Committee for Economic Development

The Emerging Budget Crisis: Urgent Fiscal Choices

Summary of Findings and Recommendations

The United States now faces daunting fiscal challenges. An aging population will exert extraordinary pressure on the provision of many vital services -- principally health care, pensions, and Social Security. This scenario is inevitable and outside of anyone's control. Policymakers, however, have been slow to meet their responsibility to prepare the nation for the challenges that lie ahead. Instead, as the demographic upheaval rapidly approaches, the United States remains ill-equipped for the economic consequences. The Committee for Economic Development (CED) warned of this prospect in its 2003 policy statement, *Exploding Deficits, Declining Growth: The Federal Budget and the Aging of America.*

The Emerging Budget Crisis: Urgent Fiscal Choices presents a renewed and intensified admonition: The United States must place itself on a rational fiscal course now in order to weather the upcoming demographic storm. Doing so will require action on all budgetary fronts, especially on high-profile issues such as Social Security, taxes, and health care.

FINDINGS

The long-term outlook for the federal budget continues to be dismal. Factoring in reasonable assumptions, such as relief for the middle class from the alternative minimum tax (AMT) and extension of the major expiring tax cuts, structural deficits will continue unabated up to and through the onset of the retirement of the baby-boom generation. We will not be able to "grow our way out of the deficit," even with a robust economy; and the nation's accumulated debt will grow faster than Gross Domestic Product (GDP) in every year. Combined with the impending retirement of the baby-boom generation, which will precipitate an explosion in spending on programs such as Social Security and Medicare, current federal budget policy is clearly unsustainable. The first baby-boomers will begin collecting early Social Security payments in 2008; the time is now to enact responsible budget policy.

The consequences of not taking action are immense. Evidence strongly suggests that large and sustained budget deficits will erode long-term investment, productivity growth, and prosperity. Deficits of this depth and magnitude "crowd out" investment (both public and private), deplete national saving, and likely will cause interest rates to rise. Additionally, as more U.S. debt is financed by foreign investment, the potential for financial instability increases. The lack of national saving will gradually undermine the nation's standard of living. Large deficits left unrestrained today will, in effect, act as delayed tax increases on future workers, who will have to contend with the consequences of overwhelming debt.

RECOMMENDATIONS

Principles for Budget Policy

There is no magic bullet to slay the budget deficit. Instituting sustainable federal budget policy will require unpalatable decisions. CED recommends that policymakers adhere to several principles in establishing fiscal policy:

- **Any tenable budget program must address the budget deficit on every front now, including both comprehensive spending reductions and alternative or additional revenues;**

- **Do no harm, policy decisions today that raise deficits tomorrow are unacceptable;**
- **Make long-term budgetary balance and economic growth explicit policy goals;**
- **Give pro-growth policies higher priority; and**
- **Distribute the costs of pro-growth policies equitably.**

Social Security Reform

A misguided approach to Social Security reform might not only debilitate the program, but also likely degrade the already bleak budget situation. Social Security reform must contribute to long-term budget sustainability, not undermine it. Reform proposals that involve borrowing will only further weaken the nation's shaky fiscal outlook.

CED developed a comprehensive plan for Social Security reform in the policy statement *Fixing Social Security*. The CED approach will maintain the essential safety net function of the program by restoring the basic system to fiscal solvency through relatively minor adjustments. The CED plan also bolsters the program's relevance to younger and future workers by "adding on" a second tier of personal retirement accounts that will increase the rate of return for these workers.

Budget Process, Appropriations & Taxation

Policymakers must acknowledge the danger of current budget deficits in determining the annual budget and appropriations. They must also recognize that cutting domestic discretionary spending alone will not achieve adequate deficit reduction, because such spending accounts for a relatively small share of the budget. While the rate of growth of non-security discretionary spending can and should be brought down below its historical level, the U.S. cannot afford to shortchange critical investments in areas such as public education and research and development. Such investments in the past have produced substantial returns, and they will contribute significantly to future economic growth.

A disciplined budget process is also necessary to confront the long-term fiscal issues facing the United States. This will require a rational appropriations process that limits spending. Furthermore, the budget process requires annual joint budget resolutions, agreed to by Congress and the President and enacted into law, that cover and direct all spending and tax legislation. Caps on discretionary spending should be also restored, as well as the "pay-as-you-go" rule, which requires that any changes in tax and entitlement spending be "deficit-neutral."

In addition to improvements in the budget and appropriations process, CED also recommends that the President and Congress establish a goal of balancing the budget (or producing a surplus) excluding Social Security over a rolling five-year horizon. The joint budget resolution should include accounting measures that provide a true appraisal of the long-term fiscal balance and how policies in the resolution will change that balance.

Considering the long-term fiscal outlook, CED urges that policymakers forgo any additional tax reductions (including the permanent extension of the Economic Growth and Tax Relief Reconciliation Act of 2001). Instead, we must seriously explore alternative or additional long-term sources of revenue and taxation systems that support long-term growth.

Health Care

The issue of health care has largely been ignored because of its complexity, but we will not be able to ignore it any longer; the aging population will cause spending on Medicare and Medicaid to grow even faster than Social Security. CED issued a package of proposed reforms in its 2002 policy statement, *A New Vision for Health Care: A Leadership Role for Business*. A key recommendation is to restructure Medicare along the lines of the Federal Employee Health Benefit Program.

Prompt and prudent action on all fiscal fronts must be taken now to improve the long-term fiscal outlook and to prepare for the challenges that lie not far ahead.

The Committee for Economic Development (CED) is an independent, non-profit, non-partisan, public policy research organization dedicated to addressing the critical economic and social issues facing society.

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CED
2000 L Street, NW, Suite 700
Washington, DC 20036
202-296-5860 (phone) 202-223-0776 (fax)

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