Committee for a Responsible Federal Budget

Twelve Principles for Fiscal Responsibility

US Budget Watch

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The US Budget Watch Project

US Budget Watch is a project designed to increase awareness of the important fiscal issues facing the country, through and beyond the election. The project seeks to bring attention to the presidential candidates' tax and spending policies, to help the public become informed about these issues, and to track the new president's fiscal policies after the election.

US Budget Watch is a project of the Committee for a Responsible Federal Budget, which is a non-profit organization committed to educating the public about issues that have significant fiscal policy impact. The Committee is a bipartisan group of leading budget experts including many of the past directors of the Budget Committees, the Congressional Budget Office, the Office of Management and Budget, and the Federal Reserve Board.

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Twelve Principles for Fiscal Responsibility

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TWELVE PRINCIPLES FOR FISCAL RESPONSIBILITY

US Budget Watch is focused on making the details of public policies that have great impact on the budget transparent and available to the public. US Budget Watch is a project of the Committee for a Responsible Federal Budget.

The United States faces a number of serious fiscal challenges. Budget deficits are back, the economy has weakened, Social Security is unsound, growing health care spending is putting immense pressure on the budget, tax policy is at a major crossroads, and borrowing is projected to reach unsustainable levels. Politicians will have to take concrete steps to confront these challenges, and some level of sacrifice will be required. The sooner decisions are made, the better—both because it will give the public more time to adjust and because it will allow us to spread the sacrifices more broadly.

The presidential campaign can either be helpful in this process, by allowing politicians to develop a mandate for change, or damaging, if politicians merely use the election as an opportunity to promise new tax and spending initiatives that would make the situation worse instead of better. It is not surprising that politicians tend to prefer to propose costly new initiatives given that proposals to increase taxes or cut spending are rarely met with appreciation by voters and are almost always met with attacks from political opponents. But considering our current fiscal situation, it is critical that policymakers be willing to address the country's budgetary imbalances. It will require real leadership to do so.

To help move the political discussion forward, the Committee for a Responsible Federal Budget has put forth "Twelve Principles for Fiscal Responsibility." These principles will help voters ask the necessary questions and develop a better understanding of important fiscal issues, and they will help politicians speak directly to these looming problems in a manner that will prepare the country for the necessary changes ahead. Unless the next president and Congress take action to put our fiscal house in order, they will put the budget, the economy, and the well-being of future generations at risk.

1. Admit That We Face Serious Fiscal Problems

The first step toward restoring the nation's fiscal health is to admit that we have a problem. Structural budget deficits—which, in recent years, have been masked by temporary surpluses in Social Security—remain a problem, and they are projected to get much worse in the coming decades. Long-term budget projections are daunting—the long-term fiscal gap over the next 75 years is an astonishing 7 percent of GDP.[1] The government will have to significantly reduce spending, raise revenues, or both, in order to rebalance the budget.

There are many solutions for dealing with these problems. There are no "right" answers. But there is a need to address these fiscal challenges responsibly in advance of the budget and economic problems that will inevitably occur as the result of inaction. Acknowledging these challenges honestly and directly is the critical first step toward finding workable solutions.

2. Elevate the Issue of Fiscal Responsibility

Politicians need to use the bully pulpit to focus attention on the nation's fiscal problems. Through speeches, public forums, town hall meetings, and conversations with the press, they should work to expand public awareness of these problems and place them on the national agenda. Ultimately, the public will have to demand that politicians act responsibly, but voters cannot be expected to lead the charge.

In the past, a crisis has often been required to generate action. In the early 1980s, it was only when Social Security was on the verge of insolvency that Congress and the President agreed on a deal to rebalance the program. Similarly, the Andrews Air Force Base Budget Agreement of 1990 was the result of widespread bipartisan concerns that budget deficits and the savings and loan crisis would push the nation into a "deficit crisis." It would be a mistake, however, to wait for a crisis before taking action. The fiscal imbalances that we currently face are much worse than in the past and, accordingly, any crisis would likely be far more damaging.

A better model for action would be to develop and respond to a political mandate for action, such as we saw in the 1990s. Because deficit reduction was made a central theme of the 1992 presidential campaign, the President and Congress agreed on a plan to reduce the deficit. Ideally, the result of this campaign season will be a mandate to address the budgetary challenges we currently face.

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[1] Using the CBO's Alternative Fiscal Scenario, from the December 2007 Long-Term Budget Outlook: http://www.cbo.gov/ftpdocs/88xx/doc8877/12-13-LTBO.pdf. The fiscal gap is the amount by which the government would have to immediately and permanently raise taxes or cut spending—or both—to make the government's debt the same size as a share of the economy at the end of a specified period as it is today.

3. Commit to Reducing the Deficit

Simply pointing out that there is a problem does not go far enough; politicians need to commit to reducing the deficit. Growing deficits divert capital from economically productive investments, lead to increased interest payments as part of the budget, leave the country reliant on foreign lenders, diminish the projected growth of future U.S. living standards, and shift the costs of today's spending onto younger and future generations. Over the past few years, both the president and Congress have proposed budgets that would increase the deficit, even while pledging to reduce it. This pattern of passing budgets that make the problem worse instead of better must be broken.

In an election year, it is not surprising that politicians put forward ideas for instituting new programs or for reforming and cutting taxes: not only does it allow them to present their priorities to voters, but it can also be politically beneficial. At the same time, however, the next president will have to take action to get the deficit under control. The total effect of any budget plan should be to reduce the deficit.

There are a number of reasonable fiscal goals such as balancing the budget over the business cycle, stabilizing the debt-to-GDP ratio, or running budget surpluses to increase government saving—to name a few. While during an election year it is unlikely that anyone will put forth a detailed plan to balance the budget, politicians should support an explicit fiscal goal as well as policies that, taken together, are consistent with that goal. At the very least, they should:

1) Commit to the goal of reducing the deficit or balancing the budget;
2) Suggest a time horizon over which they would strive to meet that goal; and
3) Provide an outline of what policies such a plan might include.

By committing to explicit deficit reduction goals now, politicians will increase the likelihood that Congress and the next president will pursue a deficit reduction agenda.

4. Suggest Solutions to Fix Social Security

Deficit reduction and balancing the budget are not the only major fiscal challenges facing the country; they are not even the largest. The nation faces an astonishing $53 trillion in fiscal exposures over the next 75 years.[2] Rebalancing this gap would require immediate spending cuts equal to 20 percent or tax increases of 25 percent.

Social Security, the largest government program, is a significant contributor to this imbalance. Social Security outlays are projected to grow dramatically as a share of the

[2] Department of the Treasury, *FY 2007 Financial Report of the United States Government.*

economy in coming decades, rising from 4.3 percent of GDP today to 6 percent in 2030. Starting in 2017, Social Security payments will begin to exceed revenues, and in 2041 its trust funds will be depleted. Repayments will cost over $250 billion in 2030, and grow to roughly $335 billion by 2040.[3]

Politicians should state what budget policies they would support to fill the gap in the program. Options outside of Social Security include: raising taxes, cutting government spending on items other than Social Security, or borrowing. Options within the program include: slowing the growth of or cutting Social Security benefits, raising dedicated taxes, or increasing the retirement age.

During an election year, it may be more reasonable to expect politicians to be specific about what sorts of policies they would support regarding Social Security rather than to propose a fully developed and detailed plan, which might galvanize opposition and make reform more difficult than it will already be. At the very least, no politician should be more specific about the policy changes he or she opposes than about those that he or she supports, since removing options from the table makes reform far more difficult.

5. Suggest Ways to Address Rising Health Care Spending

The single largest driver of the government's long-term budget problems is health care spending. Health care currently consumes 17 percent of the economy. Spending on Medicare and Medicaid—the federal government's largest health care programs—currently accounts for nearly one quarter of the federal budget. These numbers are expected to increase as health care costs continue to grow dramatically faster than the rest of the economy. Medicare and Medicaid are on track to absorb 8.4 percent of GDP by 2030—more than double their current level.[4] Spending on health care in general, which has doubled as a share of the overall economy since 1975, is expected to grow by another 20 percent—or as 3 percentage points of GDP—over the next 10 years. As rising costs make health care unaffordable for an increasing number of Americans, most reform proposals look to the federal government to play a greater role in financing health care costs, which would further tighten the budgetary squeeze.

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[3] *The 2008 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, Social Security Trustees. http://www.ssa.gov/OACT/TR/TR08/II_project.html#105057 and http://www.ssa.gov/OACT/TR/TR08/VI_OASDHI_dollars.html#140103.

[4] Numbers are taken from the CBO's alternative fiscal scenario, which incorporates policies that are widely expected to occur and that policymakers have regularly made in the past.

The options being considered to slow the growth of Medicare and Medicaid, and more generally the delivery and consumption of health care throughout the economy, include: improving incentives for both providers and consumers, reforming insurance markets, reforming the tax treatment of health care, improving the effectiveness and efficiency of health care services and delivery systems, and limiting services or beneficiaries that are covered by government spending. It is likely that no matter what steps we take, health care costs will continue to grow faster than the economy, which means that as a nation, we have to decide what we are willing to accept less of in return.

We should not, at this time, expect any politician to have a fully developed plan to control the rising costs of Medicare and Medicaid, but we should expect them to acknowledge the magnitude of the problem of health care cost growth and explain what sorts of options they support. If they do not have a plan that is likely to lead to a sustainable health care budget, they should either acknowledge that more will have to be done or that other policies will have to change to accommodate the growing portion of the budget consumed by spending on health care.

6. Suggest Solutions to Outstanding Tax Issues

There are a number of outstanding issues with respect to tax policy that politicians must begin to address. The major tax cuts that were passed in 2001 and 2003 are set to expire at the end of 2010. The cost of extending these tax cuts and making them permanent is significant. Nonetheless, most politicians have expressed a desire to extend some or all of them. Assuming the economy continues to slow, it is even more likely that politicians will not want to permit the slated expiration to take place. The major provisions of these expiring tax cuts include the reduction in personal income tax rates, the increase in the child tax credit, the reduction in the "marriage tax penalty," the reduction in and subsequent elimination of estate and gift taxes, lower tax rates on capital gains and dividends, expensing for small businesses, and additional tax breaks including for education and small businesses. A number of costly "temporary" tax reductions that politicians regularly renew—such as the R&E tax credit—are set to expire as well.

Another unavoidable tax issue is the Alternative Minimum Tax (AMT), which was designed to catch very wealthy taxpayers with low tax payments, but is hitting more and more taxpayers each year because it is not indexed for inflation. Congress has shown its commitment to keeping the tax from dramatically expanding by passing patches yearly, but it has thus far failed to enact a permanent solution. The annual cost of these patches is high and growing—and, if the Bush tax cuts are renewed, will reach $100 billion by 2012 and almost $200 billion by 2017. Eliminating the AMT would be even more expensive.[5]

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[5] Congressional Budget Office. The *Budget and Economic Outlook: Fiscal Years 2008 to 2018*. http://www.cbo.gov/ftpdocs/89xx/doc8917/Chapter1.5.1.shtml#1069806.

Finally, projected revenues are insufficient to cover the cost of government going forward—whether or not the 2001 and 2003 tax cuts are extended. Clearly, a number of major tax issues will have to be confronted in the next few years. Politicians should be clear about how they would reconcile the spending promises and the tax levels that they support.

7. Plan to Reform the Budget Process

The budget process is, in many ways, broken. Congress regularly fails to pass a budget. Accounting conventions are outdated, deadlines are routinely missed, restrictions are waived, and enforcement mechanisms are bypassed with distressing regularity. As Congress labors over appropriations bills, the larger portion of the budget—mandatory spending—operates on "automatic pilot." Particularly relevant to the question of how to reform the budget is the problem that because of how Congress is organized, policy making tends to be overly compartmentalized, and major comprehensive reforms that stretch across budget categories are difficult to enact.

As the next president and Congress work to confront our fiscal problems, they should also reform the budget-making process. Budget process reforms will not replace the need for hard choices—indeed, they can serve as a distraction from or an excuse to avoid taking the specific policy actions that will be required—but process reform should be part of any comprehensive effort to reform the budget.

8. Use Honest Numbers

Budgeting decisions should be made transparently and tax and spending decisions should be made democratically. Politicians often find it convenient, however, to avoid this principle by employing budget gimmicks that cloud the budget-making process. If their proposals are worth their true costs, politicians should be willing to defend them on the merits without resorting to budget trickery.

Timing gimmicks have abounded in recent years. Policies are made to look less expensive than they really are by structuring them to be phased in gradually or by having the bulk of their costs materialize outside of the budget window. Another budget trick involves passing "temporary" policies and relying on policy momentum to perpetuate them. In Milton Friedman's famous words, "nothing is so permanent as a temporary government program." Such programs, or tax cuts, appear cheap in the form in which they are originally passed, but actually have considerable costs, as they are inevitably renewed and/or expanded.

Politicians also try to minimize the costs of their budgets by omitting policies that will inevitably have to be added back in. In recent years, budgets have been passed that have not fully accounted for the costs of the operations in Iraq and Afghanistan, fixing the Alternative Minimum Tax, or building up reserves for natural disasters and other emergencies. Additionally, many politicians assume that domestic discretionary spending will grow at rates significantly lower than it has in the past, without explaining what policy changes they support to bring growth down to the assumed levels. In order to be useful, budgets must be comprehensive and should not omit any policy that predictably will demand federal funds.

9. Offset the Cost of New Policies

The pay-as-you-go (PAYGO) principle—that new entitlement spending and tax initiatives not increase the deficit—is a fundamental precept of sound budgeting practices. Politicians should specify if they support PAYGO and how they would offset the costs of any new policies they support. Tax cuts should not be exempt from this requirement, both because they divert considerable money from the Treasury and because exempting them would encourage Congress to pass more tax expenditures—targeted tax cuts that act just like spending programs—which dilute the tax base and complicate the tax code.

Advocates of new ideas should be equally detailed about how to pay for their initiatives as they are about how they would spend on them. Rather than saying they would "freeze" a specific area of the budget or "close the tax gap", politicians should specify what programs they would reduce or what changes they would make to the tax code in order to finance their initiatives. Furthermore, offsets should be dedicated to paying for one policy only and should not be double-counted. Even when the particulars of a fully paid-for policy are unlikely to be implemented as presented, it is nonetheless useful to be specific about costs and offsets so as to present the real types of trade-offs that will be involved.

It is important to note that PAYGO is not a panacea. Complying with PAYGO will not force the actions necessary to balance the budget, but it will prevent policymakers from making matters worse by forcing them to acknowledge budgetary tradeoffs.

10. Do Not Perpetuate Budget Myths

Elected officials should be careful not to perpetuate budget myths. Too often, these myths are used to justify fiscally irresponsible actions. Some of the most common myths include[6]:

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[6] For more on these and other budget myths, see the Brookings-Heritage Fiscal Seminar's *Taking Back our Fiscal Future* http://www.newamerica.net/files/TakingBackOurFiscalFuture.pdf

Deficits don't matter. Policymakers who believe that deficits don't matter argue that sustained deficits pose no risk, citing the glut of global savings as a source of almost unlimited capital. They also argue that deficit spending increases output and is therefore good for the economy. In reality, the availability of debt financing is far from unlimited; in fact Japan and China have already begun to slow their purchasing of U.S. debt. While deficits can spur consumption and thus improve the immediate economic situation when there is slack in the economy, they lead to slower growth in living standards over the long run. Moreover, high deficits increase interest payments, which crowd out important tax and spending priorities and leave the budget with far less flexibility than it would otherwise. Lastly, deficits shift the burden of paying for today's spending to future generations, which may cause over-consumption by present generations at the expense of consumption by future generations.

Health care reform is all that is needed to fix the problems. Since health care costs consistently grow faster than GDP, proponents of this view suggest that to close our long-term fiscal gap we need only control the growth of health care spending. Looking at future budget projections, it is clear that Medicare and Medicaid are the largest drivers of the long-run budget deficit. But although the high future costs of these programs will be primarily driven by health care cost growth, the aging of the population will also play a significant role. At the same time, Social Security—the largest government program—is expected to grow by roughly 40 percent as a share of GDP by 2030. Furthermore, most experts concede that health care costs will continue to grow faster than the economy even with significant reforms. This means that although vital to addressing our long-term budget problems, health care reform alone will not be enough to put the budget back on a sustainable path.

Tax cuts pay for themselves. Advocates of this view argue that lost revenues as a result of tax cuts will be more than made up for by the increase in tax revenues resulting from economic growth spurred by those same tax cuts. There are rare circumstances where this claim holds true, but most experts agree that these circumstances do not prevail with respect to any current federal taxes. A more realistic claim is that cutting certain taxes increases economic growth modestly, causing small amounts of "revenue feedback." However, if tax cuts are not offset, the economic cost of the deficits and debt associated with tax cuts can outweigh any positive effects. There is no realistic scenario today in which a tax cut, by itself, will lead to larger government revenues, and it is important that discussions about tax policy treat this issue realistically.

Entitlement benefits cannot be changed because people have an earned or moral right to them. Many argue that any efforts to reform the budget should exclude cuts in Social Security and Medicare benefits, since workers have paid for these benefits through their payroll taxes, and are therefore entitled to them. In reality, there is no legal right to these benefits, and the programs are structured in such a way that the taxes participants are paying in are not close to sufficient to pay for the benefits they are scheduled to receive. Since current promises made by Social Security and Medicare are unsustainable, leaving these two programs untouched would require neglecting other important government priorities in areas such as education, defense, infrastructure, and tax policy. All budget priorities should be considered on equal footing—no one part of the budget should be exempt.

Some policies are so important that we should not have to pay for them. Advocates often argue that the policy they support is so important that we should not have to find ways to pay for it. This holds true for both advocates of spending programs and tax cuts. Certainly, making the costs of policies transparent by having to find a way to pay for them can complicate passing legislation, but that complication is the very purpose of passing budgets: a democratic society presented with trade-offs must decide what programs and tax levels are most important, and make real choices as to what type of goods and services it is willing to pay for. Furthermore, while new spending and tax cuts introduced without offsets may be easier to pass initially, they are more likely to add to future budget problems and are thus more vulnerable to changes. The bottom line is that any program or tax cut worth having is worth paying for.

We can close the budget gap by reducing wasteful spending or cracking down on tax evasion. Many politicians like to suggest that our fiscal woes can be solved simply by reducing wasteful and fraudulent spending or reducing the "tax gap" between taxes owed and taxes collected. It is true that these policies could improve the fiscal situation, and they should be pursued as matters of fairness and good governance. However, it is highly unlikely that government officials will be able to eliminate all wasteful spending or collect all unpaid taxes and the savings likely to materialize will not be nearly enough to close the fiscal gap.

We can grow our way out of the nation's fiscal problems. Faster economic growth can reduce long-term budget deficits and make tax increases and spending cuts less painful, but we cannot grow our way out of our long-term fiscal problems. The main drivers of our long-term budget gap, Social Security and Medicare, tend to grow as the economy grows. Because of the way Social Security benefits are structured, higher economic growth leads to not only higher revenues, but also to larger future benefits. With health care, spending levels tend to grow even faster than the economy, as already discussed. The bottom line is that the projected fiscal gap is so large that higher revenues from faster economic growth simply will not be big enough to close it. According to the Government Accountability Office, there is no feasible growth rate of the economy that would restore us to a sustainable budget path. Moreover, economic growth over the past 60 years has been the best in the nation's entire history; there is no reason to think that any set of policies could cause substantially faster sustained growth over the next 75 years. So while politicians should support policies that foster growth for both fiscal and economic reasons, they should be careful not to present economic growth as an easy way out of our current challenges.

11. Do Not Attack Someone Else's Plan (Unless You Put Forward an Alternative)

Politics is filled with criticisms and accusations. Fiscal policies that would improve the budget situation tend to lend themselves to greater attack since they involve increasing revenues and cutting spending rather than the reverse. While rejecting policy solutions may be a useful way for a politician to define himself, by itself it is counterproductive in addressing the country's fiscal problems.

Any politician who wishes to detract from an opponent's plan should be willing to propose his or her own solution to the problem. If politicians only criticized proposals when they had proposed alternate solutions, this would dramatically lift the quality of the debate. Instead of a race to the bottom over what politicians promise not to do—a situation that can easily leave the country with leaders who have taken all the possibilities for addressing these issues off the table—this creates a race to the top where different ideas for addressing long-term challenges can be discussed and debated on their merits. Political discussions comparing various options for balancing the budget, fixing Social Security, revamping our health care system, and reforming the tax code would be productive; taking potshots at ideas without putting forth alternatives is not.

12. The Media Should Do Their Jobs

As politicians adhere to the eleven preceding principles, the media, too, have obligations. The media need to do a better job of covering all of the issues raised here. In this presidential campaign season, it is disappointing that in the debates the presidential candidates have seldom been asked how they would address the country's major fiscal challenges. Nor has this question been the focus of many editorials and opinion pieces in the nation's major newspapers. Instead, the media have too often made things worse by baiting candidates to respond to questions about whether they would, for instance, raise taxes or increase the Social Security retirement age, putting candidates on the defensive in an effort to make news rather than cover it.

The media serve a critical role of asking the hard questions in a balanced manner and then assessing the credibility of the answers. Given that politicians are more likely to discuss the new initiatives they would support than how they would pay for them, journalists can play a central role by pushing politicians harder to supply a fuller set of details. Responsible and detailed coverage of both the benefits and costs of various proposals that would affect the budget will greatly enhance voters' ability to make informed decisions with regard to budget and fiscal policy.

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The next president will have to address these pressing issues in order to strengthen the fiscal and economic position of the country. Most politicians are politically cautious about asking the public to come to terms with inevitable budget trade-offs. But if policymakers abide by the 12 principles outlined above, there is reason to hope that they can convince the American public to accept the need to make the hard decisions necessary to put our fiscal house in order.