CED

Time to Face Up

The growing urgency for tackling our nation's debt

THE CONFERENCE BOARD
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Executive Summary

For more than a decade, the federal budget has been on an unsustainable path. The promised levels of federal benefits have been rising faster than federal revenues. This process inexorably leads to a projection of rising debt burdens that would at some point exceed the nation's ability or willingness to pay.

This year the outlook is subtly but significantly worse.

In fiscal year 2020, two years sooner than in last year's budget outlook—assuming the projections prove true—the budget will record the first $1 trillion deficit since the financial crisis of the last decade. And this is projected to be only the first of an endless string of deficits at $1 trillion and more.

Furthermore—again if the projections prove accurate, and if the nation's temporary tax cuts are extended—the federal government's debt to the public will exceed the nation's collective income in 2028. In other words, the debt-to-GDP (gross domestic product) ratio will exceed 100 percent. This will be the highest our debt burden has been since the end of World War II.

Notably, both of these troubling or even terrifying indicators will occur in peacetime, without severe natural emergencies, and with the economy growing relatively comfortably. To be sure, passing such symbolic markers has no necessary substantive implication. However, the outlook for our financial markets and our economy is dependent upon market psychology. Seeing a good-times budget "baseline" with such strikingly adverse indicators suggests at least a substantial risk that markets could react adversely.

Why Our Nation's Debt Is Growing Faster

The deterioration of the budget outlook over the last year comes from several sources. But the largest cause is the enactment of H.R. 1, the Tax Cuts and Jobs Act of 2017 (TCJA). Important to note is that the projections take the law at face value and assume that the most important tax cuts for households expire at the end of 2025. If those tax cuts are extended—as many of the Act's staunchest advocates insist they will be—the cost in revenue will be substantially greater and would build a much higher 2028 deficit-and-debt platform from which the budget must leap into the long term.

Some observers believe that the TCJA will have positive "dynamic" or "supply-side" economic effects and will raise the necessary revenue to at least mitigate the budget problem. (The most optimistic economists tend to stop short of that, asserting only that the new law will not lose any revenue, and thus will not worsen last year's outlook—which was itself unsustainable.) We are concerned at just how narrow a path this perspective attempts to traverse and just how dangerous a misstep off that path would be. Specifically, our budget situation has been rendered far more perilous simply by the accumulation of the public debt over almost the last two decades. The budget has become far more vulnerable to possible increases of market interest rates.

One more weakness in our current economic and fiscal environment is adverse demographics. The labor force now grows roughly 1 percentage point per year slower than just a few decades ago, and, so, productivity growth must accelerate by roughly 1 percentage point per year just to maintain recent economic growth rates. Achieving still higher growth rates would require even more productivity growth, at rates that most experts find highly unlikely. Postponing budget correction in anticipation of such rapid productivity growth would entail enormous economic risk.

Continuing on our current fiscal path is both costly and dangerous. Big budget deficits "crowd out" both private and public investment, slowing economic growth and diminishing living standards. Also, our fiscal authorities would gradually lose their policymaking flexibility with respect to any contingencies—national security crises, natural disasters, or impending recessions among them. But at the limit, large deficits *can* yield a genuine crisis. As federal debt and debt-service costs grow exponentially, they eventually will constitute a burden that the taxpayers collectively will be unable or unwilling to bear. Fearing this, our nation's creditors will react with little warning. Markets will *impose* a fiscal adjustment on the federal government.

In short, the federal government must achieve a fiscal correction. But that correction will entail far less pain for the citizenry if it is imposed in a thoughtful way rather than in a panic reaction to a sudden shutdown of new credit. And the sooner that correction is undertaken, the milder it can be.

What is the bare minimum of deficit reduction that the markets might demand to remain on an even keel? To stop the growth of the ratio of the federal government's debt to the nation's GDP before we reach the 10-year horizon of the projection process would require cumulative policy savings (not counting debt-service savings) of approximately $3.5 trillion. CED believes that deficit reduction of this magnitude is the absolute minimum standard of fiscal responsibility for the Congress and the president at this time. Realistically, a budget remedy of that magnitude must be nonpartisan. Our budget problem has become so large that resolving it requires touching every element of the budget—including items that are strongly favored by one party or the other. Congress should start by focusing on three key areas in which savings are crucial:

> **Health care** costs are growing faster than any other operating programs, with the greatest growth in Medicare. Medicare suffers from adverse demographics including population aging and lower birthrates, compounded strongly by "excess cost growth" in the delivery of care to each individual beneficiary. CED believes that a more market-based system is the only sustainable approach. The nation must align the incentives facing consumers, providers, and insurance plans so that they all seek lower-cost delivery of high-quality care in their own interests. Building on refundable tax credits to each household, including both seniors and working-age adults, we would achieve *cost-responsible consumer choice among private health care plans*. People would save money if they chose plans that deliver high-quality care at lower cost. And providers and insurance plans would need to offer such cost-efficient care to succeed in the marketplace.
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> **Social Security** is an important issue but of a lesser weight and complexity than health care. Very low-income retirees, especially those with career interruptions (including married women), need higher rather than lower

benefits. The current Social Security minimum benefit, which was intended to aid such seniors, should provide greater support. The maximum amount of taxable earnings should be gradually increased to expand the tax base to 90 percent of all earnings, but Social Security should not "raise the cap" and then refuse to pay benefits on the additional taxable earnings. Americans who remain able to work can help themselves and Social Security by working longer, but many cannot; the earnings formula should be altered not to require more years of work but, rather, to reduce benefits modestly for those who choose to retire early. The benefit-determination formula should reduce benefits somewhat for those with higher earnings. More affluent seniors, but not those with lower incomes, should pay income taxes on all of their benefits. And inflation protection for beneficiaries of Social Security (and all other indexed spending and tax programs) should be based on the "chain-weighted" consumer price index, which takes appropriate account of the ability of consumers to substitute goods and services whose prices are relatively stable for other items that are rising more rapidly in price. Lawmakers should assemble a combination of these steps with the goal to assure that in 75 years (approximately one typical lifetime), the Social Security program has a cash reserve that covers one year of total benefits. This would re-establish the "pay-as-you-go" rationale that has served us (and Social Security) well.

Revenue must be an important part of deficit reduction, especially if the economic growth benefits of the 2017 tax cut do not materialize. CED has recommended true tax reform whose objective should be to maintain as much as possible of the incentive benefit of the 2017 tax cuts, while reducing or even eliminating their revenue cost. It would repeal preferential tax provisions, simplify tax filing for households, reduce tax rates, and reset the federal statutory corporate income tax rate to leave the US system competitive with our international trade partners but recapture most of the lost revenue. It is less than ideal to change the federal income tax twice within a short period of time, but it is far worse to allow the federal budget deficit and the public debt to explode.

We believe that the nation has courted fiscal crisis for far too long, and that we truly have come to the point where the forces of inertia are sufficient to damage our nation irreparably. US and world financial markets likely will fail to recognize the problem until the process of deterioration has gone well past the point of no return. When we all recognize the crisis, it already will be too late.

We implore our nation's elected policymakers to face up to the building crisis that many of those leaders acknowledge—but only behind closed doors. History will not accept the excuses of partisan politics—that "we would have fulfilled our responsibilities if only the electorate had been wise enough to give our faction total control." We are running out of time to arrest the resulting inexorably mounting debt.

If the two political parties will cooperate to take the necessary but painful steps together, then at least the political blame for imposing that pain can be shared and defused. Without action soon, the blame will fall on all with full force.

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