

Choices for a Sustainable Budget

Given the fiscal arithmetic, changing the nation's economic course will almost certainly require an early dramatic adjustment in the level and mix of government spending and/or higher revenues. As discussed in Chapter 2, if people want to continue all the federal government programs at levels consistent with current policies, given the growing elderly population and rising health care costs, spending will have to greatly increase as a percentage of gross domestic product (GDP). This higher spending will require commensurately higher revenues. Also, as is discussed in Chapter 8, given the inefficiency of the present tax structure, it will almost certainly also be necessary to change *how* revenue is collected. If, instead, people prefer to keep government's share of the economy's resources about what it has been in recent years, the government will have to do much less in the future than implied by current policies, and choices will have to be made about what social goals to pursue less vigorously or what programs to give up. And it is important to stress that there are many possible paths between these two that would both reduce spending growth and raise revenue levels.

Chapters 5-8 present major policy options for three major categories of spending and for revenues. Options for the three major entitlement programs are treated first: Medicare and Medicaid in Chapter 5 and Social Security in Chapter 6. Spending options for defense and domestic programs other than the three big entitlements are treated in Chapter 7. Each combination of options to create a future spending path implies a roughly parallel revenue path needed to ensure fiscal sustainability. Chapter 8 describes alternative approaches to raising the necessary revenues, including structural changes to the tax system that would be required for the higher revenue

levels. Chapter 9 then puts the spending and revenue pieces together to illustrate different ways to reach fiscal sustainability.

This chapter serves as the broad introduction to the detailed analyses in Chapters 5-9. It also outlines how the options can be assembled to produce an illustrative set of budget “paths” (or “scenarios”). The purpose of presenting a set of options and paths is not to argue for a particular set of policies, but to highlight the range and magnitude of the choices that the nation has to confront in seeking a sustainable course for the budget. All of the options to adjust spending and revenues are changes relative to the study baseline, which is the path of the budget projected by the continuation of current policies; see Box 1-3 in Chapter 1.

SPENDING OPTIONS

Options for Medicare and Medicaid

The health care policy problem is extraordinarily difficult. From a budget standpoint, one of the greatest difficulties is the inability to estimate with any confidence how most of the widely discussed reform options, or combinations of them, will affect the future trajectory of health spending.

Although spending increases for federal health programs are driven in part by the same demographic forces as Social Security (i.e., the aging of the U.S. population), for other reasons health spending has grown and is likely to continue growing at a faster rate than the economy.

Any plan to change the health care system is likely to be highly complex. There is little agreement on an overall approach or even on incremental steps to limit spending. The budget savings from any single option or a combination of options are highly uncertain. In addition, if savings can be realized, there will be strong pressures to use the savings for improvements in health and to extend federal support to people who would not otherwise have adequate insurance or care.

Given the uncertainties about savings and recognizing the pressures for spending, the committee's approach is to present an array of options that could, collectively, reduce cost growth; but we do not attribute savings to any particular option or strategy for Medicare and Medicaid. The resulting paths for health spending are essentially a range of guesses as to the potential effectiveness of any change. As described in Chapter 5, at least in the short run, achieving any significant savings in Medicare and Medicaid with some measure of certainty will most likely require strong measures that directly control their costs in order to slow their rate of spending growth. Such measures could take several forms. The high cost of health care in the United States compared with other industrialized countries certainly suggests that the nation can provide care more efficiently than it currently

does. However, imposing direct limits on Medicare and Medicaid spending runs the risk of reducing either access to care or the quality of care, with potentially negative consequences for some people's health. For the Medicare and Medicaid programs, there is a limit to how much cost containment can be achieved, without doing harm, and without reorganizing the nation's overall health care system. In the medium term, major reforms that change incentives for providers and consumers, provide better information to both about costs and benefits, and reorganize health care delivery can both improve care and yield budget savings. Such reforms will ease the pain imposed by—and eventually perhaps obviate the need for—an overall budget limit for health spending.

Options for Social Security

The committee's options for Social Security are among many that have received wide discussion. Unlike the options for health, it is possible to estimate their budgetary effects with a good deal of confidence. Absent policy changes, future spending for Social Security benefits and future payroll tax revenues are relatively predictable from data on population aging, work and retirement patterns, immigration, and trends in wages.

The range of options for Social Security is wide, and a set of frequently discussed and relatively incremental reforms can put the program on a financially self-sustaining trajectory. Moreover, there is precedent from the early 1980s for agreement on significant changes, although the adjustments required now to bring Social Security revenues and benefits into alignment over the long run would be larger than those adopted earlier.

The options the committee presents would eliminate the now-projected Social Security shortfall in different ways, showing how it is possible to preserve benefits scheduled under current law by increasing payroll taxes or what adjustments to the rate of the growth of benefits would be needed to avoid payroll tax increases. The committee's options illustrate the broad range of choices available to keep Social Security solvent without changing the fundamental nature of the program. Restoring Social Security to solvency is not a prerequisite for putting the entire budget on a sustainable path, but it is desirable in itself and can make an important contribution to the broader goal of budget sustainability.

Options for Defense and Other Domestic Spending

In 2008, 56 percent of all spending (excluding interest on the national debt) was for programs other than Medicare, Medicaid, and Social Security.¹ The hundreds of programs in this broad category address a wide range of goals pursued by the federal government: for national and homeland

security, veterans, education, the environment, transportation, and many other functions. This diverse category of domestic and defense spending rose sharply in 2009, if temporarily, as the government addressed the major economic downturn and its consequences.

People have widely differing views of the value of some of the programs in this category, and some arguably are sustained more by the power of their political constituencies than by evidence of their effectiveness. The options for limiting this range of spending are similarly numerous. For this category, the committee broadly illustrates in Chapter 7 how priorities for spending cuts might be set and what the likely implications are of different levels and mixes of spending.

Four options are presented for defense. All assume that costs for the wars in Iraq and Afghanistan are reduced over time, as in the study baseline. On the high end of the committee's options, defense spending would remain nearly at its current level as a percentage of GDP, although lower than in the Cold War period. At the low end of the committee's options, defense spending would be a smaller share of GDP than in any recent period, though it would be higher than the combined amount spent by U.S. allies in the North Atlantic Treaty Organization (NATO).

Four options are presented for other domestic spending. At the lowest spending level, this broad category of programs would be reduced by 2019 to a level 15 percent below the study baseline. At somewhat higher spending levels, two broad strategies for other domestic spending are illustrated. One intermediate option would allow other domestic programs to grow to a level 10 percent higher than the baseline. This growth would allow for substantial new investments intended to enhance the economy's future growth, as well as benefiting people directly. These kinds of investments might be viewed as favoring younger age cohorts, because they will have more years to enjoy the future returns. The other intermediate option would reduce other domestic spending to a level 6 percent below the baseline, leaving no room for new investments unless offset by other program cuts. A fourth option for other domestic spending suggests what could be done if spending were to grow to a level 14 percent above the study baseline.

REVENUE OPTIONS

Options for federal revenues depend in part on whether the nation pursues a path to sustainability that keeps spending and revenues close to their recent historical levels, as a percentage of the economy, or pursues a path with higher spending, which would require higher revenues. If revenues need to increase substantially, then there are severe limits on how much can be collected efficiently by simply raising rates within the current income and payroll tax structure. Reform of the tax structure would be

needed, probably including (in the higher-spending scenarios) new forms of taxation. An alternative to the present tax structure that is simpler and treats various sources of income more uniformly is described in Chapter 8, as is the possibility of a value-added tax (VAT) similar to that used in other industrialized countries. The analysis in that chapter of options for collecting additional taxes illustrates the different levels and mixes of taxes and other revenues that could be used to move the budget to a stable relationship between revenues and spending.

BUDGET SCENARIOS

The policy options presented in Chapters 5 through 8 can be combined to produce long-term federal budget scenarios (or paths) that first close the gap between spending and revenues to reduce the debt to no more than 60 percent of GDP and then align spending closely with revenues, to put the budget on a sustainable trajectory. In Chapter 9, four such scenarios are presented, each of which leads to long-term budget sustainability. The four scenarios differ significantly in their composition and in the resulting level of spending and revenues. As a set, they are hardly exhaustive (but, rather, are illustrative) of the wide range of plausible—not necessarily politically feasible—potential policy paths to long-term fiscal stability.

The rest of this section provides an overview of the committee's four scenarios:

1. low spending and revenues
2. intermediate-1 spending and revenues
3. intermediate-2 spending and revenues
4. high spending and revenues

The low path strives to maintain revenues at about their historical share of GDP and tightly limits federal spending to align with that level. In contrast, the high path envisions substantially more robust spending for the federal government (although less robust than under current policies), with correspondingly much higher revenues. The intermediate-1 and intermediate-2 paths lie in between, with the latter committing more resources to elderly oriented entitlement programs and the former more to investments that confer greater benefits on the young and on future generations.

These scenarios—all of which meet the primary tests of fiscal prudence presented in Chapter 3—have differing implications for the values and beliefs that shape budget debates, as discussed in Chapter 2. The lowest spending and revenue path would limit what government can do to provide health care, pensions, and a range of other benefits. Certainly, in that

scenario, many people who rely on the federal government for income, health care, or other benefits will suffer, even if some spending reductions are offset by more efficiency in government programs. Much slower spending growth would almost certainly also slow the rate of public investment in future growth—in people, infrastructure, and technology—which would probably limit the opportunities for future generations.

Choosing a path of lower spending and revenues also means that more decisions about spending and savings would be made by private households and businesses, or by state and local governments, rather than by the federal government. People who doubt the national government's ability to make wise spending decisions or fear that too large a government will have too much power are likely to prefer leaving more choices in private or local government hands.

Under scenarios for higher levels of spending, the federal government would be able to do more, although not all, of what it has been doing to aid people and invest in public goods that contribute to future growth. If the government can increase its effectiveness by shifting resources to programs that provide greater return on the public dollar, it can do still more. But a sustainable budget scenario at a higher spending level requires much higher revenues: In at least one scenario the government's claim on the economy's resources would increase to levels unprecedented in U.S. history.

Clearly, it is possible to construct many other scenarios. The committee's four should be viewed as illustrative. Policy makers, analysts, and others can use them as the starting point for constructing other paths that achieve the same long-term sustainability and are more consistent with their personal values and beliefs.

Low Path

The committee's low path will appeal to people who seek to minimize future revenue increases. Even if they would prefer a somewhat different mix of spending options, they can use it to estimate the extent to which spending in each of the three major areas must be constrained. In considering the options for Medicare and Medicaid (see Chapter 5), for example, one can assess the realism of enacting and maintaining policies that would hold the growth of per capita health spending to no more than the growth rate of incomes over a long period. And one can consider which combination of options discussed for Medicare and Medicaid are sufficient to achieve this result.

The low path also helps one assess whether it is both feasible and desirable to constrain the growth of Social Security benefits in the future to what can be financed with payroll taxes under current law and perhaps ask whether the options proposed or some other set are the best available

to do so. For defense and other domestic spending, people can decide whether the program cuts suggested to reduce spending by 20 percent from the study baseline are the best available and whether such reductions are feasible and consistent with their values and view of the role of the federal government. Apart from changes to existing spending programs, it is also important to consider easy-to-imagine but hard-to-specify future demands for federal spending that could be difficult to accommodate within such a constrained budget.

Intermediate Paths

People who believe that the reductions from the baseline rate of spending required to hold revenues near current levels are either infeasible or unacceptable will find other scenarios more appealing. However, these scenarios will all require substantially higher federal revenues in the future than have been historically acceptable in the United States. By some time in the next decade, on these intermediate paths, government's share of the economy would need to be 4 or 5 percentage points higher than in the three decades prior to the recent downturn (when spending temporarily soared and revenues sagged as a proportion of the economy) and would continue to grow faster than the economy for many years thereafter. Although such proportions are within the experience of most wealthy countries, they would represent a change in government's share of the nation's resources that some people may find unacceptable. The two intermediate scenarios also illustrate the broad choice between spending that makes more room for the growth of benefits to an aging population and spending that represents investments in future growth, including education. And within the context of that broad tradeoff, there are many possible variations in the specific mix of policies that put spending and revenues on a higher long-term path consistent with a sustainable budget.

Government can do more with more revenues, but it is important to recognize that both of the intermediate scenarios (and the high revenue and spending scenario discussed below) represent reductions in the baseline rate of growth in spending implied by current policies. As noted above, collecting more revenue efficiently probably would require broadening the base of the income tax and perhaps adding a new form of taxation.

High Path

People who are most concerned about the effects of reductions in the rate of projected spending growth may prefer the committee's high path. The current tax structure cannot be used to achieve the high levels of revenue, so a more efficient structure with new sources of revenue would be re-

quired. This scenario would permit health spending to grow faster than the economy for a few more decades, although eventually at a rate slower than in the baseline. Under this scenario, Social Security benefits and retirement ages would continue as they are scheduled under current law. And spending for all other programs would grow at the same rate as the economy. Budget savings from any reductions due to efficiencies or changing needs in this category could be used to pay for new initiatives or to respond to emergencies and other unanticipated events or needs.

The result would be a federal government that spends and taxes at rates far higher than in the past—possibly one-third higher as a percent of GDP within two decades and even higher thereafter. The implications of a much larger government for the economy's performance and for individuals are important considerations in constructing a sustainable budget. It is also important to reiterate that even this scenario would represent a major reduction in spending for health relative to the baseline projection of current policies.

CONCLUSION

Although some people will see raising revenues—especially other people's taxes—as the best way to address anticipated higher spending, other people will argue just as strongly against this path. Given the pressures for higher spending for an aging population and rising health care costs, holding revenues near recent historical levels would force large changes to limit spending growth. Such a limitation would probably require drastic restructuring of the nation's entire health care system, and it would certainly require caps on health spending, reductions in rate of growth of benefits for future Social Security recipients, and abandonment or curtailment of federal support for many other purposes. But if revenues are increased to permit faster spending growth, the federal government's claim on national resources will be far larger than ever in the nation's history, necessarily reducing the resources available for private purposes.

Taken together, the various policy options discussed in the following four chapters and the four scenarios that are presented in more detail in Chapter 9 illustrate the very wide range of available policy choices and plausible fiscal strategies that can be pursued to achieve a sustainable budget. They are the building blocks of a prudent fiscal policy consistent with the principles proposed in Chapter 3.

As noted above, the committee is not recommending any one of these paths to sustainability. Our task was to identify how to put the federal budget on a sustainable path, and in this report we present many ways to do so. The decisions that will be made will reflect the diversity of values and preferences of the nation's population. The best choices consistent with

a sustainable budget are matters for the public and the nation's leaders to debate and decide. We stress, however, that finding compromises around some set of options that leads to a sustainable budget is a must. Doing nothing is not a viable option.

NOTE

1. Because this category of domestic and defense spending rose sharply, if temporarily, as the government addressed the downturn and its consequences, 2008 may be a better benchmark for many historical and future comparisons.