Can a New Homestead Act Solve the Debt Crisis?

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The Trump budget will need a lot more than 3 percent growth to ease America's growing debt burden.

Last week, President Donald Trump released his full budget request, outlining priorities for this year and the subsequent decade. He forecasts that by 2027, assuming a 3 percent GDP growth rate, the budget would be balanced and the debt in the hands of the public (about 30 percent is held by federal entities) would be pushed below 60 percent.

Balancing the federal budget and reducing debt is a formidable task, to say the least. The debt-to-GDP ratio is now at the highest level in the nation's history, and it is projected to rise even higher. The federal government faces major headwinds against effort to reduce and eliminate deficits, including slow economic growth, higher interest rates, and explosive growth in entitlement spending.

In a forthcoming study that relies on the Congressional Budget Office's "Long Term Forecast," we use a dynamic simulation model to estimate the impact of alternative fiscal policies on the economy over the next two decades. Our simulations show that even with a 3 percent growth rate, the federal government would continue to incur deficits and accumulate debt at an unsustainable rate. This is discouraging news for those who pin their hopes on higher rates of economic growth as a solution to the nation's debt crisis.

In our study, we estimate the potential impact of new fiscal rules on the U.S. economy over the next two decades. The new rules would require a cyclically balanced budget and an expenditures limit. The study shows that over the forecast period, the budget could be balanced and the total debt-to-GDP ratio reduced to the 60 percent tolerance level under this scheme, but this fiscal consolidation can only be achieved using a combination of fiscal reforms that go far beyond what's been proposed by the Trump administration.

The centerpiece of the fiscal reforms proposed by our study is a spending limit. It brakes growth in discretionary spending based on the size of the debt and actual deficits, including unplanned spending. Because the total debt is far above the consensus tolerance level of 60 percent of GDP, the spending limit holds the rate of growth in discretionary spending below 1 percent per year. Even with this stringent limit on discretionary spending, it would be impossible to balance the budget without other fiscal reforms. A prerequisite is the reform of entitlement programs, including Social Security and Medicare. The federal government must also sell a significant amount of federal assets each year, with the proceeds earmarked to pay down the federal debt.

Following the precedent set in the Congressional Budget Office's forecasts, we estimate the magnitude in federal savings required to balance the budget and reduce the debt-to-GDP ratio to tolerance levels over the forecast period. In the most likely scenario, it will take the spending limit based on the debt and deficit levels, plus $600 billion per year in combined entitlement savings and federal asset sales.

We recognize that $600 billion in annual savings will be difficult to achieve. Indeed, some will argue that it is impossible. But the path to a sustainable fiscal policy is clear. Reforms of the needed magnitude have been identified. The Congressional Budget Office has shown that Social Security and Medicare reforms can generate hundreds of billions in savings each year. Trump will not be able to achieve his ambitious fiscal targets without fundamentally reforming these entitlement programs.

Federal asset sales made to pay down the national debt was not part of Trump's budget proposal, but during his presidential campaign, candidate Trump promised a 'deal' to sell mineral rights and use the proceeds to pay down the debt. He argued this 'deal' could make America energy independent. In our research, we find that this kind of sale of federal assets is a necessary to solve the debt crisis.

We propose the sale of a broader range of federal assets that are now underutilized. For instance, Congress could pass a new Homestead Act, thereby selling federal land, real estate, and mineral rights. This Homestead Act could improve the nation's finances in several ways. The revenue generated from the asset sales could be earmarked for debt reduction. As assets are transferred into the private sector, profit-maximizing owners and entrepreneurs would bid for the resources, ensuring they will be allocated toward their most productive uses. The more efficient allocation of these resources would generate higher levels of income and tax revenues.

While the proposed new Homestead Act could achieve multiple objectives, the primary objective would be debt reduction. To determine the potential for federal asset sales to reduce the national debt requires an inventory of federal assets, and several studies provide such estimates. The Federal Real Property Council estimated in 2006 the value of all federal land, buildings, and infrastructure at $1.3 trillion. One class of property not included in that estimate is the value of oil, natural gas, and coal on federal property. In 2017, Shughart and Close estimated the value of these mineral deposits at $55.6 trillion.

Clearly, federal asset sales could play an important role in reducing debt. However, selling federal assets in a discontinuous way could disrupt resource markets. But our proposed new Homestead law would link such asset sales to debt reduction in the long term. Because federal assets could be sold over many decades, they could be sold at a rate that would not significantly distort resources markets.

Our simulation analysis reveals that federal asset sales must be combined with entitlement reform to generate the savings required to reduce debt to tolerable levels over the forecast period. Contrary to what many have said and will say, Trump can balance the budget and reduce the national debt burden, but this will require more fundamental fiscal reforms than those proposed in his recent budget request.

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