Center for American Progress

Restoring Fiscal Balance

The New Deficit Commission's 2015 Targets

By Michael Linden and Michael Ettlinger April 26, 2010

Members of the bipartisan National Commission on Fiscal Responsibility and Reform appointed by President Barack Obama in February should, as they begin to meet, avoid drawing any firm lines taking options off the table, whether on the revenue or spending side. Such lines will only turn the already difficult task of addressing the nation's mid- and long-term budget deficits into an impossible one. Even though the commission's final recommendations won't include cuts in every program or increases in every tax, there is little question they will have to include both spending reductions and an increase in revenue.

The most specific obligation of the commission is to propose recommendations to bring the federal budget into primary balance by 2015. This, along with a more vague instruction to "meaningfully improve the long-run fiscal outlook," are the charges found in President Obama's executive order.

"Primary balance" is when total government expenditures, except for interest payments on the debt, equal total government revenues. President Obama's 2011 budget blueprint includes hundreds of billions of dollars in deficit reductions over the next 10 years, but even so the Congressional Budget Office projects that the primary deficit—the gap between revenue and spending, excluding interest payments, that the commission will have to address—will exceed $250 billion in 2015.

In strictly arithmetic terms, of course, this could be closed either purely by cutting taxes or by raising revenue. But a closer look at what that would really entail reveals that, as a practical matter, getting to primary balance in 2015 is going to require a mix of spending reductions and increased revenue.

Primary balance through spending cuts

To get $250 billion worth of deficit reduction without raising a single extra dollar in new revenue would require a nearly 6.8 percent cut on all primary spending, across the board. At first blush, a cut of almost 7 percent may not seem impossible, but remember that it would have to apply to every single dollar the federal government spends. That means cuts to:

- Airport security
- Education
- Social Security benefits
- Medicare
- Defense
- Scientific research
- Veterans' benefits
- Military retirement benefits
- Highway funding
- Unemployment insurance

And everything else the federal government funds. The consequences of cutting all of these services would be far reaching and highly unpopular.

Of course, the likelihood of such a "true" across-the-board cut ever coming to pass is vanishingly small. Not only does such a policy not make much sense (surely some kinds of federal spending are more important than others), but it also doesn't pass the political reality test. There is simply no conceivable way President Obama and Congress—not to mention the American people—will allow cuts of this magnitude to be applied equally to all parts of the budget.

Besides, to the extent that some of the spending is important to economic growth, cutting it would be counterproductive—the additional revenues and reduced safety net spending that come from a growing economy are key to deficit reduction. But exempting some programs and services from big cuts only means that whatever else is remaining will have to be cut even further.

Social Security, for example, is projected to be the single largest federal spending program in 2015, with about $880 billion in expenditures. More than 98 percent of those costs go out in the form of benefits to retirees, the disabled, and their families. Given the five-year time frame of the commission's recommendations, the only way to reduce Social Security expenditures for 2015 would be to cut benefits for those who already receive benefits or those who are about to. This would be unfair, not to mention politically impossible, since current and soon-to-be beneficiaries have acted in reliance on the Social Security program as it is currently structured.

What's more, Social Security as an overall program doesn't contribute to the deficit in 2015 because the dedicated Social Security payroll tax collections are projected to be greater than the expenditures. These realities are why, though several proposals exist to reduce future Social Security costs, very few appreciably affect benefits in the near or medium terms.

The simple fact is that significant reductions in Social Security spending for 2015 are just not going to happen. But if Social Security cuts will not contribute significantly in 2015, then the rest of the federal budget would have to be reduced by 9 percent to achieve primary balance.

Another category of federal spending that will probably be exempt from significant cuts in 2015—beyond what was recently enacted in the comprehensive health reform bill—is health care expenditures, specifically Medicare and Medicaid. The new health reform law already includes at least $50 billion in spending reductions for Medicare and Medicaid, and the cost savings may well be higher. The bill incorporated a raft of cost containment measures, most of which were scored conservatively by the Congressional Budget Office.

The likelihood of squeezing any substantial further savings without seriously undermining the quality of the health care provided—beyond what health reform has already put into motion—is very small. Taking health care off the table beyond current projected savings, the rest of the budget would have to be cut by 14 percent to get to primary balance.

The "rest of the budget" that would be subject to a 14 percent reduction includes a variety of programs, services, and benefits that we might also reasonably deem "untouchable." Veterans' benefits, for example, are as close to fully protected from cuts as any spending in the budget. And cuts to unemployment or promised federal employee and military retirement benefits are also quite unlikely. If those are off the chopping block then all remaining spending would face a 16 percent reduction to get to primary balance.

Social Security, Medicare and Medicaid, and the various other untouchable programs such as veterans' and military retirees' benefits together add up to about 60 percent of total federal primary spending. The largest remaining single spending category is defense. The president's budget already assumes some decline in defense spending from current peaks, as the wars in Afghanistan and Iraq come to a close. Even so, defense spending in 2015 is still projected to be more than $100 billion over its previous post-war apex, even after accounting for inflation. Certainly, there must be significant budgetary savings to be found here, but cuts of up to 16 percent beyond what the president has already proposed seem unlikely.

But so do such cuts across the rest of the government. Are cuts of 16 percent feasible for:

- The Department of Homeland Security
- All federal support for education
- The National School Lunch Program
- The Federal Aviation Administration
- Highway funding
- The Consumer Product Safety Commission
- The Federal Bureau of Investigation
- The Food and Drug Administration
- The National Institutes of Health

Just to name a few. While one can, in theory, suggest that defense be cut by, say, 10 percent instead of 16 percent, or the FAA be untouched, that only creates more pressure and bigger cuts on the rest of the budget—extremely little of which is easy or wise to cut by the amounts needed to achieve primary balance in 2015 without any revenue increases.

The bottom line is that there will be, and should be, spending reductions as part of achieving primary balance in 2015. But doing it all through spending would be irresponsible, unwise, and unpopular. The cuts to programs the public and businesses rely on that are important to our national security and that provide important investments that help our economy grow would do more harm than good.

Primary balance through tax increases

To reduce the deficit by $250 billion in 2015 without cutting any spending would require a 7.3 percent increase on all federal taxes and fees. Everyone who pays the income tax, payroll taxes, federal excise taxes, and corporate income taxes would have to pay 7.3 percent more than is currently projected. This could be achieved in any number of ways, from raising marginal rates to reducing various credits and deductions.

In pure economic terms, it would hardly be calamitous to raise the additional revenue needed to get to primary balance without reducing any spending. The extra $250 billion raised would bring total federal revenues to just over 20 percent of the gross domestic product, which is approximately the same level that tax revenues were from 1998 through 2001—years when the budget was in surplus.

And the United States would still be very much "low tax" in comparison to other economically developed countries. Currently, the United States has the fourth-lowest taxes as a share of GDP among the 30 economically advanced countries in the Organisation for Economic Co-operation and Development. Collecting an additional $250 billion in revenue would move us up only two or three spots, and we would still be firmly in the bottom third.

But even if closing the entire $250 billion gap could be accomplished solely through raising everyone's taxes by 7 percent, this may not be a desirable or politically feasible policy. And of course, if the tax increases were limited to narrower subsets of the population—the very wealthy, for example—the increases would have to be much larger. To raise $250 billion in added revenue only from those making more than $250,000 and corporations would require tax collections from these groups to increase by almost 25 percent.

It will have to be a mix

The commission's task of bringing the budget into primary balance by 2015 will require making hard choices among a range of spending cuts and tax increases. There is no quick fix, which is why beginning the process by declaring certain options off limits would be precisely the wrong way to accomplish the goal. The idea that the commission could easily find $250 billion in spending cuts is pure fantasy, especially when considering the fact that some parts of the budget are likely to be exempt from reductions. Raising $250 billion in additional taxes is equally unlikely.

The commission also needs to recognize that solving this problem is no mere accounting exercise. Every option to reduce the deficit has broader consequences and deeper implications, as CAP details in our companion piece "Setting the Stage for Fiscal Reform: The Six Big Questions for the New Deficit Commission." The choices that the commission makes will have ramifications far beyond the federal bottom line.

The medium- and long-term budget gaps that are currently projected carry with them significant risks. Reducing those risks should be a national priority. If the commission can offer a reasonable solution to this problem, it will have done the country a great service.

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