Why the Federal Debt Must Be a Top Priority for the 2016 Presidential Candidates

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The Debt Remains a Problem That Transcends Partisan Agendas

The next president will face an array of pressing issues; everything from income inequality to crumbling infrastructure, terrorism, retirement security, tax reform and health care costs. One issue, however, transcends them all: the unsustainable projected growth of the federal debt. No candidate's vision of the future, regardless of party or ideology, will be credible if it rests on the premise of unsustainable debt.

With the annual deficit having come down by more than two-thirds from its trillion dollar heights during the Great Recession, (never mind that this follows an unprecedented increase of 800 percent) candidates may be tempted to conclude that our fiscal problems are behind us. That would be a mistake. Deficits are projected to begin rising again as the next president prepares his or her first budget. Over the coming decade, the debt is on track to grow by more than $7 trillion and resume a long-term path that is unsustainable.[i]

The debt is already at a post-World War II high as a share of the economy (GDP). It has grown from 35 percent of GDP in 2007—about the post-World War II average—to 74 percent today, and is projected to be bigger than the entire economy by 2039.

Interest on the debt will become the fastest growing part of federal spending. In 2017, the next president will inherit a government projected to spend over $300 billion on interest payments that year alone, an amount that grows to more than $800 billion by 2025—more than the current combined federal spending on the Defense Department, education, transportation, and medical research. Absent change, by 2030 all federal government revenue will be needed just for interest payments and mandatory spending(the spending programs that grow on auto-pilot), putting increased pressure on spending controlled through the annual appropriations process, which includes investments in human and physical capital and national defense.

By the end of the next president's theoretical second term (2025), the major health and retirement programs, along with interest on the debt, are projected to account for over two thirds of total spending—up from 58 percent of spending in 2017. Thus, ignoring the debt problem will not make it go away. In fact, the longer corrective actions are delayed, the more difficult the choices will become.

According to the Congressional Budget Office (CBO), it would take spending cuts or tax increases totaling 1.1 percent of GDP in every year, relative to current law, just to keep the debt from rising as a share of GDP through 2040. That translates to roughly $210 billion in 2016. Similar sized cuts or tax increases relative to the size of the economy would be needed in each successive year.[ii] These estimates assume, however, that corrective actions begin immediately. Waiting just five years to begin would require annual deficit reduction totaling 1.4 percent of GDP to keep the debt at today's level in 2040, which would add another $850 billion to the cost. More ambitious goals, such as reducing the debt to its pre-Great Recession share of the economy, would necessitate much larger cuts.

The bottom line is that current and future spending promises cannot be paid for with today's level of revenues. The end result is an unsustainable budget. It's a matter of arithmetic, not ideology.

While incremental progress is possible over the next two years—as is more backsliding, such as we have seen in the past few years—it is very unlikely that a major initiative to alter the budget's unsustainable path will be undertaken. The next opportunity for such an initiative will likely come with the first budget of the next president. First budgets have often set the tone and the agenda for the years ahead: Reagan in 1981, Clinton in 1993, George W. Bush in 2001 and Obama in 2009 all serve as examples.

It is therefore important for the 2016 presidential candidates to present not just a vision of new spending or lower taxes, but a vision that fits within a sustainable budget. It is also important for voters and the media to carefully scrutinize the candidates' fiscal proposals. Presidential candidates should craft their campaign promises with a realistic appreciation for the magnitude of the debt problem, its root causes, and the consequences of doing nothing. If they believe that it is premature to set out detailed deficit reduction proposals during the campaign, they should at least be careful not to box themselves in with pledges of what they will not do; pledges that would make it impossible to actually solve the problem. They should also avoid new proposals that are not paid for and would accelerate the projected growth of debt.

Addressing the debt need not be a candidate's top priority. It must, however, be among the top priorities so that voters can assess the trade-offs involved in each candidate's budgetary proposals. Moreover, unlike other policy issues, putting forward a budget is something a president is required to do. Having a sustainable fiscal vision should be important to all candidates no matter what their priorities, because a failure to address our fiscal outlook will limit a president's ability to address a range of issues.

Reducing the Long-Term Debt Burden Will Pay Dividends

A long-term fiscal sustainability plan is, in fact, an economic growth plan. Too often a false choice is posed between addressing our fiscal challenges and growing the economy. They are not mutually exclusive policy goals. In fact, when properly structured, they are mutually supporting. Failing to address the unsustainable long-term growth in the debt will have negative ramifications for the economic well-being of Americans. On the other hand, putting the debt on a sustainable long-term path would pay dividends in the future for jobs, wages, opportunity and growth.

Government debt crowds out productive investments in people, machinery, technology, and new ventures. This diminished private investment results in fewer job opportunities and lower wages. And as the share of federal resources pledged to retirement, health care and interest on the debt grows, it will leave shrinking amounts for all other purposes including investments in national defense, education, infrastructure, low-income support, or basic research. Spending on children's programs, for example, are already declining. Meanwhile, rising debt can lead to higher interest rates, increasing costs of mortgages, car loans, student loans, and credit card debt.

The currently projected path of fiscal imbalance not only threatens the health of the economy, it also places ever-tighter constraints on the ability of future generations to determine their own priorities or to meet challenges that cannot be foreseen. In the extreme case, failure to get the national debt under control could also eventually cause a crisis where investors are no longer willing to loan money to the government at affordable rates. By contrast, addressing deficits now can be a source of strength even if implemented gradually. According to a CBO analysis, a responsible deficit reduction plan could boost per-person economic growth by as

much as $6,000 after 25 years, in today's dollars, and could be phased in to avoid slowing the economic recovery.[iii]

A Structural Mismatch is Driving the Problem

If candidates are to make sense on the debt issue, they must understand what's causing it and be willing to explain the facts to voters. The root cause is not "waste, fraud and abuse," which is often targeted on the campaign trail. Is there waste? Of course there is and we should ferret it out, but the possible savings here will amount to little more than a rounding error. Another frequent target, foreign aid, makes up just 1 percent of total federal spending.

Economic growth is crucial but alone can't solve the debt problem. The amount of growth required would be unprecedented. Furthermore, many spending programs—including the large retirement and health care programs—grow faster when the economy grows, which counteracts some of the deficit-reduction benefits of economic growth. Productivity growth would have to be 50 percent higher over the next quarter century just to hold debt at its current record-high levels.

The real cause of projected deficit growth and rising debt is a built-in mismatch between projected revenues and popular benefit programs that operate on autopilot, especially Medicare, Medicaid and Social Security. Those three programs already comprise 47 percent of the budget. As the population ages and per-person health care costs continue to rise, these programs will steadily become more expensive. Revenues are not projected to keep up.

The Congressional Budget Office (CBO) projects that over the next 25 years, Social Security and the major federal health care programs will grow from roughly 10 percent of GDP to more than 14 percent. All other federal programs are projected to shrink as a share of GDP over that time.

Rising deficits will increase interest costs on the debt. The CBO projects that interest costs will add another 3 percent of GDP to the budget by 2040, digging the hole deeper. Revenues, while already above their historical average, are projected to grow, but not by enough to keep up. Moreover, many Americans have become accustomed to huge tax-code subsidies for everything from home mortgage payments to employer-provided health care benefits. In total, "tax expenditures" amount to more than $1 trillion per year.

Key Issues the Candidates Should Discuss in their 2016 Campaigns

Borrowing our way through the problem is not a viable option because the rising cost of Social Security, Medicare and Medicaid is not a temporary blip. All three programs get bigger with time. Finding solutions means coming to grips with the demographic and health care cost dynamics that will drive spending and revenues farther apart. We can't simply grow our way out of this problem; we can't simply cut our way out; and we can't simply tax our way out. We need a combination.

Finding such a solution will take leadership, which will require conducting a straightforward conversation with the American people, setting priorities, avoiding short-term gimmicks, and negotiating difficult choices across party lines. The president and Congressional leaders who have the courage to attack the debt will need broad public support to face down opposition from special interests.

Voters have a right and a responsibility to find out what the candidates are prepared to do about this problem in their first budget as president.

At a minimum, candidates should:

1. Acknowledge that the long-term debt is a serious problem.
2. Make dealing with the debt a top policy priority in their campaign.
3. Put forward a plan for what they would do, not what they wouldn't do.
4. Explain how they would pay for their policy initiatives.
5. Use their speeches, white papers, press briefings, and party platform to engage and educate the public about the tough choices.

More specifically, candidates should commit in their first budget to:

1. Achieve declining debt levels with debt (as a percent of the economy) lower at the end of the first term (2021) than when taking office; with debt even lower at the end of a second term (2025); and set on a continuous downward path thereafter.
2. Include policies that grow the economy and address pressures on the budget by:
   - Slowing the growth of federal health care spending and improving the health care delivery system so that it is less of a drain on our economy and the budget
   - Making Social Security sustainable and secure, strengthening it for future retirees and generations
   - Reforming the tax code by eliminating, reducing or reforming tax preferences in order to simplify the code, grow the economy, enhance competitiveness and reduce the deficit
   - Protecting or even expanding critical investments (such as education and infrastructure) to promote economic growth and opportunity
3. Work closely with Members of Congress in both parties to enact the budget into law.

In preparing their campaign proposals with an eye towards the first budget, candidates should be mindful of some key considerations regarding the three crucial programs for long-term sustainability: Social Security, health care and taxes.

Social Security

Social Security is a vital program that provides retirement and disability income to 59 million Americans. It is also the largest federal program, accounting for nearly one-quarter of all federal spending. Despite its dedicated revenues, Social Security promises more benefits in the future than it can deliver. Since 2010 Social Security has been paying out more than it takes in on an annual basis and its Trustees warn that the program cannot sustain its projected long-run costs:

- The combined Social Security trust funds are projected to be depleted in 2034, which would result in an across-the-board 21 percent benefit cut. The Social Security Disability Insurance fund is projected to be depleted even earlier, in late 2016.
- In 1960 there were approximately five workers for each Social Security beneficiary. As the baby boom generation retires, today's ratio of nearly three workers for each beneficiary will shrink to roughly two workers per beneficiary by 2030. This means without placing a larger tax burden on workers or cutting benefits, the program will incur large deficits.
- Waiting to address Social Security's finances will require larger cuts or tax increases in the future; even worse, waiting will spread this larger burden over fewer people, necessitate abrupt and less targeted changes, and leave workers with less time to plan and adjust. Making changes sooner rather than later will make it easier to design thoughtful, pro-growth, and well targeted reforms.

Health Care

Despite recent slowdowns in federal health care spending, it remains a large piece of the federal budget and is still projected to grow faster than the economy. The recent slowdown has led to lower growth projections in Medicare and other government programs, yet great uncertainty remains about how much of the slowdown represents a permanent shift to a more efficient health care system. Our aging population is the main driver of future health care spending because aging results in more Medicare and Medicaid beneficiaries:

- One-sixth of all economic activity in the United States involves health care. Health care spending is the largest piece of the federal budget, comprising over one-quarter of all federal spending in 2015 (more than $900 billion).
- Over an 8-year term, the next president would see annual federal health spending grow by more than 70 percent, from $1.1 trillion to $1.9 trillion.
- Spending on federal health care programs is projected to grow from 5 percent of the economy (GDP) to 8 percent of GDP over the next 25 years faster growth than in any other government programs both because of health care cost inflation and an aging population.[iv]
- Historically, health care costs have grown more quickly than the economy, putting pressure on businesses, wages, and government programs. Every nonpartisan projection shows health care costs continuing to grow more quickly than the economy.
- The recent slowdown in cost growth makes this an important moment to address health care costs, with an opportunity to inject changes into the health care system and federal programs that can have long-lasting positive effects on the budget as well as the quality of care.

Tax Reform

Federal revenues are not keeping pace with expenditures, a trend that will continue as federal spending on health and retirement programs increase. At the same time the U.S. tax code is complicated, inefficient, and hurts our competitiveness. There is little wonder that there is bipartisan agreement on the need for reform:

- The exemptions, deductions, credits and preferential rates within the income tax system are often called “tax expenditures” because they are essentially spending programs in disguise. They have much the same impact as if the government had simply written checks to the beneficiaries but they generally receive far less scrutiny than direct spending.
- Tax expenditures total more than $1 trillion a year in foregone federal revenue.[v]
- Many bipartisan groups have suggested cutting these provisions to make the tax code simpler and fairer and to promote economic growth.
- Comprehensive tax reform is possible to achieve in a way that lowers tax rates for everyone, retains or increases progressivity, and brings in additional revenue to reduce the deficit.

Conclusion

In the past, we have seen some elections in which the candidates competed to be fiscally responsible, and other elections in which they pandered and ran from the issue. This is a critical moment for the United States and the debt; the next president, whoever he or she is, will

have to face a number of looming fiscal issues from the depletion of the Social Security disability fund, to a likely increase in interest rates, to the ongoing extremely expensive retirement of the baby boom generation. Growing the economy is one of the themes of this campaign and yet it cannot happen without a sustainable fiscal plan. Citizens are willing to be part of sensible reforms that would help control the debt and grow the economy, but they will need presidential candidates—and ultimately a president—who is willing to honestly talk about and tackle the issue.

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[i] Unless otherwise noted, all 10-year budget projections for Fiscal Years 2015-2025 are taken from the March 2015 Congressional Budget Office (CBO) baseline. U.S. Congressional Budget Office, "Updated Budget Projections: 2015 to 2025" (Washington: 2015), https://www.cbo.gov/sites/default/files/cbofiles/attachments/49973-UpdatedBudgetProjections.pdf. Budget projections through 2040 are taken from CBO, "The 2015 Long-Term Budget Outlook" (Washington: 2015).

[ii] CBO, "The 2015 Long-Term Budget Outlook," Summary Figure 1, 7.

[iii] Ibid, Figure 6-1, p.75.

[iv] CBO, "The 2015 Long-Term Budget Outlook," 28.

[v] CBO, "The Budget and Economic Outlook: 2015 to 2025," Figure 4-3, 102.