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Commentary:

Why Balancing the Budget by the End of the Decade Is Not the Right Goal

by Joel Friedman and Robert Greenstein

As the House and Senate consider their respective budget resolutions this week, a key point of debate will be whether balancing the budget over the decade is an essential goal. We don't think it is. We agree with Alice Rivlin, a former director of both the Congressional Budget Office (CBO) and the Office of Management and Budget, who told the *New York Times* last week, "There's nothing magic about exact balance. The really important thing is to keep the debt from growing faster than the economy."

Rivlin's focus on the debt ratio — the debt held by the public as a percent of gross domestic product (GDP) — is the soundest approach. The debt ratio should rise only during hard economic times or major emergencies and should decline during good times. That approach enables the government to combat recessions through tax cuts and spending increases (and to address rising economic hardship during bad times), while creating a presumption against policies that significantly increase the deficit during good times.

The debt ratio cannot rise forever without impairing future productivity growth and ultimately living standards. In a crisis, international credit markets might refuse to lend to the U.S. public or private sectors at a reasonable price. While no one knows precisely what "too high" means for the United States, a debt ratio that rises in both good times and bad will become increasingly problematic.

That's why we think ensuring that the debt ratio does not rise during normal economic times is the minimum appropriate budget policy. The critical goal now is to stabilize the debt in the coming decade without hindering the economic recovery from the worst recession since the Great Depression.

A lower debt-to-GDP ratio has benefits — for instance, it gives policymakers additional flexibility to respond to economic and financial crises. But it also comes at a cost in terms of deeper program cuts, larger revenue increases, or both.

To achieve a balanced budget by the end of the decade necessitates putting the debt ratio on a *very sharp* downward path, as the budget championed by House Budget Committee Chairman Paul Ryan shows. While resisting raising revenues, the Ryan budget cuts programs deeply, with about two-thirds of these cuts occurring in programs that help low- and moderate-income individuals. The Ryan budget would increase poverty, result in tens of millions more Americans lacking health insurance, and squeeze investments in programs such as education and basic research that can boost future productivity growth.

Requiring Balance in Ten Years Risks Serious Unintended Problems

Of course, balancing the budget over the decade wouldn't necessarily require the type of spending-cuts-only approach embodied in the Ryan budget. Yet even a package seeking to balance in ten years that includes both revenue increases and spending cuts, and avoids some of the Ryan budget's worst excesses, would risk causing serious unintended problems.

Such a budget, for example, would almost certainly include deep cuts in health care programs. It's certainly true that we must significantly slow the rate of growth of health care costs throughout the U.S. health care system to help ensure long-term fiscal stability, and our knowledge of effective ways to do so will likely grow in coming years due to changes underway in the health care sector as well as various research and demonstration projects. Right now, however, we don't know how to slow health cost growth on the scale needed to balance the budget in ten years without sacrificing health care quality, impeding access to care, or raising the number of uninsured. Mandating very large cuts in major health care programs now in pursuit of a balanced budget would likely result in shifting substantial costs and burdens to states, families, and private employers and harming some of the most vulnerable members of society — while failing to effectively address the underlying causes of the unsustainable growth in health-care costs.

Balancing in ten years also would have substantial adverse near-term effects on the economy. The austerity required to balance the budget in ten years would be considerably greater than the cuts required under sequestration, which CBO recently reported will cost 750,000 jobs by the end of 2013. Indeed, when CBO analyzed the economic effects of a plan that would reduce deficits by $4 trillion over the coming ten years — which is *less* than would be needed to get to balance — it found that the amount of near-term deficit reduction involved would suppress economic growth in 2014-2016, compared with CBO's baseline projections (which already include the economic slowing and substantial job losses from sequestration).

Insisting on a deficit-reduction package so ambitious that it achieves balance in ten years could also prove counterproductive. The large savings targets required to reach balance would encourage policymakers to resort to major budget gimmicks, timing shifts, and "magic asterisks" (claims of big savings without specific policies to achieve them). The result could be a budget plan that achieves balance only on paper.

Comparisons to Family and State Budgets Are Seriously Flawed

To be sure, the call for a balanced budget is intuitively appealing, as are arguments 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.

First, families do *not* balance their budgets every year. For example, 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 income and well-being in the future.

Second, while states must balance their *operating* budgets, they can borrow to finance their *capital* budgets, which include long-term investments such as roads and schools. If state budgets were constructed as the federal budget is, with no separate capital budgets, most states would be out of balance.

Recent Bipartisan Deficit Plans Haven't Called for Balance in Ten Years

Finally, it's important to highlight that *none* of the major bipartisan deficit-reduction plans crafted over the last several years have called for balance within ten years. The bipartisan plan that Alan Simpson and Erskine Bowles developed for the presidential fiscal commission in 2010 didn't; nor does their recent proposal, unveiled just a few weeks ago. Similarly, the Senate's "Gang of 6" largely followed the Simpson-Bowles outline, eschewing balance. And the bipartisan budget plan that Alice Rivlin and former Senator Pete Domenici developed in 2010 didn't call for balance either; nor does the recent update of their plan.

These serious, bipartisan plans sought to reverse the upward trend in the debt ratio, but without chasing the bumper-sticker slogan of a balanced budget. Congress should do the same when it considers its budget this week. Balancing by the end of decade requires a debt-reduction path that is simply too steep. Once the budget is on a more sustainable path and the economy is stronger, a balanced budget or even small surpluses could materialize — as they did during the Clinton Administration — but balance as the singular fiscal goal is not very meaningful and is inappropriate for the coming decade.