

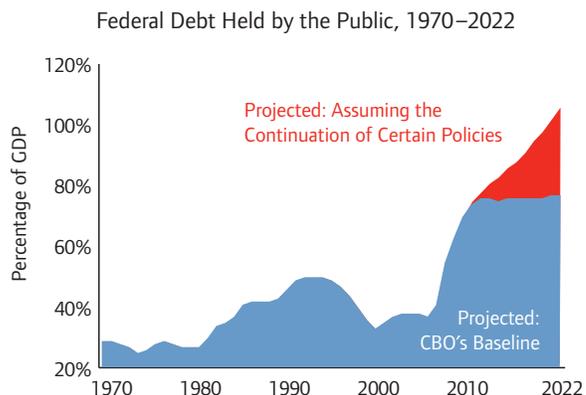
# SOUND FISCAL POLICY



## Fast Facts

- U.S. debt levels have jumped sharply in recent years. The ratio of publicly held debt to gross domestic product (GDP) has nearly doubled from 36 percent of GDP in 2007 to 68 percent of GDP in 2011.<sup>1</sup>
- Under the Congressional Budget Office's (CBO) alternative fiscal scenario projection, which assumes the widely expected continuation of certain policies, publicly held debt will exceed 100 percent of GDP in 2022 and approach 190 percent of GDP in 2035.<sup>2</sup>
- Under the alternative fiscal scenario, the CBO estimates that national income will be 2 percent to 6 percent lower in 2025 and 7 percent to 18 percent lower in 2035.<sup>3</sup>
- CBO projects that spending on Social Security, Medicare and Medicaid will account for 53 percent of all federal spending in 2020,<sup>4</sup> up from 28 percent in 1980.<sup>5</sup>
- Under the alternative fiscal scenario, the CBO projects that total spending will increase to 34 percent of GDP by 2035 — compared to an average of 21 percent over the last 30 years. Under this scenario, the deficit will exceed 15 percent of GDP in 2035. Interest payments on that debt will rise from about 1.5 percent of GDP today to 9 percent by 2035.<sup>6</sup>
- Stanford University and University of Chicago economists recently estimated that policy uncertainty has dramatically reduced economic activity in the United States in recent years.<sup>7</sup> Eliminating uncertainty over future fiscal policy and adopting policies that stabilize the debt sooner rather than later would boost confidence among consumers, investors and businesses. These improvements would contribute to higher long-term incomes and higher living standards for American families.

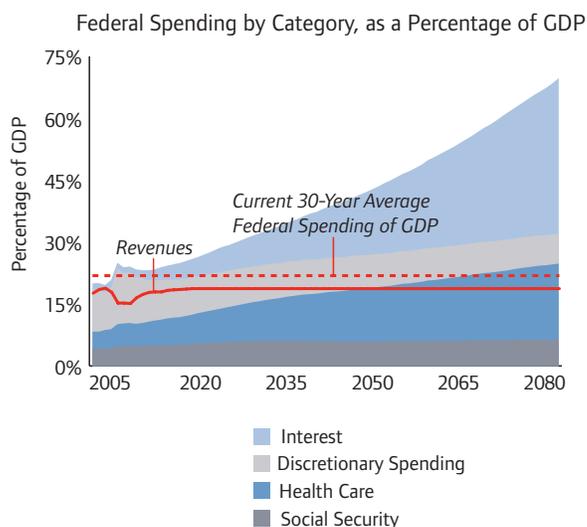
Without a meaningful policy response, the U.S. debt-to-GDP ratio is expected to soar to more than 100 percent by 2022.



Note: The projected debt with the continuation of certain policies is based on CBO's Long-Term Budget Outlook, Alternative Fiscal Scenario (June 2011).

Sources: U.S. Census Bureau, Statistical Abstract of the United States: 2012 (Table 470); CBO Budget and Economic Outlook, Fiscal Years 2012–2022 (Jan. 2012); CBO's Long-Term Budget Outlook (June 2011)

As a share of total government outlays, health care costs are projected to grow out of control in the coming decades.



Source: CBO's Long-Term Budget Outlook, Alternative Fiscal Scenario (June 2011)

Long-term fiscal health is a tangible indicator of effective governance and an essential aspect of an attractive business environment. Nations that manage their fiscal and monetary affairs responsibly are rewarded by the marketplace with low borrowing costs and strong currencies. Conversely, a growing and unsustainable debt burden can undermine confidence, increase business uncertainty, disrupt financial markets and increase government borrowing costs. If not addressed, large debt burdens will have painful economic consequences, including high unemployment, chronically weak consumer confidence and a slowdown in investment.

U.S. debt levels have jumped sharply in recent years. The ratio of publicly held debt to GDP has nearly doubled in the last four years, up from 36 percent in 2007 to 68 percent in 2011, driven in large part by the recession of 2007–09 and the financial meltdown of 2008.<sup>8</sup> However, the CBO has estimated that even if the economy were operating at full capacity today, the deficit would be reduced by only about one-third, and total debt would continue to grow.<sup>9</sup> As debt grows relative to the economy’s ability to service it, private investment may be seriously reduced. As seen in Greece and other European nations, where unproductive economies cannot service fast-rising debt, the resulting loss of international confidence can cause interest rates to soar in a matter of months or even weeks — and quickly make a debt situation unsustainable. Economists Carmen Reinhart and Kenneth Rogoff have recently estimated that levels of indebtedness as high as those on the United States’ horizon are associated with sharply lower growth.<sup>10</sup>

While some reduction in U.S. deficits should be expected as the economy continues to recover, the most significant long-term obstacle to reducing the nation’s large and growing annual budget deficits is the increasingly unsound financial footing of the entitlement programs: Social Security, Medicare, Medicaid and other health programs. Driven by demographic trends and fast-rising medical costs, these programs will claim an ever-growing portion of the federal budget and, without meaningful policy reforms, will produce a number of negative consequences for the U.S. economy.

*“Businesses know how to create jobs, create value, and win in a diverse global market. Most CEOs believe the fundamental engine of American business is sound. If Washington and business can once again find the ability to get aligned on fundamental priorities, American business will once again unleash America’s economic potential.”*

*— W. James McNerney, Jr.,  
Chairman, President and CEO, The Boeing  
Company, and Chairman, Business Roundtable*

Projections of fast-rising government debt tend to erode confidence among financial markets and their investors. As the economy recovers, increased borrowing by the government will drive up interest rates, crowd out private investment, and make the U.S. economy more dependent on foreign borrowing and foreign investment. To the extent that private capital stock investment is smaller than it would be otherwise, the United States will experience a smaller productive capacity, reduced GDP and lower future living standards for American families.

Although an unsustainable debt position need not — and usually cannot — be addressed in a short period of time, markets and investors may be reassured by tangible and credible steps taken by political leaders seeking long-term solutions.

First, policies to enhance the credibility of long-term fiscal realignment, including immediate efforts to place Social Security, Medicare and Medicaid on a sustainable path, can boost consumer, business and market confidence in the near term. Second, medium-term and long-term fiscal consolidation must balance spending and revenues. Fiscal consolidation efforts undertaken primarily through cuts in government spending are likely to be more successful over the longer term than fiscal consolidation that relies primarily on tax increases.<sup>11</sup>

Sound fiscal and monetary policies can reduce real interest rates and stimulate private investment. These results support higher levels of capital spending and employment, which in turn increase productivity and consumer confidence, creating a virtuous cycle of economic prosperity.

## Solutions

- ▶ Given the need to reduce future annual federal budget deficits by significant amounts, **keep economic growth as a core principle of fiscal reform.** Without healthy growth, it will be dramatically more difficult to reduce future deficits. Securing America's safety net — including Social Security, Medicare and Medicaid — for future generations in a sustainable and fiscally responsible manner must be another core principle of fiscal reform. A considerable amount of work has been devoted to fiscal policy reform. The Bowles-Simpson<sup>12</sup> and the Rivlin-Domenici<sup>13</sup> plans, for example, represent thoughtful, nonpartisan approaches that include significant policy solutions for America's leaders to consider and take action upon.

Now is the time for the debate to stop and for our elected leaders to act by sending a powerful signal to the world: America is serious about addressing its fiscal challenges. BRT CEOs urge Congress and the President to coalesce around a multiyear growth and deficit reduction plan to restore long-term stability to the U.S. economy, including:

- Passing prudent reforms to reduce the growth of both discretionary and mandatory government spending, focusing on reforms to America's safety net. No area of spending should be off limits. Programmatic reforms — building from recommendations by the Bowles-Simpson, Rivlin-Domenici and other plans — will be needed to modernize and preserve the social safety net so that these benefits are available to future generations.
  - Enacting a modern and fiscally responsible competitive tax code similar to the rest of the world that spurs economic growth and job creation and funds government programs and commitments.
  - Stabilizing and reducing federal debt relative to the size of the economy by achieving a balanced federal budget, excluding interest payments on the debt, within the next five years.
- ▶ **Reach a consensus as a nation as to the size of government** that the United States can afford and the budget priorities within this target — mindful that employment, investment and growth often slow when government is an unsustainably large portion of the economy. It is clear that the government cannot take a larger percentage of the nation's GDP without sacrificing the opportunities of future generations.

Most Americans understand that neither families, nor states, nor nations can prosper if they persistently and dramatically spend more than they take in. Large-scale deficit spending has been the norm in the United States in recent years. The current fiscal path is unsustainable, and the nation can no longer afford continued inaction. BRT's members stand ready to contribute their experience, expertise and commitment to act. America's economic future and credibility in global fiscal markets depend squarely on its willingness to demonstrate leadership and solve these problems — now, not later!

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- 1 Congressional Budget Office. (2012). *The budget and economic outlook: Fiscal years 2012 to 2022*. Washington, DC. Retrieved from <http://cbo.gov/doc.cfm?index=12699>
  - 2 Congressional Budget Office. (2011). *CBO's 2011 long-term budget outlook*. Washington, DC. Retrieved from [www.cbo.gov/doc.cfm?index=12212](http://www.cbo.gov/doc.cfm?index=12212)
  - 3 *Ibid.*
  - 4 Congressional Budget Office. (2012). *The budget and economic outlook: Fiscal years 2012 to 2022*. Washington, DC. Retrieved from <http://cbo.gov/doc.cfm?index=12699>
  - 5 Congressional Budget Office. (2012). *Historical budget data*. Washington, DC. Retrieved from [www.cbo.gov/topics/budget/historical-budget-data](http://www.cbo.gov/topics/budget/historical-budget-data)
  - 6 Congressional Budget Office. (2011). *CBO's 2011 long-term budget outlook*. Washington, DC. Retrieved from [www.cbo.gov/doc.cfm?index=12212](http://www.cbo.gov/doc.cfm?index=12212)
  - 7 Baker, S., Bloom, N., & Davis, S. (2011). *Measuring economic policy uncertainty*. Chicago, IL: University of Chicago Booth School of Business. Retrieved from <http://faculty.chicagobooth.edu/steven.davis/pdf/PolicyUncertainty.pdf>
  - 8 Congressional Budget Office. (2012). *The budget and economic outlook: Fiscal years 2012 to 2022*. Washington, DC. Retrieved from <http://cbo.gov/doc.cfm?index=12699>
  - 9 Congressional Budget Office. (2011). *The portion of the deficit due to cyclical weakness*. Washington, DC. Retrieved from [www.cbo.gov/doc.cfm?index=12440](http://www.cbo.gov/doc.cfm?index=12440)
  - 10 Reinhart, C., & Rogoff, K. (2010). *Growth in a time of debt*. Cambridge, MA: National Bureau of Economic Research. Retrieved from [www.nber.org/papers/w15639](http://www.nber.org/papers/w15639)
  - 11 Hassett, K., Briggs, A., & Jensen, M. (2010). *A guide for deficit reduction in the United States based on historical consolidations that worked*. Washington, DC: American Enterprise Institute for Public Policy Research. Retrieved from [www.aei.org/papers/economics/fiscal-policy/a-guide-for-deficit-reduction-in-the-united-states-based-on-historical-consolidations-that-worked/](http://www.aei.org/papers/economics/fiscal-policy/a-guide-for-deficit-reduction-in-the-united-states-based-on-historical-consolidations-that-worked/)
  - 12 National Commission on Fiscal Responsibility and Reform. (2010). *The moment of truth*. Washington, DC. Retrieved from [www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform](http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform)
  - 13 Bipartisan Policy Center. (2010). *Restoring America's future*. Washington, DC. Retrieved from <http://bipartisanpolicy.org/projects/debt-initiative/about>