Testimony for the
U.S. House of Representatives
Committee on the Budget
John M. Spratt, Jr., South Carolina, Chairman

on

"Perspectives on Long-Term Deficits"

by

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Mr. Chairman, members of the Committee, thank you for inviting me here today and giving me the opportunity to talk about the Center for American Progress's recent proposal for achieving fiscal sustainability.

The position you are in today is not one I envy. This committee is faced with a very serious, and very delicate challenge – addressing a truly dangerous long term deficit outlook, while also ensuring our economy recovers fully from the worst recession since the Great Depression. To get it right, policymakers must perform the metaphorical equivalent of navigating the ship of state through an extremely narrow waterway.

Both overcorrecting and undercorrecting pose serious threats to our economy. Failing to adequately address long term deficits, on the one hand, threatens to result in a number of negative consequences. High levels of government borrowing can reduce

domestic investment, raise interest rates, and spur inflation; seriously hinder the ability to make important public investments; and potentially leave us unable to stimulate the economy in a time of future crisis. The threat of sustained deficits can also lead to strong reactions by economic actors – investors, consumers, trading partners – that increase the likelihood of additional financial turbulence and threaten the stability of the dollar.

Overcorrecting, on the other hand – closing the spigot on the American Recovery and Reinvestment Act, in particular, before the economy has fully recovered – would both jeopardize our economy and kill the prospect of job growth, while also making it *harder*, over the long run, to address the deficit outlook over the next decade. Pursuing drastic and immediate deficit reduction when the economy has only recently returned to growth and unemployment is still at 10 percent would be an enormous mistake; fiscal retrenchment right now could lead to a double-dip recession. Those who would use current deficits as an excuse to curtail or prevent policies designed to speed the recovery are doing the country and future budgets a disservice. Recovery spending today is both necessary and entirely appropriate, even in light of the long term budget challenge. It accelerates the recovery. Taking these appropriate steps today, in order to bring the economy back to its full health, will put us in the strongest position from which to undertake deficit reduction over the longer term. Deficit spending in the near term will help produce a return to robust economic and employment growth, yielding significant dividends in terms of future deficit reduction.

Again, the challenge at hand is to strike a delicate balance – to implement measures that will restore growth, create jobs, and bring the U.S. economy back to full strength while, at the same time, laying out a credible path for stabilizing, then reducing, U.S. debt levels. The Center for American Progress has proposed a roadmap for making steady progress towards fiscal sustainability between now and the end of this decade. But before looking forward, I'd like to provide some broader context on how we arrived in this position in the years since I served in the Clinton Administration.

In 1998, we had balanced the budget after inheriting a deficit of 4.6 percent of GDP. After the 2000 elections, we left the incoming administration a balance sheet that was $236 billion in the black – the largest surplus since 1948 – and CBO projected surpluses would reach almost $710 billion by 2009 based on policies then in place.

By the time President Obama was sworn in, the deficit had already reached $1.2 trillion, a remarkable swing of 10 percentage points of GDP since our Administration left office, and the debt had nearly doubled. How did we get from record surpluses to record deficits?

The near-term deficits are primarily the result of fiscal deterioration occurring since 2001. Deep tax cuts, especially for high-earners, dramatically affected the federal balance sheet, while the wars in Iraq and Afghanistan and major new spending programs were undertaken without being paid for. The predictable result of cutting taxes while increasing spending at this rate was steep fiscal decline on a scale unseen since World

War II, along with an unprecedented explosion in debt. Under the previous administration, publicly held debt ballooned from $3.4 trillion to $6.3 trillion, which marks the largest increase in debt of any president in history.

Multiple independent analyses conducted by the New York Times, the Economic Policy Institute, the Center on Budget and Policy Priorities and the Center for American Progress have all shown that huge portions of current and future deficits are directly attributable to the lasting effects of those policies. Policies enacted during this period are responsible for more than half of the deficits in 2009 and 2010; the cost of the Bush tax cuts alone, if not permitted to expire, will exceed $5 trillion over the next ten years.

The recession has also contributed to the corrosion of the near-term fiscal outlook. Tax revenues plummeted; in fiscal year 2009, they dropped to their lowest point since 1950. In fact, the decline in tax revenues from 2008 was four times larger than all new spending initiated since the inauguration of President Obama. Only 18 percent of the 2009 deficit is attributable to policies passed by this Congress.

The country is in a weaker economic and fiscal position today not because of the American Recovery and Reinvestment Act that passed in 2009, but because of fiscal policy and regulatory decisions made in previous years. Having said that, it is also clear that going forward, long-term deficits pose substantial risks to the overall economic well-being of the United States and to prospects for shared prosperity. These long-term deficits are driven largely by two underlying trends: the aging of the population and the

rising cost of health care. During the past eight years, these two trends went unaddressed, even as the dangers they posed to our long-term fiscal health became clearer and clearer. Combined with a chronic need for more overall revenue, these underlying trends threaten to overwhelm the federal budget in the near future. According to current projections, the federal budget deficit will remain well above four percent of GDP for at least the next ten years and will balloon even further afterwards. If we allow that to take place, publicly held debt will mushroom from around 50 percent of GDP currently to over 80 percent by 2019.

The scale of these challenges means that there are no easy or simple answers. Meeting the challenge will require a balanced approach that includes a variety of contributing solutions. Primary among them must be policies that bring down the costs of health care. Let me underscore this point: there can be no return to fiscal sustainability without substantial health reform. While the prospects of reform may seem uncertain as we sit here today, the economic health of our country – as well as the health and well-being of American citizens – depends on finding a way forward on health reform that produces significant delivery reform, reduces the rate of health care inflation, and makes health coverage affordable for families and businesses.

In addition to controlling health care costs, there needs to be a renewed commitment to setting priorities, only spending taxpayer dollars on programs that work, and building a smarter, more productive government that makes the most of every tax

dollar. We will also need a sustainable and affordable national security policy and well-designed reforms to large entitlement programs, including Social Security.

Finally, it must be acknowledged by everyone who is serious about improving the nation's fiscal future that spending cuts alone will not solve the problem. The country will need more revenue. Any serious review of the budget numbers necessarily results in this conclusion. For example, balancing the budget by 2019 without significant cuts to certain priorities such as debt-service payments, defense spending, Medicare or Social Security and without raising any additional revenue would lead to cuts in the rest of the budget of close to 70 percent. Cuts of that magnitude are both unrealistic and unwise. Simply put, those who suggest deficit reduction can be achieved only through spending cuts or only through tax increases misunderstand the enormity of the challenge.

It is also worth noting that the last time we faced a major budget problem in the 1990s, tax increases were a significant part of the solution, and the country enjoyed the longest period of continued economic growth in history. The supply-side economic policies pursued during the subsequent decade proved far less effective, whether measured by growth in the overall economy, job creation, or median wage growth.

We believe that Congress can take action now to lay out a path back to fiscal sustainability. Many of the dangers of large, persistent deficits stem from the perception that the budget is permanently out of balance. A reasonable, realistic plan to get the budget back in the black would alleviate those fears. And while, as I've already

mentioned, it would be extremely unwise to try for immediate fiscal retrenchment, setting out a path allows us to take meaningful, concrete steps toward the ultimate goal without risking economic backsliding.

We propose an ultimate goal that is simple and straightforward: a completely balanced budget by 2020. During good economic times, there is no reason to run deficits. The default position of the federal budget should be balance, and the red ink should be reserved for recessions and emergencies. However, given the deep hole in which we currently find ourselves and the strength of underlying trends, we cannot rush to full balance right away. The magnitude of the problem is simply too large to try and solve it all in one fell swoop.

That is why we have proposed an intermediate goal, in addition to the ultimate goal, that can be set in the near-term and which will, if reached, put the budget on much stronger ground. We believe that intermediate goal should be primary balance. Primary balance is when total revenues equal total spending with the exception of debt service payments. A budget in primary balance would mean a fundamental return to responsible budgeting – we would not be borrowing to pay for any government programs, services or public benefits. Furthermore, budgets in primary balance have historically resulted in a declining debt-to-GDP ratio.

To reach these two goals, intermediate and ultimate, we are proposing specific annual targets that make steady progress in each year. These targets are expressed as

revenues as a share of spending. In fiscal year 2009, for example, federal revenues covered only 60 percent of all spending. Our proposal has that ratio going up to 100 percent over the next ten years, with targets in each individual year. These annual targets will need to be supported by a system of statutory mechanisms designed to enforce fiscal discipline that will make it difficult to deviate from the path. To accomplish this, we would recommend that missing the annual revenue to spending ratio target trigger automatic reductions in spending that would affect both traditional programs and tax expenditures. The point is not to trigger sequestration, but to ensure that the consequences of failure are clear and therefore avoided. Of course, the statutory regime should also include "safety-valve" measures to allow for flexibility if weak economic conditions persist or reappear.

To achieve deficit reduction targets will require a statutory budget enforcement regime. It was, in part, through statutory provisions that included PAYGO that the budget discipline of the 1990s was achieved and the surpluses of that era accomplished. Statutory PAYGO enforced by a sequestration process has been effective in the past and can again serve us well as we address our fiscal challenges. The House is to be praised for reinstating statutory PAYGO and the Senate should follow suit. We believe, however, that in order to really serve as a discipline on the process PAYGO enforcement should be broadened to include not just spending but taxes as well—tax expenditures in particular. Tax expenditures have the same impact on deficits as mandatory spending, have had a growing role and should not be held harmless if we are serious about enforcing PAYGO discipline.

A deficit commission appears likely and this could prove to be a useful step forward for addressing our deficit challenges. However, a commission without a clear mandate and specific goals is likely to fail. If the purpose of creating a commission is to have a mechanism to make progress on an extremely difficult issue, then it is important to charge that commission with a clearly defined goal. Otherwise, the commission is likely to do no better than any other process in getting us closer to a fiscally responsible budget. As noted earlier, we believe an achievable set of goals for the commission could be primary balance by 2014 and full balance by 2020.

There is no doubt that we face serious fiscal challenges in the years ahead. Persistent deficits carry with them significant risks and simply cannot be tolerated in perpetuity. Acting hastily would also be dangerous and therefore substantial deficit reduction should be delayed until the economic recovery is stronger. But we can take steps now to mitigate many of the most serious risks that stem from our long-term budget woes. By adopting an appropriate path to fiscal sustainability, complete with annual targets, we will demonstrate a real commitment to getting the budget gap under control. In the near term, achieving primary balance will prevent our debt level from rising further and it will put the government in a much stronger position to realize the long-term goal of complete balance. Though the challenge is certainly daunting, it is not insurmountable. Adopting a path to balance, such as the one we have proposed, is a good first step toward meeting that challenge.

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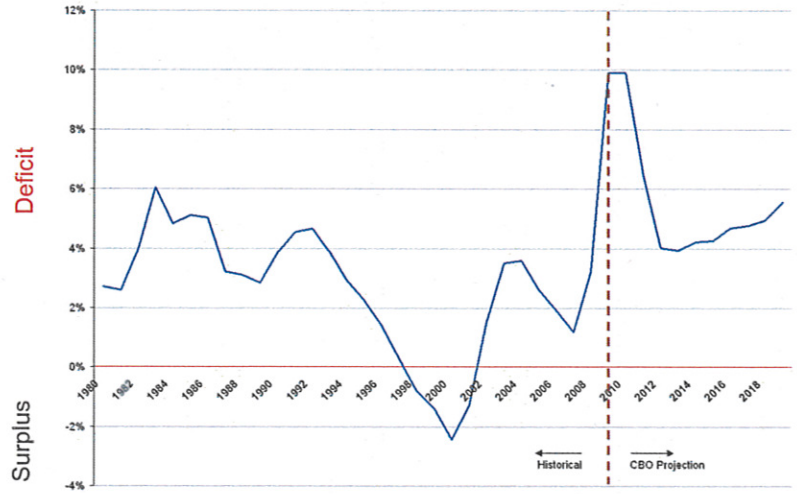
Federal deficit/surplus, as a percent of GDP (1980-2019)



Sources: Congressional Budget Office and the Office of Management and Budget

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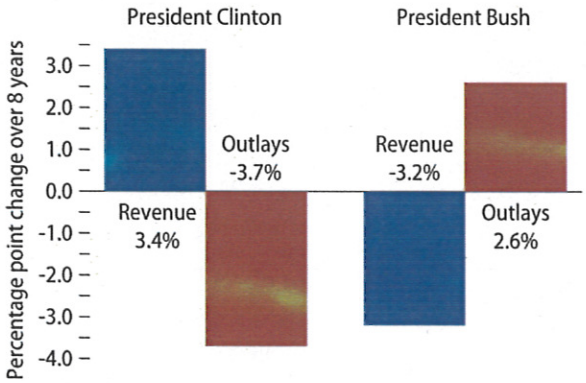
Total change in federal revenues and outlays under Presidents Clinton and Bush, 1992–2008



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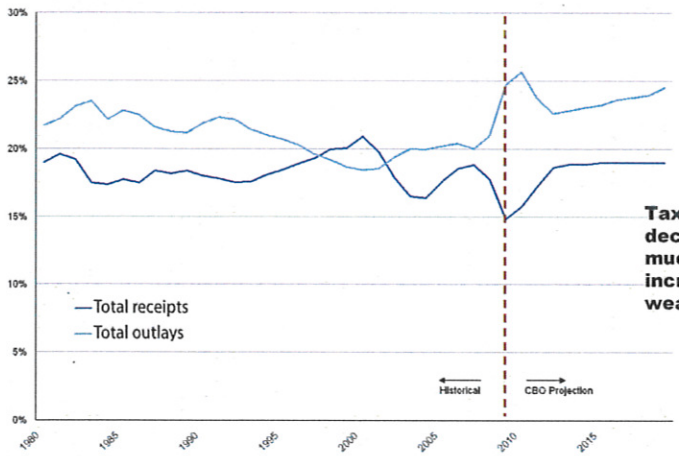
Total federal receipts and outlays, as a percent of GDP (1980-2019)



Tax revenues in 2009 declined by about as much as spending increased due to the weak economy.

Sources: Congressional Budget Office and the Office of Management and Budget

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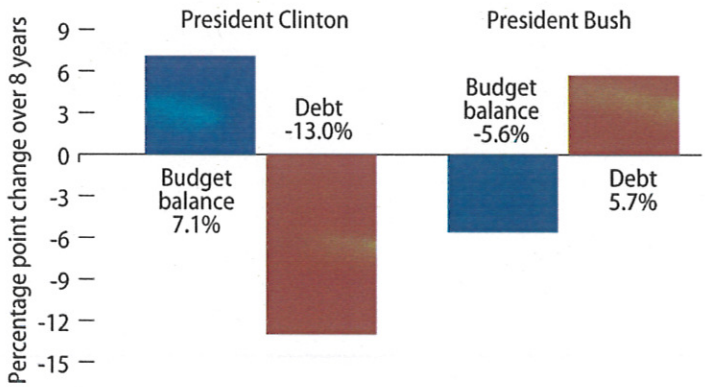
Total change in federal budget and debt relative to GDP under Presidents Clinton and Bush, 1992–2008



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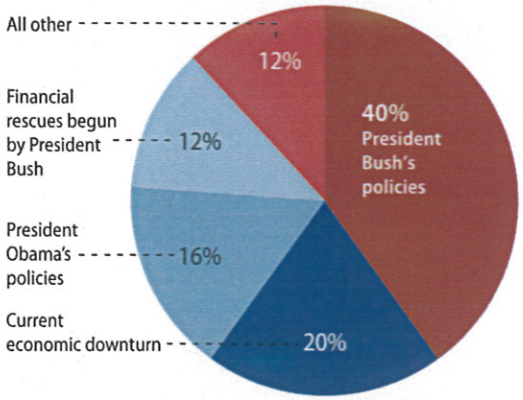
Contribution to fiscal deterioration 2009 and 2010



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

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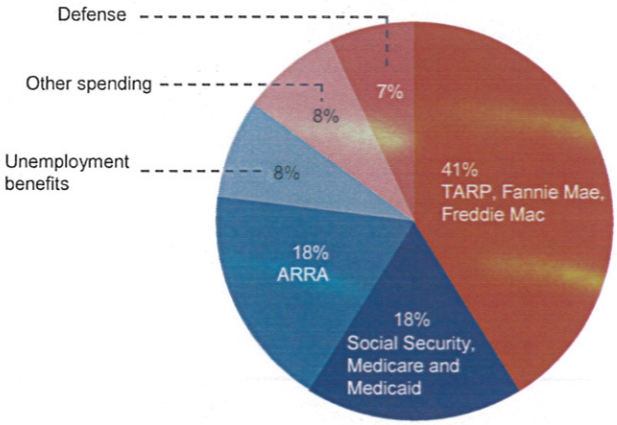
Sources of increased spending in fiscal year 2009 over fiscal year 2008 levels



Source: Michael Linden, "Breaking Down the Deficit" (Washington: Center for American Progress, 2009).

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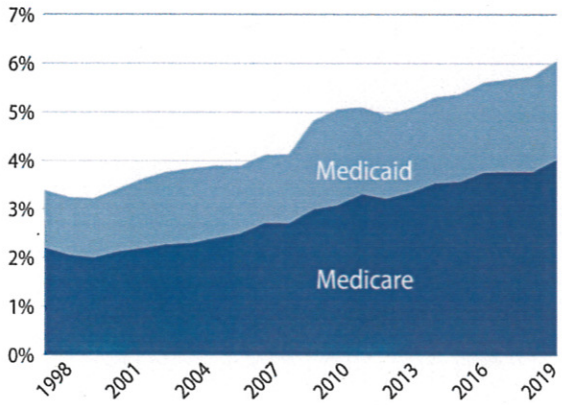
Federal Medicare and Medicaid spending, as a percent of GDP (1998-2019)



Source: Congressional Budget Office

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What would it take to achieve primary balance by 2014?

(rough estimates based on projected primary deficit of 1.8% of GDP)

Spending Cuts Alone

If we cut:

Everything - 8% cut

Everything but…

- debt service – 9% cut
- debt service, Social Security – 12% cut
- debt service, SS, Medicare – 15% cut
- debt service, SS, Medicare, defense – 22% cut

Just non-defense discretionary – 49% cut

Tax Increases Alone

If we increased taxes on:

Everyone - 10% increase

Only those making over $250,000 - ~40% increase and corporations

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