



A Path to Balance

A Strategy for Realigning the Federal Budget

Michael Ettlinger, Michael Linden, and Lauren Bazel December 2009

Center for American Progress



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Introduction and summary

It's time to show the world that the U.S. government has a path to reducing its budget deficits. Current projections show that annual deficits will be running at above 4 percent of gross domestic product and be on the rise even once the nation is well clear of the Great Recession. That's too high. The mere prospect of large sustained deficits poses risks to financial markets, endangers the rest of the economy, and undermines U.S. standing in the world. The reality of those deficits would mean pirating public expenditures away from needed public services and investments into the sinkhole of debt service. No one seriously denies that we face a real fiscal challenge. We need lower deficits.

Yet we need to move along a sloping path to get to those lower deficits, not dive off a precipice. It would be unwise to try to completely balance the budget at the same time as we are fighting our way back from the worst economic period since the Great Depression. Deficit spending is needed right now to change the momentum of the economy and to spur growth. Policies that produce immediate GDP growth and attack unemployment will help the economy in the short term and the nation's fiscal health in the long term.

Spending reductions and revenue increases are the tools for achieving fiscal balance, but just as important are the natural increases in revenue and reduced budget pressures that come from a strong economy. It is not only that jumpstarting the economy is currently a higher priority than deficit reduction; it is also that running deficits now will actually help reduce deficits later by bringing about a faster recovery.

We shouldn't leap to a balanced budget, but neither can we do nothing. Without a defined path that has credible stepping stones along the way, the markets and the world will wonder at our intentions, worry about purchasing the debt we're selling, question investments in the United States, and act with excessive caution in fear of higher interest rates. Balancing the budget right now could slam the brakes on economic recovery, but not embracing a way forward could slow our recovery as well, and in the worst case, provoke a crisis of confidence that scuttles the progress we have made.

The path proposed in this paper is a gradual one with an ultimate goal of a fully balanced budget in 2020, an intermediate target for 2014, and benchmarks along the way. Adopting such a path, as well as a way to enforce it, would send a strong signal to financial markets and the world that we are serious about addressing federal budget deficits. It would also create a necessary discipline for Congress and the president.

Of course, having alternative routes is always advisable. There are many uncertainties regarding how economic and fiscal circumstances will unfold over the next few years. Economic growth, unemployment levels, the timing of savings from health care reform, and war costs are not entirely predictable at this point and are variables that will need to be accounted for as we go along.

The path we propose is, to a large extent, designed around those unknowns. We will have a better sense by 2014 of how the economy has recovered, how health care reform will affect costs, and where we stand with defense spending. But dictating a balanced budget that soon, with stringent limits along the way, would be irresponsible and unrealistic. By 2020 the economy should be well clear of the Great Recession, and we can honestly hope that the nation will be at peace and we will have started to see substantial fiscal benefits from health reform. Other challenges may arise in the interim, but with a defined path and committed policymakers, such challenges can be dealt with in the context of the goal of a balanced budget instead of swept under the rug as they have been in recent years.

This paper proposes that the intermediate goal for 2014 be a return to the fiscal discipline that existed in the 1990s before the Bush era practice of cutting taxes while increasing spending and engaging in two expensive wars. The specific objective for 2014 is a budget that is in “primary balance”—where federal revenues equal program spending. There will still be overall deficits under this plan because of the cost of payments on past debt, but we will be paying for all spending on federal government programs by 2014 under this proposal. Our estimate is that a primary balance in 2014 will equate to an overall deficit of about 2.7 percent of GDP.¹

But undoing the deficit legacy of the Bush era is not enough. There are another set of forces driving our future deficits, as well. The aging of the population and rising health care costs have been putting more and more pressure on the federal budget—and that pressure is only going to increase. This has been well known for some time and was partially addressed under both a Republican president and a Democratic one. With bi-partisan support, President Reagan substantially extended the solvency of Social Security and President Clinton substantially extended the solvency of Medicare. Yet this discipline was lost under President Bush. In fact, the long-term problem was made worse when the Bush administration extended Medicare to prescription drugs without any plan to pay for it.

Another substantial challenge is cost of increased interest payments on the debt that has been built up by past deficits. These payments are projected to exceed 11 percent of all spending by 2013 and top 15 percent by 2019.

Once primary balance is achieved in 2014, the next goal should be overall budget balance by 2020. That is, revenues should be equal to all expenditures, including the cost of servicing the debt. Achieving a balanced budget will reduce our overall debt and our debt servicing costs. This declining debt burden will leave us less vulnerable to interest and exchange

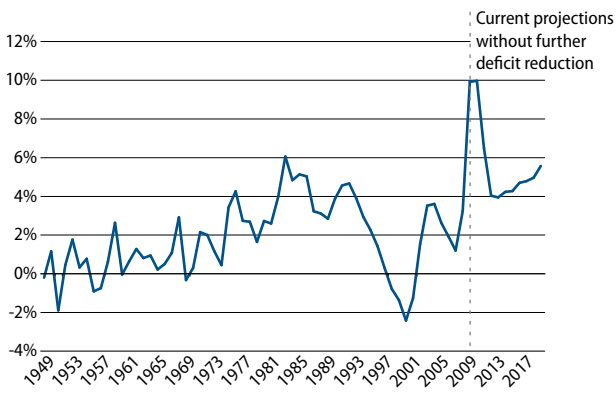
rate fluctuations and in a better fiscal posture to deal with crises. If we can achieve budget balance by 2020, the nation will be in a strong position to face whatever challenges may lie ahead. Unanticipated events may still intervene, but achieving the fiscal fortitude to withstand these crises by 2020 should be our ultimate goal.

This paper also offers a path for annual deficit improvement, starting in fiscal year 2011, with specific yearly targets. These signposts will prevent us from meandering off course and show the world that we are sincere about getting to our destination. Our recommendation is that Congress pass and the president sign statutory mechanisms to enforce these targets.

The fiscal challenges we face are serious, but not insurmountable. It would be a mistake to try and balance the budget in the next few years, but it would also be a mistake to put off any fiscal improvement until some undefined later date. We should adopt a credible plan for balancing the budget over a reasonable amount of time with clear targets along the way in order to avoid the most dramatic dangers posed by intransigent deficits. Adopting the plan offered here would demonstrate a very real commitment to fiscal sustainability, without the risk of undermining economic recovery.

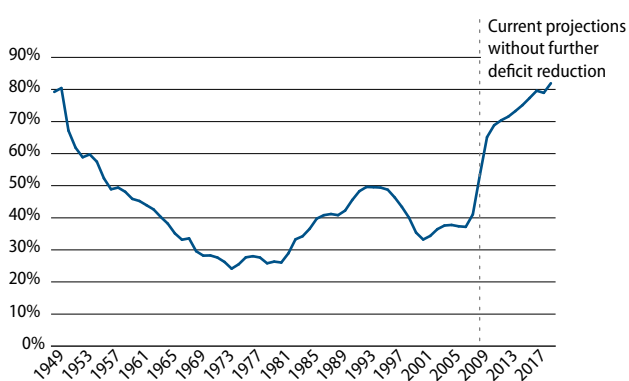
Dangers from deficit and debt

Federal budget deficit as a percent of GDP, 1949-2019



Source: Congressional Budget Office.

Publicly held debt as a share of GDP, 1949-2019



Source: Congressional Budget Office.

The federal government in fiscal year 2009 ran the largest deficit since the end of World War II, measured as a share of the total economy. The deficit in fiscal year 2010, which began on October 1, 2009, is likely to be close to that magnitude. Even if Congress enacts the deficit reduction measures proposed by President Barack Obama in his initial budget outline, deficits will remain at or above 4 percent of GDP, with an upward trajectory, for the next decade. Debt levels are also expected to rise to heights not seen in close to 70 years. By 2019, debt as a share of GDP is projected to exceed 80 percent.²

These facts have generated a substantial amount of attention and angst. Some prominent figures have played the role of Chicken Little, crying that the sky is falling and that we need to abandon other priorities and balance the budget immediately.³ Cooler heads have recognized that the immediate deficits are in fact desirable given the economic situation.

The deficits projected beyond the recession are, however, of concern to everyone—though there are differences of opinion over how quickly they need to be addressed. Some believe that we have time and can ignore the problem for the immediate future. Others believe that, while we do have time, we nevertheless need to signal clearly now that we will take action later. Still others believe that we need to take action as soon as the economy is in recovery.

What almost everyone agrees on is that running deficits of the size currently projected carries substantial risks and will eventually, if not immediately, lead to some undesirable outcomes. Large deficits can reduce national savings, push up interest rates, spark inflation, and adversely affect exchange rates. At the very least, running large deficits requires borrowing, often from foreign investors, and that means diverting a portion of our future income to pay them back.⁴

High deficits, and their associated debt levels, can also prevent us from making needed investments. As the debt level grows, so too do interest payments on that debt. These interest payments are projected to rise to close to 4 percent of GDP by 2019, more than federal spending on all domestic discretionary programs combined.⁵ High deficits also provide fodder to those who wish to block new initiatives and scale back existing programs. The recent debates about economic stimulus, health care, and job creation show how the fiscal situation can be exploited as a way to block even the most needed action.

Finally, there are risks that come with the mere perception that the federal budget is permanently out of balance. This perception could lead to serious economic consequences as creditors, investors, and traders try to protect themselves from the potential dangers. Fears of inflation could become self-fulfilling if the federal government appears to have no intention of, or credible plan for, bringing the budget back onto a sustainable path. This would make borrowing more costly across the board and deter investment. In the worst-case scenario, another financial crisis could ensue.

All of these risks, from inflation to potential financial crisis to ever growing interest payments, strongly suggest that the federal government needs to adopt a serious plan to achieve fiscal sustainability within a reasonable time frame.

Our two fiscal challenges

Our recent report “Deal with It” outlined how the nation moved from the period of surpluses that began in 1998 to the projected deficits of 2019.⁶ Not surprisingly, it is a story of a rise in some types of spending coupled with the consequences of repeated tax cuts. It is also a story of the interaction between (1) short-term fiscal irresponsibility and (2) the growing costs of addressing long-term societal challenges.

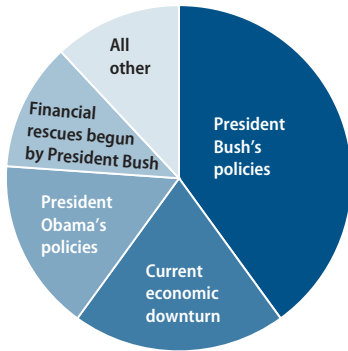
The federal government was running deficits even before the economy fell into recession. President George W. Bush and a complicit Congress ran deficits every year after 2001, a year when they enjoyed a surplus inherited from President Bill Clinton. Those deficits were the result of tax cuts in a time of peace, the costs of two wars, tax cuts in time of war, and expanded domestic spending with no way to pay for it. A budget that began with a historic surplus turned into one with growing deficits.

A brief period of deficits was to be expected given the events of September 11, 2001 and the accompanying economic disruptions, but continuously cutting taxes while increasing spending is not so defensible. Making matters worse, the Bush administration and Congress repeatedly used a myriad of budgetary gimmicks to hide the future costs of these policies. Running deficits during a time of economic growth was problematic. Distorting the understanding of the future fiscal picture was dangerous.

The nation saw its first trillion-dollar deficit in fiscal year 2009 when the Great Recession ran into this weakened federal fiscal posture. The budget in FY 2010 will likely look almost as grim. The detrimental effects of the Bush era policies will continue unless action is taken, even as the recession gradually recedes.

The problem of irresponsible fiscal policy during much of the last decade is overlaid on top of a more fundamental problem: the growing costs associated with an aging population and the rising price of health care. These trends have been building up fiscal pressure for decades, but after Presidents Reagan and Clinton’s important interventions, President Bush made this problem worse.

Contribution to fiscal deterioration, 2009 and 2010



Contribution to fiscal deterioration

President Bush's policies	40%
Current economic downturn	20%
President Obama's policies	16%
Financial rescues begun by President Bush	12%
All other	12%

Source: Michael Ettlinger and Michael Linden, “Who’s to Blame for the Deficit Numbers” (Washington: Center for American Progress, 2009).

Dealing with one of these challenges would be difficult; dealing with both is harder and will take some time to solve. This is another reason we allow 10 years for reaching our ultimate goal, with intermediate steps along the way. It is also the basis for, in essence, dividing the solution into two parts—a first step that restores basic responsibility, and a second step that tackles the much harder challenge of bringing revenues and spending in line in the face of all of the combined head winds.

The path to balance

The ultimate goal: a balanced budget by 2020

Our goal in tackling the fiscal challenge does not have to be a completely balanced budget. We have run a deficit in all but 12 of the 65 years since the end of World War II. The average fiscal balance over the period, leaving out recession years, has been a deficit of 1.7 percent of GDP. Yet the republic has thrived. There are arguments that small deficits matter, but it's hard to argue they matter much. Most perceive that deficits of less than 2 percent of GDP are safe, and some would argue that sustained deficits as high as 3 percent of GDP are tolerable.

There are, however, two reasons not to accept persistent deficits in the range of 2 to 3 percent of GDP. The first is that “safe” or “tolerable” is not the same thing as “desirable.” Deficits in this range mean incurring debt and accruing debt-service costs. Those costs are manageable at low levels, but there is seldom a reason for the government to run deficits during good economic times. Government should be paying its bills. The default position on the budget should be balance with the red ink reserved for recessions and emergencies.

The second reason not to continue to tolerate deficits when they are not needed is that we have an extraordinary amount of accumulated debt that we should pay down. Even if we follow the ambitious path outlined in this paper, we are almost certain to top debt of 70 percent of GDP—the highest levels since just after World War II. Debt levels have been at much lower levels when we have temporarily run deficits of 2 or 3 percent of GDP in the past. Running deficits in the range of 2 to 3 percent of GDP will not allow us to make a serious dent in our debt obligation. This is a problem.

There are substantial consequences to carrying such high debt levels. One is simply that debt service becomes an enormous drain on the treasury. The table on the left shows an approximation of what the debt service costs would be at different levels of debt as a share of GDP for 2014. The difference in the cost of paying the interest on a debt level of 50 percent of GDP and 80 percent of GDP is enough to pay for the entire Department of Veteran Affairs, the entire space program, all Pell grants, and still have a little left over.

Estimated interest payments given increasing levels of debt

Publicly held debt as a share of GDP	Interest payments in 2014 (billions)
40%	\$257
50%	\$322
60%	\$386
70%	\$450
80%	\$515
90%	\$579
100%	\$643

Source: Author's calculations based on the Congressional Budget Office's June 2009 projection of the President's 2010 budget request.

High debt levels also make the budget vulnerable to spikes in interest rates. When borrowing costs rise, the cost of debt service rises roughly proportionately. If interest rates were to go up by 10 percent, which is not an outlandish possibility, then all the numbers in the table would be approximately 10 percent higher.

Finally, the higher the debt is, the less flexibility the federal government has to deal with a crisis. For example, had debt already exceeded 60 percent of GDP when this Great Recession hit our ability to respond would have been much reduced. The world is only willing to buy so much of our debt.

Absent unusual circumstances, the lower the debt, the better. And the quickest way to lower debt is balanced budgets or surpluses. Our ultimate goal should therefore be a fully balanced budget.

The question is, when? There are important considerations that recommend a gradual approach to bringing down the deficit. There is considerable uncertainty on the speed and vigor of the economic recovery, and continuing high levels of unemployment are almost a certainty. Dramatic cuts in spending or a rise in taxes could nip an economic recovery in the bud. Bringing unemployment down has to be a top priority. Furthermore, the current ambiguity surrounding several major aspects of the federal budget, including the cost of health care programs and defense spending, suggests we should take a gradual approach.

These uncertainties make it unwise to adopt a path to budget balance that is overly restrictive. This does not mean that we should postpone any action until all of the uncertainty disappears. It merely underscores the need to choose a path that is attainable and responsible, but will not excessively constrain policymakers as the appropriate course becomes clearer. Deadlines should not be too soon and the intermediate steps not too drastic.

Setting an ultimate target for complete budget balance in 2020 allows for a range of unexpected events along the way. This path serves the goal of sensible fiscal policy, as long as we return to the path, even as circumstances require deviation. But a long-term plan for addressing the deficit needs clear benchmarks along the way to be credible.

An intermediate goal: primary balance by 2014

We propose a goal of “primary balance” by 2014 as a major intermediate objective. Primary balance is when total revenues equal total program expenditures. Achieving primary balance does not, it’s important to note, completely eliminate the overall budget deficit, because interest payments on the debt are over and above program expenditures. But the federal government would not be spending more on programs, benefits, and ser-

vices than it collects in revenues. We estimate that the overall deficit in 2014 will be about 2.7 percent of GDP if the federal government achieves primary balance. Meeting this goal is essentially a return to basic fiscal responsibility.

The target of revenues matching program spending has several features that make it appealing. First, it is simple, clear, and easy to measure. Primary balance—like overall balance but unlike some other potential targets such as a deficit that is a specific percent of GDP—is an objective that depends only on one number equaling another number, revenues equaling programmatic expenditures. Budget gimmicks to avoid compliance are less likely with such a clear measure.

Second, a budget in primary balance would stabilize publicly held debt as a share of the economy—although there can be small variations depending on interest rates and economic growth. After eight years of rising debt relative to GDP, this feature makes primary balance attractive as an intermediate step because it would mean an end to the fiscal bleeding and put the budget on much more stable ground from which to take the next steps toward full balance.

Third, this is an objective that we can achieve by 2014. This more modest intermediate target provides a credible goal, but will allow policymakers room to maneuver and recalibrate their efforts as the path of the economy, the wars, and health spending become clearer.

The path to primary balance

Providing targets for 2014 and 2020 is not enough. Without benchmarks along the way, it is too likely that any target adopted will just be a distant glimmer in the annual budget-making process. But our ambitions should be modest, particularly in the immediate future as we face an uncertain climb from an economic abyss. The benchmarks between now and 2014 should be attainable and allow room for further action to buoy the economy, yet constrain deficits to a downward path.

The statistic we suggest for measuring progress is the primary revenue-to-spending ratio—the ratio of federal government revenue to federal government spending.⁷ This telling and underused measure captures the key relationship that determines the level of deficit—the relationship between spending and revenues. Yet it avoids using dollar measures, which can be problematic as inflation and the current economic outlook can change the meaning of hard dollar targets set well in advance. Other potential measures have similar limitations.

Benchmarks on the path to the 2014 target of primary balance are set at revenue-to-spending ratios that represent percentages of *noninterest* or program spending required to be covered by revenues. When the 2014 target is hit, and revenues equal program spending, the primary revenue-to-spending ratio will equal 100 percent.

For 2009, total federal revenues equaled less than 64 percent of noninterest spending. The ratio is expected to be about the same for fiscal year 2010. These are record lows by a wide margin. The previous post-war record was in 1983, under President Ronald Reagan, when revenues constituted 84 percent of noninterest spending.

Congress should adopt a very specific set of annual targets to gradually increase the primary revenue-to-spending ratio. Our proposed targets are as follows:

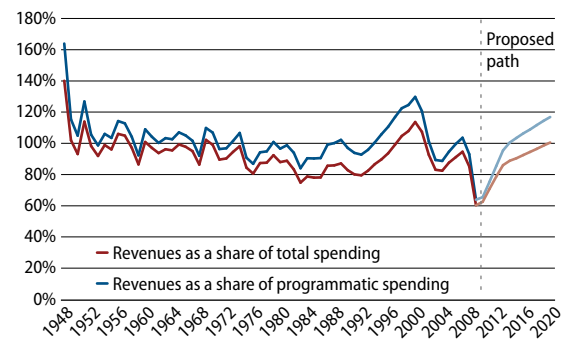
- Fiscal year 2011: revenues must equal 75 percent of programmatic spending
- Fiscal year 2012: revenues must equal 85 percent of programmatic spending
- Fiscal year 2013: revenues must equal 95 percent of programmatic spending
- Fiscal year 2014: revenues must equal 100 percent of programmatic spending

This path requires significant progress in each year, starting in fiscal year 2011, and it results in complete primary balance within four years. The improvements mandated by these targets can be achieved either by revenues rising up to meet expenditures, by programmatic spending dropping to meet revenues, or by some combination of the two.

Barring substantial economic setbacks, however, an improving economy alone should make the targets for 2011 and 2012 very reachable assuming that Congress does not extend the Bush era tax cuts set to expire at the end of 2010. The targets for the later years, when the economy is expected to be in better shape are, fittingly, more challenging.

This path will steer the federal budget to much sturdier ground, and it will immediately signal the government’s intention and willingness to return to fiscal responsibility after eight years of poor budgetary management.

The revenue to spending ratio and the proposed path to balance



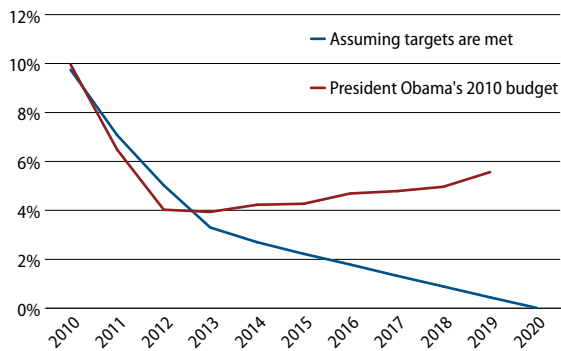
Source: Congressional Budget Office.

The path to full balance

If primary balance is achieved in 2014, the budget will still have an overall deficit. Revenues will fully cover noninterest spending, but the federal government will still have to borrow to pay for debt service expenditures. The second step after accomplishing the intermediate goal of primary balance will be to move to overall balance by 2020.

We estimate that a 2014 budget in primary balance will mean that revenues will equal about 88 percent of total spending, which includes both programmatic spending and interest payments on the debt. Achieving the final goal will mean making deliberate progress from this overall revenue-to-spending ratio of 88 percent to 100 percent, when total revenues

Projected deficits as a percent of GDP



The above graph displays the unified deficits, expressed as a share of GDP, which we estimate would result from hitting the proposed targets. For comparison purposes, it also displays the unified federal deficits proposed by President Obama's 2010 budget blueprint, as evaluated by the Congressional Budget Office in June 2009.

Source: Congressional Budget Office.

will match total spending. And just as with the intermediate goal, policymakers should seek to hit specific targets along the way to ensure that the budget makes annual progress. We propose that those overall revenue-to-spending targets be:

- Fiscal year 2015: revenues must equal 90 percent of all spending
- Fiscal year 2016: revenues must equal 92 percent of all spending
- Fiscal year 2017: revenues must equal 94 percent of all spending
- Fiscal year 2018: revenues must equal 96 percent of all spending
- Fiscal year 2019: revenues must equal 98 percent of all spending
- Fiscal year 2020: revenues must equal 100 percent of all spending

This path requires measureable but not unrealistic progress in each year. The culmination is a fully balanced budget.

Enforcing government benchmarks

Setting targets is only part of what the federal government needs to do to balance the budget. There must also be a way to ensure that the government adheres to these targets until it reaches the goal. Once the goal is hit, there should be a mechanism to ensure that budget discipline is maintained over the long term. The challenge is how to design an enforcement mechanism that can impose sufficient discipline on the system while providing appropriate flexibility so lawmakers can adjust to changing national priorities and economic conditions. There are some lessons to be learned from past attempts and principles to which lawmakers should adhere in designing such a mechanism.

Past attempts at establishing an enforcement mechanism

Congress has tried since the enactment of the Congressional Budget and Impoundment Control Act of 1974 to perfect a process that would help them achieve fiscal discipline. These efforts are, not surprisingly, associated with periods of high deficits.

The unprecedented deficits caused by the Reagan era tax cuts and unpaid-for defense buildup led to the Balanced Budget and Emergency Deficit Control Act of 1985, also known as “Gramm-Rudman-Hollings.” This bill established a schedule of fixed, declining deficit targets and also created a sequestration procedure to automatically cut spending for many federal programs if the deficit for a fiscal year was estimated to exceed a target level. The crude statutory targets proved, however, to be unworkable. Congress and a complicit president were faced with the prospect of sequestration but failed to address the substantial deficits. They employed budget tricks to make it appear as if the targets had been met or simply revised the targets rather than allow the automatic budget cuts to actually take effect.

Congress passed a multiyear deficit reduction plan in 1990 to address the general failure of Gramm-Rudman-Hollings. The Omnibus Budget Reconciliation Act raised taxes, reduced spending, and included new enforcement procedures—the Budget Enforcement Act. The BEA took a less ambitious, more flexible approach to enforcing the deficit reduction plan. It did not force lawmakers to enact legislation that achieved set deficit targets; it instead focused on preventing new legislation from increasing the deficit.

The BEA looked at the distinct pieces of the federal budget and applied different enforcement rules to each. Discretionary spending, which is allocated by the annual appropriations process, was limited by annual aggregate spending caps. New laws that affected mandatory

spending or revenues were covered by pay-as-you-go rules to prevent those laws from increasing the deficit. An across-the-board reduction in discretionary program spending would have remedied a breach in the discretionary spending caps, and a breach of the PAYGO control triggered automatic sequestration of spending in certain mandatory programs.

The next decade did witness an improving fiscal situation. The new budget processes made it difficult for Congress to legislate increases to the deficit. The Clinton era tax increases and spending discipline, coupled with strong economic growth, worked to turn deficits into surpluses. The federal budget climbed out of the red and ran surpluses from 1998 to 2001.

Yet Congress and President Bush allowed the statutory PAYGO and sequestration procedures that were enacted in 1990 and extended in the Balanced Budget Act of 1997 to expire in 2002. This opened the doors to the budget-busting policies described above. The House and Senate adopted rules in 2007 that attempted to impose some budget discipline on the legislative process. But there is no sequestration or other sanction associated with those rules, which still exist today.

Considerations in designing an enforcement mechanism

There is little question that enforcement mechanisms, when designed correctly, can play an important role in helping policymakers adhere to budget goals. There are critical lessons to be learned from the last 35 years about how to design an effective budget enforcement regime that will complement the deficit reduction targets set out in this plan.

First, the enforcement mechanism should be statutory. Mere congressional rules are too easily breached or disregarded. A system of PAYGO backed up by an automatic sequestration process, such as the BEA provided, should be reinstated through federal law and reformed so that it is a true incentive for Congress to stay on course. Statutory PAYGO has worked to get Congress to enact responsible budgets in order to avoid a draconian imposition of sequestration. The House of Representatives, by voting to reinstate statutory PAYGO rules this year, took a critical first step and the Senate should follow suit.

That measure, however, will only help keep Congress from making the deficit problem worse. It will not by itself drive deficits down. Congress should set out a path toward balance with measurable targets that are effectively enforced. There are several elements that could be important to structuring a truly strong enforcement measure.

The central objective of an enforcement measure should be to motivate Congress and the president to make the policy tradeoffs needed to hit targets, rather than face the arbitrary effects of sequestration. The sequestration rules must therefore apply broadly. If the threat of sequestration only puts a few programs at risk, the rules invite obstructionism.

The concept of sequestration should be broadened beyond its previous implementations. It should apply to spending across the board. More importantly, it should include automatic tax increases as well as automatic spending cuts. Revenues that are too low are as much of the cause of deficits as spending that is too high.

Automatic tax increases should be part of sequestration in two forms. First, across-the-board tax increases akin to the spending provisions should be in place. Second, with more-and-more government policy being implemented through the tax code rather than the spending budget, tax expenditures should be included in the automatic spending cuts. Tax expenditures are the equivalent of spending. In energy policy, for example, it's measures like the oil depletion allowance and the Production Tax Credit; for innovation policy it's the Research and Experimentation Tax Credit; and for housing policy it's the mortgage interest deduction and the Low-Income Housing Tax Credit. These are government programs just like those that are handled through the spending side of the budget. Not including these costs distorts and undermines the sequestration and would encourage lawmakers to move even more programs to the tax side of the ledger.

An across-the-board rule that requires in equal parts cuts in traditional government spending, cuts in tax expenditures, and increases in taxes would concern champions of all programs and opponents of all taxes. The pain of such a sequestration rule would strongly motivate all policymakers to engage in responsible budget making in order to avoid its use.

An enforcement mechanism must have teeth, but also be flexible when economic or other circumstances require a change in direction or short-term deviations. In the past, a safety valve was tripped when economic growth was negative for two consecutive quarters. The federal unemployment rate would be a more appropriate trigger than falling GDP for temporarily suspending budget discipline. We do not want to put the brakes on the economy by constraining deficit spending as long as unemployment is high, even if there is GDP growth.

Congress and the president should certainly have the flexibility to forego strict compliance with the more stringent standards on the path outlined above when unemployment is high. The path should be calibrated to the level of unemployment. When unemployment exceeds 8 percent, Congress and the president should be left to their discretion on the appropriate level of deficits. When unemployment is running in the 6.5 to 8 percent range, the final step to complete primary or total balance should not be required. More generally, any system should allow for exceptions where special circumstances and events occur. The purpose of enforcement mechanisms is to further better budget policy, not block needed action.

Finally, no enforcement mechanism, no matter how expertly designed, will work unless there is broad, shared agreement among policymakers on the goals and targets—and continuing support as they start to bite. The process can only support lawmakers' will to make hard policy choices; it cannot be a substitute for it.

Conclusion

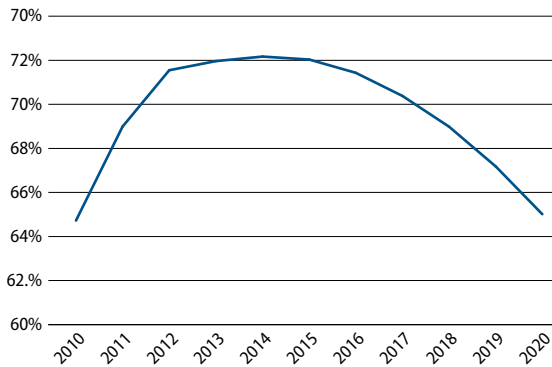
The dangers posed by ignoring persistent, large deficits are real, but so too are the dangers posed by overreacting or attempting immediate fiscal retrenchment. That is why we have proposed a path toward full budget balance that entails significant measurable steps forward in each year without risking our economic well-being.

Our plan includes both an ultimate goal of full balance by 2020 and an intermediate goal of primary balance by 2014. The plan also includes annual benchmarks against which we can measure our progress toward the goals. We have also outlined some principles to guide lawmakers in setting up a budget enforcement regime that will help them achieve the goals in recognition that a deficit reduction plan without enforceable rules for budget discipline is less likely to succeed.

The results of following this path will be notable. Our national debt will pause at 70 percent of GDP instead of climbing to 80 percent of GDP or more; it will drop to 65 percent of GDP by 2020, and it will be on a downward trajectory.⁸ Markets will be reassured, the burden of paying of debt will be relieved, more funds for important services and investments will be available, and we will have a stronger nation.

Getting the federal budget into balance will not be easy or simple. It will require making hard choices about how we want to expend public resources, and how we want to pay for the public services we expect to receive. It will require compromise and discipline. The path will be hard, but not impossible.

Projected debt as a percent of GDP, assuming targets are met



Source: Author's calculations.

Endnotes

1 Our estimates of the overall deficits produced by hitting the targets proposed in this paper are based on the June 2009 Congressional Budget Office projection of the president's 2010 budget. Obviously, any analysis of our fiscal future is dependent, in part, on the specific projections one chooses to employ.

While CBO's baseline projections are often used, they are problematic given the magnitude of expected changes from current law. For example, the CBO baseline assumes that all of the tax cuts passed under the Bush administration will expire. It also assumes that revenue from the Alternative Minimum Tax will grow at a very fast rate and that Medicare payments to doctors will be cut. It makes these assumptions because that is what is scheduled to happen under current law, even though Congress and the president have clearly signaled their intentions to do otherwise. One could, instead, employ a current policy baseline, but there are problems inherent in that choice as well. A current policy baseline would assume that none of the Bush tax cuts expire, and that is similarly unlikely.

As a representation of likely overall spending and taxing trends, if not the details, President Obama's budget blueprint serves well. As the analyses in this paper are largely unaffected by the details of what's in the budget, which we know will be different than what the president proposed, we choose this as the basis for our analysis.

2 Congressional Budget Office, "An Analysis of the President's Budgetary Proposals for Fiscal Year 2010" (June 2009).

3 See, for example, Senator Charles Grassley, "Time to Reverse Spending Spree," Iowa Politics.com, available at <http://www.iowapolitics.com/index.iml?Article=178814>.

4 See, for example, Robert E. Rubin, Peter R. Orszag, and Allen Sinai, "Sustained Budget Deficits: Longer-Run U.S. Economic Performance and the Risk of Financial and Fiscal Disarray" (Washington: Brookings Institute, 2004); William G. Gale and Peter R. Orszag, "The Economic Effects of Long-Term Fiscal Discipline" (Washington: Tax Policy Center, 2002).

5 According to the Congressional Budget Office's projections of the president's budget, net interest payments on the debt will be almost \$800 billion in 2019, while total nondefense discretionary spending will be less than \$750 billion.

6 Michael Ettlinger and Michael Linden, "Deal with It: A Guide to the Federal Deficit and Debt" (Washington: Center for American Progress, 2009), available at http://www.americanprogress.org/issues/2009/09/deal_with_it.html.

7 Funds borrowed from the various government trust funds, especially the Social Security Trust Fund, do not count as revenues. Similarly, the costs associated with paying back those borrowed funds are not counted as outlays. This is typical of federal budgeting, consistent with how the Congressional Budget Office scores these transfers of funds. Tax revenues that feed the trust fund, like payroll taxes, do count as overall revenues and spending on government programs that are associated with trust funds, like Social Security, does count toward overall outlays. In other words, the measure proposed here does not exempt any portion of the unified budget.

8 These projections of publicly held debt include estimates of the savings incurred from the reduced debt service payments that would be associated with meeting our proposed targets.

The Center for American Progress is a nonpartisan research and educational institute dedicated to promoting a strong, just and free America that ensures opportunity for all. We believe that Americans are bound together by a common commitment to these values and we aspire to ensure that our national policies reflect these values. We work to find progressive and pragmatic solutions to significant domestic and international problems and develop policy proposals that foster a government that is “of the people, by the people, and for the people.”

