Center for American Progress

A Path to Balance

A Strategy for Realigning the Federal Budget

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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.

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