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What Should Be Done Now?

The members of the study committee disagree about many questions of policy. We hold widely differing views, in some cases, about the priority to give different categories of spending, about who should pay for government and how much government they should pay for, about the proper division of responsibilities between federal and state and local governments, and even about the fundamental purposes of government.

What we firmly agree on is the need for strong action now to adjust the long-term relationship between federal government spending and revenues—the urgent need to put the budget on a sustainable path. We also agree that this is going to be one of the biggest political challenges the nation has ever faced.

WHY IS THIS SO HARD?

Two defining characteristics of the long-term fiscal challenge distinguish it from other budget or policy problems and make it difficult for people, including leaders, to grapple with:

- The pain of cutting spending, increasing taxes, or both, is immediate, while the gain of avoiding a fiscal train wreck—and its devastating consequences—is in the future.
- Because all fiscal projections are inherently uncertain, the long-term benefit that will result from the short-term pain cannot be precisely specified.

It is tempting, given uncertainty about the future, to discount the problem and hope that it will diminish, if not go away. People can use the lack of precision inherent in all projections to deny troubles ahead.

When faced with immediate pain and uncertain gains, the natural and perhaps rational reaction is to do nothing, to delay. In the case of an unsustainable U.S. fiscal policy, the costs of delay are not immediately obvious. They are insidious, and the time in the future when remedial action becomes unacceptably painful or no longer possible cannot be pinpointed. Moreover, a potential signal of unsustainable policies—higher pricing of U.S. Department of the Treasury borrowing to finance current spending—may have been masked during the recent downturn by the market's perception that alternative investments are even riskier. If so, interest costs could increase before policy makers have had time to act. As described in Chapter 1, increased interest costs could lead to escalating problems: first, crowding out or forcing abandonment of other government functions and priorities as interest payments swallow greater shares of the federal budget; and later, decreasing wealth, slowing growth, and reducing future standards of living.

Even if everyone becomes convinced today of an urgent need to act, differences in values and perceptions of what government should do and how to pay for it would constrain possible agreement on what to do. Policy disagreements are bound to be intensified by the need to limit what government will be able to do in the future. The likely unwillingness of many to consider the interests of future generations—perhaps because of profound disagreements regarding what those interests are or what sort of government should be bequeathed to the future—will complicate choices.

Reaching agreements to minimize and share the inevitable pain may require a change in political culture toward less partisanship, more openness to compromise, and more trust and honest communication between people and their leaders. To the extent that compromises can be found and choices can be made that allow public resources to be used more productively, the needed policy changes can be a positive sum game. But to the extent that some government programs will be eliminated or scaled back, it will not be a net gain for everyone. To forge agreement on a plan that moves the budget to a sustainable path, attitudes and practices will have to change. Realistically, such changes will take time. The committee recognizes that at least some delay in fully responding to the nation's fiscal challenge is likely, although we stress that delay means the challenge will only loom larger.

In sum, tackling the fiscal crisis is perhaps the toughest kind of political problem. Given its characteristics, quick, decisive action to put the nation's budget on a sustainable course may be improbable. Yet if action is not taken in the near future, the nation will face a calamity, and the possible actions will be fewer and far more disruptive than what is now possible. Thus, now is the time to debate alternatives, to choose, and to act. If this

is done, the nation's fiscal course can be corrected in ways that avoid the worst pain.

WHY IS DELAY RISKY?

Although waiting is a normal reaction to any difficult problem, in this case it is especially risky. Consider two possibilities and their potential consequences: (1) that the fiscal problem proves to be overblown or self-correcting or (2) that the problem is as serious as the committee (and most analysts) argue. Even if these two outcomes were equally likely, it is probable that the costs of acting too late or ineffectively would be much greater than the costs of acting too soon and too precipitously.[1]

Consider first the costs of acting to address what proves—contrary to all current evidence—to be an exaggerated fiscal challenge. Some people point to the risk of having taken large and difficult choices that raise taxes or reduce the government's ability to address many urgent needs but that later prove to have been unnecessary. A too stringent fiscal policy could slow the growth of the U.S. economy or even tip the economy into another downturn. This would, in turn, require a corrective policy response—either easing fiscal policy or relaxing monetary policy or both. Yet the probability is high that the political system would adjust without difficulty. As at the end of the 1990s, the problem of projected endless surpluses tends to be self-correcting.

Now consider the costs of failing to act in the face of a serious fiscal challenge. The first risk is that of having to take bigger and much more difficult steps later to put the budget on a sustainable course. At the same time, the risks of a disruptive financial crisis would continue to grow. As detailed in earlier chapters, such a crisis could take the form of higher interest rates on U.S. Treasury debt that would complicate corrective action by draining resources for government programs; or it could take a more disruptive form. The risk would be compounded if, for instance, standard population projections underestimate growth of the elderly population.[2] After a tipping point that is inevitable but impossible to pinpoint, there will be no simple fiscal strategy to bring revenues and spending into alignment. If that point were reached, the social and economic costs of delay would explode.

So, there are two possible ways to err. One kind of error—overreacting—is readily reversible; the other—underreacting—may not be. That is, the committee has concluded that the risks of error in dealing with the fiscal challenge are asymmetric. Even in the face of great uncertainty, the safer course is to take decisive action soon to change the nation's fiscal course.

Despite the seriousness and scope of the budget challenges, however, there are a number of reasons for optimism and for believing in the efficacy of action:

- If action is taken soon, the nation can preserve Social Security and Medicare for future generations close to their current form, although not without lowering the rate of growth of benefits and/or raising additional revenues to finance them. Even under the low spending and revenues scenario outlined in Chapter 9, monthly Social Security benefits rise in real terms for most workers. That is, even if benefits are sharply reduced relative to current law, most future Social Security benefits will still be higher, after inflation, than today's benefits.
- For Medicare and Medicaid, it is more difficult to forecast future costs because of the many factors that drive health care spending, but benefits are likely to continue to cover at least the big ticket health care items for senior citizens. Thus, the fiscal challenges facing the United States by no means imply the devastation of these programs that have been so instrumental to the well-being of senior citizens and to reducing the proportion of seniors who live in poverty.
- Although the demographic pressures facing the United States are serious, they do not look overwhelming, based on standard projections of labor force participation, future retirement ages, immigration, and other relevant factors (cf., Social Security Administration, 2009d). The U.S. challenge from this source is less formidable than that facing most other major industrialized nations—many of whom will see much greater imbalances between their working and nonworking populations and sooner than the United States.[3]
- Given its relatively low current tax levels, in comparison with other industrialized countries, the United States has more leeway than most of its peers to raise revenues, should it take that route, provided that the tax system is reformed to make revenue collection more efficient and to promote economic growth.

Just as an ordinary household can meet its budget challenges by taking charge, gathering information, and seeking financial advice, the people of the United States and the nation's leaders should feel empowered and moved to action, not to despair. The nation's problems are not insurmountable, but the sooner action is taken the more likely is success.

HOW CAN THIS REPORT HELP?

One product of the committee's study is a framework for analyzing and addressing the long-term budget challenge, presented in Chapters 2 and 3. We believe this framework can contribute to how people think about the fiscal challenge and, therefore, what solutions they will consider. Psychologists have studied the effects of framing on cognition (see, e.g., Kahneman,

2002). The proper framework can enable one to use structured reasoning in place of immediate perceptions or intuition, leading to better judgments. Groups who use a common framework are more likely to find areas of agreement. In this case, how the budget problem is presented, and in what context it is viewed, will affect the ability of everyone to recognize its essential character and therefore the urgent need for action.

The Committee recognizes, however, that merely describing the problem and putting it in proper perspective is not sufficient. Therefore, this report uses the framework to develop illustrative budget paths to sustainability. These examples—combining major policy options described in Chapters 4 through 8—show how one can apply the framework to construct a very broad range of plausible paths meeting the primary tests of fiscal prudence presented in Chapter 3, leading to budget sustainability. The committee hopes that these scenarios are used as a starting point for vigorous rational debate and early action.

WHAT CAN EVERYONE DO?

When the President proposes a budget and as Congress considers a budget resolution or adopts a budget, everyone should apply the six tests of fiscal prudence detailed in Chapter 3. Because they are central to the committee's analysis, we repeat them here:

1. **Does the proposed federal budget include policy actions that start to reduce the deficit in the near future in order to reduce short-term borrowing and long-term interest costs?**
2. **Does the proposed budget put the government on a path to reduce the federal debt within a decade to a sustainable percentage of gross domestic product (GDP)?**
3. **Does the proposed budget align revenues and spending closely over the long term?**
4. **Does the proposed budget restrain health care cost growth and introduce changes now in the major entitlement programs and in other spending and tax policies that will have cumulative beneficial fiscal effects over time?**
5. **Does the budget include spending and revenue policies that are cost-effective and promote more efficient use of resources in both the public and private sectors?**
6. **Does the federal budget reflect a realistic assessment of the fiscal problems facing state and local governments?**

The first tests are particularly hard for nonexperts to apply by themselves. Therefore, the committee urges the Congressional Budget Office, the U.S. Office of Management and Budget, and other organizations to regu-

larly publish projections of the long-term effects of the President's budget and alternatives that can be used by anyone to assess the extent to which the proposals are sustainable.[4]

People can also use the six tests to analyze not just the entire budget but major policy proposals and legislation that affect the budget—to assess their effects on the long-term outlook. To help such assessments, we also urge the Congressional Budget Office, the Office of Management and Budget, and other organizations to extend their analyses beyond the standard horizon to consider long-term effects of proposed legislation. Interested people and groups also can construct their own preferred budgets, using as a starting point the analysis of options for major spending categories and revenues in Chapters 4 through 8. And in looking at analyses of proposals, everyone should be skeptical of the estimates of budget effects provided by advocates of a particular proposal and search for analyses of such proposals prepared by those who do not have a vested interest in their enactment.

People can communicate their views on all of these matters to political leaders and policy makers. It is important for leaders to know that their constituents, armed with the facts and working with the right framework, can support leaders who advocate policies contributing to a sustainable federal budget.

Finally, constituents can reward leaders who make the difficult choices needed for long-term budget sustainability. The U.S. political system, with its frequent elections, tends to reward lawmakers who support programs and policies that have short-term benefits while ignoring long-term consequences. By their own behavior at the ballot box and in direct communication with leaders and policy makers, people who understand the long-term fiscal challenge and recognize that it requires hard choices can push leaders to pay attention to the need to meet the long-term challenge.

WHAT SHOULD LEADERS DO?

Leaders obviously have a responsibility to lead and to present budgets and policy proposals consistent with a budget that is sustainable over the long term. Committee members are well aware of just how difficult it will be for leaders to gain broad popular support for any combination of policies that would put the nation on a sustainable path. The committee urges leaders to use the study's framework to address the fiscal challenge in a manner that promotes public support for rational and creative action. It may be too difficult—given the nature of the fiscal challenge and the habits of partisanship—for leaders to develop specific policies in a single year's budget sufficient to accomplish the entire, large task of aligning spending and revenues. However, the coming year's budget should show a credible commitment to policy changes that substantially bend the curve toward

sustainability and an explicit commitment to the goal of aligning revenues and spending over the long term. The committee's scenarios allow some time for debate and response and for correction of the short-term economic situation by assuming that policy changes take effect beginning in 2012.

Only if the process is supportive of forward-looking and prudent fiscal policy choices can this problem be solved. If the current federal budget process is found to be a hindrance rather than a help—too short-sighted and cumbersome—then the first step for leaders may be to change it. The committee's ideas for how to establish a new budgeting regime that is forward-looking and provides incentives and means of accountability to encourage responsible, far-sighted actions, are presented in Chapter 10. Reforms can help leaders act as responsible stewards of the interests of the nation's children and grandchildren. The committee favors reforming the federal budget process to use better information about the long-term budget outlook as a basis for setting medium- and long-term fiscal goals and to consider adoption of new procedures to hold leaders accountable for responsible fiscal stewardship.

It is not the job of a group of experts, but rather the job of leaders and the people, acting through the political process, to make the necessary choices. Those leaders who recognize the seriousness of the challenge will realize that all other important policy goals are hostage to first putting the budget on a sustainable course. Their job must be to lead a creative national dialogue, beginning now and pressed vigorously, to help the United States find a way to a sustainable fiscal future.

NOTES

1. Greater uncertainty implies the discounting of future costs and benefits at a higher rate. The higher the discount rate, the smaller future costs and benefits appear when compared to costs and benefits in the near term. Great uncertainty would therefore favor a decision to delay action unless the distribution of expected outcomes between the two alternatives were asymmetrical. For an interesting analysis of this issue applied to global warming policies, see Nordhaus (2008), especially Chapter 9.
2. A new set of population and life expectancy forecasts for the United States, with a focus on transitions that will take place by mid-century, illustrate potential budget effects of hypothesized accelerated advances in biomedical technology that either delay the onset and age progression of major fatal diseases, or slow aging itself. "Results indicate that current forecasts of the U.S. Social Security Administration and U.S. Census Bureau may underestimate the rise in life expectancy at birth for men and women combined, by 2050, by from 3.1 to 7.9 years. As such, there could be 164 to 419 million more person-years-of-life lived among the population aged 65 and older by 2050 than current government estimates predict, and cumulative outlays for Medicare and Social Security could be higher by $3.2 trillion and $8.3 trillion" (Olshansky et al., 2009). If such an alternative forecast proves correct, the policy adjustments needed to attain budget sustainability would have to be much larger than portrayed in this report.

3. The share of the U.S. population over 65 is projected to rise from 12 percent in 2000 to 20 percent in 2050 in the United States, but in the same year it is projected to reach 25 percent in France, 30 percent in Germany, 33 percent in Italy, and 37 percent in Japan (Census Bureau, 2007).
4. One difficulty in setting standards for assessing budgets over the long term concerns the proper horizon for projecting policy effects and assessing sustainability. A good discussion is by Ulla (2006:160-162), who argues that, although "the possibility to forecast beyond the next 50 years may be low . . . going beyond 50 years may provide information to help reformulate present entitlement programmes and build a strategy to deal with future challenges." The Social Security and Medicare actuaries focus on a 75-year horizon, long enough to encompass the lifetimes of most people who are already alive.