Crime Victimization Survey for 1998.