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Balancing the Budget in Ten Years and No New Revenue Are Flawed Budget Goals

By Robert Greenstein and Joel Friedman

The House is expected to begin work on its fiscal year 2017 budget resolution as soon as next week. Press reports suggest that the forthcoming House budget, like other Republican budgets in recent years, will be shaped in substantial part by two fiscal goals: balancing the budget over ten years, which would likely require more than $6 trillion in policy savings (not counting the related interest savings),[1] and doing so without any new revenue. The combination of these two goals makes it highly likely that the House Republican budget will be built around policies that would increase poverty and inequality and adversely affect many low- and middle-income families.

Last year, congressional Republicans adopted a budget calling for nearly $5 trillion of cuts in domestic programs over ten years, with about two-thirds of those cuts coming from programs focused on low- and moderate-income households — even though such programs account for about one-quarter of all program costs. That budget would have made health insurance unaffordable for tens of millions of Americans, increased poverty and serious hardship, and squeezed investments in programs such as education and basic research that can boost opportunity and future productivity growth. This year's Republican budget would likely cause even more hardship, as more than $1 trillion of additional cuts (relative to last year) will be needed to reach balance by the end of the decade.

The structure of Republican budgets has changed little over the past few years, dating back to the budgets authored by Speaker Paul Ryan when he was chairman of the House Budget Committee. So congressional GOP leaders will likely continue to adhere to the goals of balancing the budget and placing the entire burden of deficit reduction on spending programs.

Some may defend a no-new-revenue approach to deficit reduction by claiming that the federal government's size and reach are expanding dramatically. The data, however, do not support such a claim, as a recent CBPP analysis demonstrates. Federal program spending (excluding interest costs)

[1] With the associated interest savings, the total deficit reduction would likely approximate $7 trillion. The estimates in this paper are measured relative to the CBPP baseline, which is similar in nearly all respects to the Congressional Budget Office baseline. For an explanation of the differences, see the technical note in Robert Greenstein, Joel Friedman, and Isaac Shapiro, "Program Spending Historically Low Outside Social Security and Medicare, Projected to Fall Further," Center on Budget and Policy Priorities, updated February 24, 2016, http://www.cbpp.org/research/federal-budget/program-spending-historically-low-outside-social-security-and-medicare?fa=view&id=3696.

outside Social Security and Medicare is now *below* its average over the last 40 years (1976-2015) and is projected to decline further under current policies. To be sure, Social Security and Medicare spending is projected to rise over time. But that reflects an aging population and rising health care costs throughout the U.S. health care system, rather than expanded coverage or more generous benefits.[2]

By ruling out any deficit reduction from revenues, Republican budgets leave untouched the more than $1 trillion a year in tax expenditures — tax credits, deductions, and other preferences that are effectively spending through the tax code. Conservative Harvard economist and former Reagan economic advisor Martin Feldstein has said that reducing tax expenditures is "the best way to reduce government spending." Moreover, tax expenditures disproportionately benefit well-to-do Americans. So a budget that adheres to the balanced-budget mantra while ruling out any deficit reduction from tax expenditures will almost certainly place the onus of deficit reduction on programs disproportionately serving Americans with modest incomes.

The major successful deficit-reduction efforts of the past have relied on a balanced mix of program reductions and revenue increases. They include the bipartisan budget deal of 1990 (under President George H.W. Bush) and the Democratic plan of 1993 (under President Clinton). Those plans contributed to transforming the huge deficits of the early 1990s into four straight years of budget surpluses starting in 1998.

The separate bipartisan plans that Alan Simpson and Erskine Bowles (co-chairs of the National Commission on Fiscal Responsibility and Reform) and Alice Rivlin and Pete Domenici (co-chairs of the Bipartisan Policy Center Debt Reduction Task Force) produced in late 2010 also underscore these points. Both plans contained major deficit-reduction measures, including substantial revenue increases as well as program cuts. Neither plan called for budget balance within ten years. These plans sought to reverse the upward trend in the debt ratio without chasing the bumper-sticker slogan of a balanced budget.

In addition, both plans adhered to a principle that deficit reduction *should not increase poverty*. That core principle is virtually impossible to honor if revenues contribute nothing to deficit reduction. Ruling out a revenue contribution virtually ensures that a heavy share of the deficit reduction burden will fall on those least able to bear it.

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[2] Greenstein, Friedman, and Shapiro. A related analysis shows that programs targeted at low-income Americans (outside of health care programs) are not driving the nation's long-term fiscal challenge. Indeed, as a share of gross domestic product, total spending on low-income programs (including health care programs) is expected to decline over the next decade. See Robert Greenstein, Isaac Shapiro, and Richard Kogan, "Low-Income Programs Not Driving Nation's Long-Term Fiscal Problem," Center on Budget and Policy Priorities, updated February 24, 2016, http://www.cbpp.org/research/long-term-fiscal-challenges/low-income-programs-not-driving-nations-long-term-fiscal?fa=view&id=3772.

Budget Balance in Ten Years Not Necessary

"There's nothing magic about exact balance," Alice Rivlin, a former director of both the Congressional Budget Office (CBO) and the Office of Management and Budget, has noted. "The really important thing is to keep the debt from growing faster than the economy."[3]

Box 1: Comparisons to Family and State Budgets Are Seriously Flawed

A common argument is that families and state governments must balance their budgets, so the federal government should do so as well. But these simple analogies are seriously flawed.

Families *don't* balance their budgets every year. When a family buys a house or sends a child to college, it often takes out a mortgage or loan and thereby runs a "deficit." If a family had to balance its budget every year, it could spend only what it earned that year, which would preclude important investments that could raise its future income and well-being. The family couldn't even spend amounts it had saved in prior years, as even that would constitute "deficit spending."

Similarly, while states must balance their *operating* budgets, they can and do borrow to finance their *capital* budgets, which include long-term investments such as roads and schools. Overall, state and local governments have outstanding debt of about $3 trillion. If state budgets were constructed like the federal budget, which combines capital and operating budgets, then most states would be out of balance.

Rivlin's observation is on point. Keeping the debt ratio — the debt held by the public as a percent of gross domestic product (GDP) — from rising is the soundest approach. The debt ratio should grow only during hard economic times or major emergencies, and budget plans should be designed with their effects on the debt ratio in mind.

Currently, the debt ratio is 76 percent of GDP. It will remain roughly stable for the next few years under current policies and then begin to slowly rise for the rest of the decade (and beyond).

Keeping the debt ratio on a reasonable path (and at a reasonable level) is important for several reasons. A perpetually rising debt-to-GDP ratio is unsustainable. Most economists view temporary increases in deficits and debt as normal and desirable in a weak economy; these increases support demand for goods and services, maintain jobs, and make recessions shorter and shallower than they otherwise would be. In contrast, most economists view large, sustained budget deficits when the economy has fully recovered as harmful. The borrowing needed to finance them leaves less national saving available for U.S. businesses to make productive investments, and borrowing abroad creates obligations for future interest payments to foreigners that reduce future U.S. national income.

In addition, investors both here and abroad view Treasury securities as among the safest in the world, as reflected by the historically low interest rates on our debt; but if the debt ratio grows too high, international credit markets might at some point decline to lend to the U.S. public or private sectors at a reasonable price. No one knows precisely what "too high" means for the United States, and such a turn of events seems remote and unlikely today, with interest rates historically low. But even if chances of such a disruptive event are very small, keeping the debt ratio from rising during good times is prudent.

[3] Annie Lowrey, "Balanced Budget Dispute is Fiscal and Philosophical," *New York Times,* March 12, 2013, http://www.nytimes.com/2013/03/13/us/politics/balanced-budget-fight-is-philosophical-and-fiscal.html.

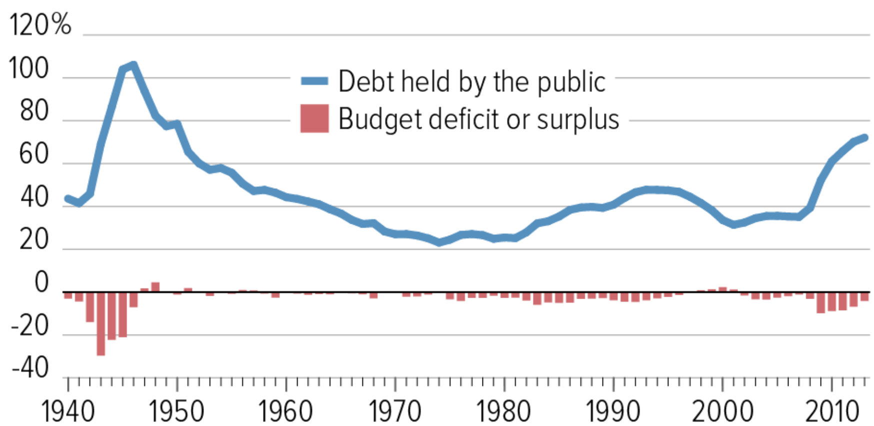
Stabilizing the debt ratio at a reasonable level also gives policymakers the fiscal flexibility to respond to crises and combat economic downturns through temporary program increases and tax cuts. Policymakers can boost the economy and address rising economic hardship during bad times without the risk of sending the debt to unmanageable levels.

This approach creates a presumption against policies that increase the debt ratio during good times. Rather, the debt ratio should be stable or decline during good times; ensuring that it does not rise during normal economic times is a minimum appropriate budget policy.

FIGURE 1

Budget Deficits and Debt Held by the Public

Percent of gross domestic product



Source: Office of Management and Budget, Historical Tables 7.1 and 1.3

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But it isn't necessary to balance the budget — whether in ten years or over a longer period — in order to stabilize or reduce the debt ratio. Between 1946 and 1979, the debt ratio plummeted from 106 percent of GDP to only 25 percent. Yet in only *eight* of those 33 years was the budget in balance or in surplus. (See Figure 1.) And in dollar terms, the debt grew by more than two-and-one-half times over that period. Annual deficits were relatively modest, however, and the debt grew much more slowly than the economy did. As a result, the debt ratio fell markedly, which is what counts. This also is why maintaining or enhancing economic growth is very important to fiscal sustainability.

Moreover, while a lower debt ratio has benefits, putting the debt ratio on a declining path can also have significant costs, depending on the circumstances. As discussed below, the steeper the declining path, the larger the required program cuts or revenue increases, which in some circumstances could weaken an economic recovery, erode health coverage, and/or damage the safety net, adversely affecting millions of Americans.

Requiring Balance in Ten Years Poses Significant Risks

Balancing the budget in ten years would likely necessitate more than $6 trillion of program cuts or revenue increases over the decade. And while balancing the budget over the decade would not have to occur through the spending-cuts-only approach that Republican leaders have championed, even a package seeking budget balance in ten years through a combination of budget cuts and revenue increases would risk significant problems.

First, in the short run, balancing in ten years would likely have adverse effects on the economy. Although the economy is continuing to recover, CBO expects some slack to persist for a few years. The substantial deficit reduction required in the near term to put the budget on a path to balance in ten years would slow the recovery. In fact, CBO estimated that last year's Republican plan to balance the budget over ten years would slow economic growth for the first three years because the reduction in spending would weaken overall demand.[4]

In addition, any plan to balance the budget in this timeframe almost certainly would include deep cuts in health care programs. Slowing health care cost growth is vital, but we don't yet know how to do so on the scale needed to get to budget balance in ten years without sacrificing health care quality, impeding access to care, or significantly increasing the number of uninsured Americans. Adding to this challenge is the fact that a substantial part of health care cost growth reflects medical advances — treatments and medications that improve health and save lives, but raise costs.

As a result, mandating very large cuts in major health care programs now in pursuit of a balanced budget in ten years would likely shift substantial costs and burdens to states, families, and private employers and harm some of the most vulnerable members of society — and could do so *without* addressing the underlying causes of rising costs. Our knowledge of effective ways to slow cost growth without sacrificing quality of care will likely grow substantially in coming years, as various research and demonstration projects now underway (some initiated under the Affordable Care Act) begin to yield results and as we amass more data that helps policymakers better understand changes occurring in the health care sector.

No-Revenue Approach Hurts Middle- and Lower-Income Households

Last year's Republican plan, which followed the outline of four previous plans crafted by then-House Budget Committee Chairman Paul Ryan, slashed non-defense programs by $4.9 trillion over ten years, with nearly two-thirds of those cuts occurring in programs targeted on people with low or moderate incomes. Under the plan, tens of millions of low- and moderate-income people would have become uninsured due to the elimination of the Affordable Care Act's health insurance coverage and deep cuts to Medicaid.[5]

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[4] Congressional Budget Office, "Budgetary and Economic Outcomes Under Paths for Federal Revenues and Noninterest Spending Specified in the Conference Report on the 2016 Budget Resolution," April 2015.

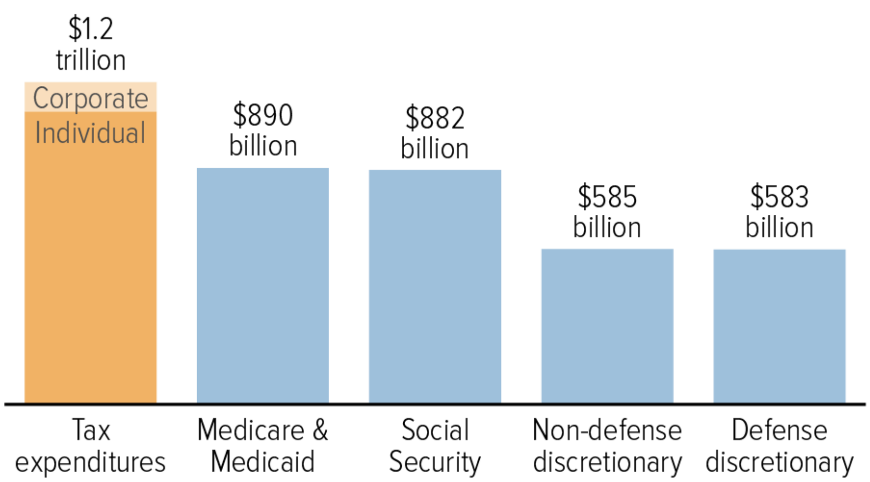
[5] While the conference agreement did not specify the policies to achieve these deep Medicaid cuts, the House-passed budget called for converting Medicaid from an entitlement to a block grant. History shows block grants tend to lose value over time. See Isaac Shapiro *et al.,* "Funding for Housing, Health, and Social Services Block Grants Has Fallen Markedly Over Time," Center on Budget and Policy Priorities, revised November 20, 2015, http://www.cbpp.org/research/federal-budget/funding-for-housing-health-and-social-services-block-grants-has-fallen.

The plan also called for sharply cutting basic food aid provided by SNAP (formerly food stamps) and cutting Pell Grants, which would make it harder for low-income students to afford college. In addition, the plan cut funding for non-defense appropriated programs *below* the already-austere levels required under sequestration, dangerously squeezing the portion of the budget that invests in infrastructure, research, education, and other building blocks of economic growth and opportunity.[6]

FIGURE 2

Tax Expenditures Are Very Costly

Tax expenditures vs. selected major program expenditures, 2015



Notes: Tax expenditure estimates do not account for interaction effects and do not include associated spending ($161 billion), effects on excise and payroll receipts ($128 billion), or "tax extenders" made permanent or extended retroactively at the end of 2015.

Source: Office of Management and Budget, Historical Tables 8.5 and 8.7, and Analytical Perspectives Table 14.2

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These outcomes were in no small part a result of the budget's rigid adherence to a "no new revenue" pledge. Such a pledge means more than simply eschewing tax rate increases. It also means ignoring the vast amounts of spending through the tax code — the broad category of tax exclusions, deductions, and other tax preferences known collectively as "tax expenditures."

Martin Feldstein, a former chair of President Reagan's Council of Economic Advisers, has said that tax expenditures are "a major form of government spending."[7] Because many are wasteful, he

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[6] Robert Greenstein and Richard Kogan, "Ten Serious Flaws in the Congressional Budget Plan," Center on Budget and Policy Priorities, updated June 8, 2015, http://www.cbpp.org/research/federal-budget/ten-serious-flaws-in-the-congressional-budget-plan. For all CBPP analyses of last year's Republican budget resolution, see "Congressional Budget Roundup 2015: Everything You Need to Know About the House and Senate Budget Plans," http://www.cbpp.org/blog/congressional-budget-roundup-2015-everything-you-need-to-know-about-the-house-and-senate-budget.

[7] Martin Feldstein, "Tax Reform for Economic Growth: Testimony to the Committee on Ways and Means," House Ways and Means Committee, January 13, 2015, http://waysandmeans.house.gov/uploadedfiles/feldstein_testimony_011315_fc.pdf.

argues that "cutting tax expenditures is really the best way to reduce government spending."[8] Similarly, former Federal Reserve Chairman Alan Greenspan has called them "tax entitlements"[9] because most of them closely resemble entitlement programs and are essentially subsidies provided on an entitlement basis and delivered via the tax code. (See Box 2 for the similarities between spending and tax subsidies for child care.)

Tax expenditures cost more than $1 trillion a year — more than Social Security, more than Medicare and Medicaid combined, and double the total cost of all non-defense discretionary programs (see Figure 2).

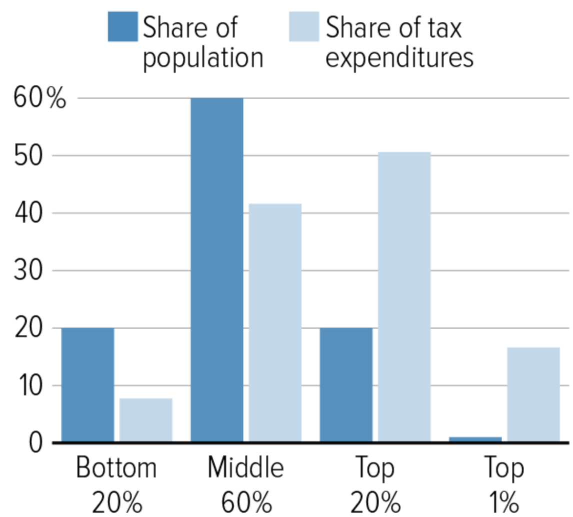
Tax expenditures include many popular and meritorious provisions, but also a wide array of inefficient or special-interest provisions, which litter both the individual and corporate sides of the tax code. (President Obama's budgets have proposed eliminating or reining in many dubious tax provisions; we've examined a number of such provisions.[10])

And overall, tax expenditures disproportionately benefit the most well-off. As Figure 3 shows, the most affluent 20 percent of Americans receive 51 percent of all tax expenditure benefits, with the richest 1 percent alone getting 17 percent of the benefits, while the middle 60 percent of households receive 42 percent of the benefits and the poorest 20 percent of households receive just 8 percent.

FIGURE 3

Wealthy Households Receive Disproportionate Share of Tax Expenditures

Shares by income group, 2013



Note: Bottom 20% means 20% of tax units with lowest incomes, etc.

Source: Congressional Budget Office

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In sharp contrast, the middle 60 percent of households receive a proportionate share (58 percent) of the benefits of entitlement programs on the spending side of the budget. The poorest fifth of households receive 32 percent of these benefits.[11]

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[8] Martin Feldstein, "The 'Tax Expenditure' Solution for Our National Debt," *Wall Street Journal,* July 20, 2010, http://online.wsj.com/article/SB10001424052748704518904575365450087744876.html.

[9] Alan Greenspan, in response to a question from Rep. Eva Clayton before the Bipartisan Commission on Entitlements and Tax Structure Reform, Federal News Service Transcript, July 15, 1994.

[10] Chuck Marr and Chye-Ching Huang, "President's Capital Gains Tax Proposals Would Make Tax Code More Efficient and Fair," Center on Budget and Policy Priorities, January 18, 2015, http://www.cbpp.org/cms/?fa=view&id=5260. For a discussion of tax expenditures that can be reformed as part of a deficit-reduction effort, see Chuck Marr, Chye-Ching Huang, and Joel Friedman, "Tax Expenditure Reform: An Essential Ingredient of Needed Deficit Reduction," Center on Budget and Policy Priorities, February 27, 2013, http://www.cbpp.org/cms/?fa=view&id=3912.

[11] Robert Greenstein, "Achieving Further Deficit Reduction Solely Through Spending Cuts Entails Cutting Entitlements That Benefit the Poor and Middle Class While Shielding the Biggest Entitlements for the Wealthy," Center on Budget

As a result, cutting spending entitlements while shielding tax entitlements would be highly regressive. It also would constitute a highly selective approach to so-called "entitlement reform" — cutting entitlement programs whose benefits go principally to poor and middle-class families while asking for no deficit-reduction contribution from the entitlements that are heavily skewed to people at the top of the income scale and include some particularly wasteful and special-interest-oriented programs.[12]

Box 2: Child Care Illustrates Problem With Spending-Cuts-Only Approach

The budget's treatment of child care subsidies illustrates the illogic — and the inequity — inherent in the posture that programs on the spending side of the budget should be cut, but spending delivered via the tax code must be off limits for deficit reduction.

The federal government provides subsidies for child care costs through both the spending and tax sides of the budget. On the spending side, it funds mandatory and discretionary programs that help low- and moderate-income working parents afford child care. On the tax side, it subsidizes middle- and upper-income families' child care costs through the Dependent Care Tax Credit.

These spending and tax subsidies differ, however, in a key respect. Child care assistance for low-income families that's provided through the spending side of the budget is *capped.* As a result, only one out of every six children in low-income working families that meet the federal eligibility criteria for federal child care assistance receives it.[a] In contrast, the tax subsidy is *open-ended,* so all families that qualify for it — no matter how high their income — can receive it. The tax subsidy, not the spending program, is therefore the pure entitlement.

To insist that all further deficit reduction come from the spending side of the budget is effectively to suggest that Congress cut programs like child care assistance for low- and modest-income working families — even though many of those parents can't afford to work without it — while ruling out any deficit savings from changes in tax expenditures like child care subsidies for affluent parents who don't need them to afford child care.

[a] "Estimates of Child Care Eligibility and Receipt for Fiscal Year 2011," U.S. Department of Health and Human Services, ASPE Issue Brief, February 2015, https://aspe.hhs.gov/report/estimates-child-care-eligibility-and-receipt-fiscal-year-2011.

"Tax reform" that curbs some tax expenditures but uses all of the resulting revenue to reduce tax rates, with none going for deficit reduction, is similarly problematic. It, too, would almost certainly lead to an increase in poverty and inequality. That's because policymakers would have used up the politically feasible savings from reforming tax expenditures and devoted all of those savings to lowering tax rates. They would then likely have no place left to go for deficit-reduction savings on the tax expenditure front, and revenue would effectively be off the table for deficit reduction, likely for years to come. That would place the onus for deficit reduction entirely on spending programs.[13]

and Policy Priorities, January 9, 2013, http://www.cbpp.org/research/achieving-further-deficit-reduction-solely-through-spending-cuts-entails-cutting.

[12] Marr *et al.,* "Tax Expenditure Reform: An Essential Ingredient of Needed Deficit Reduction."

[13] Chuck Marr, Chye-Ching Huang, and Nathaniel Frentz, "The Problem with Deficit Neutral Tax Reform," Center on Budget and Policy Priorities, July 10, 2013.

Conclusion

Enshrining budget balance as the preeminent fiscal policy goal is neither necessary nor appropriate. Such a goal becomes especially damaging if combined with a no-new-revenue stricture that takes all deficit reduction from revenues off the table, including any measure to pare back inefficient or special-interest tax subsidies.

Policymakers should instead seek to put the budget on a sustainable path while encouraging a stronger economic recovery that leads to full employment and a broader sharing of the benefits of economic growth. If that is accomplished, a balanced budget might even materialize at some future point, as it did during the final years of the Clinton Administration.