



Budgeting for Growth and Prosperity

A Long-term Plan to Balance the Budget, Grow the Economy,
and Strengthen the Middle Class

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Introduction and summary

The purpose of the Center for American Progress plan for long-term deficit reduction is to build a strong American economy that provides the best opportunities for personal success of any country in the world, strengthens and builds a thriving middle class, and secures the position of the United States as the leading nation of the 21st century. To achieve these goals, federal budget deficits must be brought under control to keep credit markets strong and interest payments to foreign creditors low. But a balanced federal budget is far from all that is needed.

America must also invest in its economic future to achieve the economy we envision. Most of America's investments are made by businesses and individuals, but the federal government plays critical roles as a direct investor in areas such as education, basic science, technology, and infrastructure, and as a catalyst for private investment. Without it effectively playing these roles U.S. economic growth will be weak, America will no longer be the global leader it is today, and all Americans will lose.

Central to our strategy is investing in the middle class. The America we know was built by middle-class workers and consumers, innovators, and entrepreneurs. The fortunes of the Forbes 400 have their roots in the opportunities our country has offered those in the middle class. Policies that invest in the middle class are investments in a successful American economy.

The public sector's contribution to the economy we envision, however, goes beyond balanced budgets and investments. An economy must have a basic set of rules and protections that ensure trust and confidence in the marketplace. This role ranges from policing insider trading on Wall Street, to enforcing contracts, to ensuring that our food and medicine are safe. Certainly there is such a thing as too much regulation. But, as the recent financial market disaster painfully reminds us, there is also such thing as too little.

Our economic success also depends on the effective and efficient provision of the public services on which the nation relies. Finally, the tax system's incentives and disincentives should enhance economic growth and address the growing inequality that undermines our national prosperity.

While the central motivation for the reforms we propose is the long-term success of the American economy, our plan also achieves several objectives motivated by

other values. There are national responsibilities that simply must be honored whatever their economic payoff, among them:

- National security
- Public safety and health
- Preventing destitution
- Honoring valued national commitments, including those to the elderly and disabled

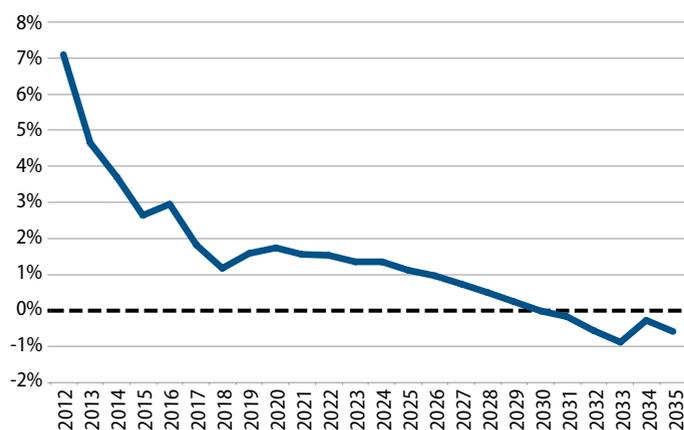
Achieving all of these objectives requires a numerical balancing, but it also requires an extremely challenging political balancing. The *honest* public debate over spending cuts and tax increases is in its infancy, with a long road ahead before there will be sufficient political space for the compromises that must be made in order to achieve a fully balanced federal budget. There is, at this point, no legislative path forward without broader agreement than is now possible. While some deficit reduction plans circulating in Washington appear to reach very low deficit levels quickly, the paths they offer are simply unrealistic. Our plan is designed with an eye on the political journey our nation will have to take and deliberately allows time for the building of a consensus for the major reforms that will be necessary.

We also must allow time for our economy to fully recover before administering the strongest deficit-slashing medicine. Deficit reduction that is too big, too fast would be

FIGURES 1 AND 2

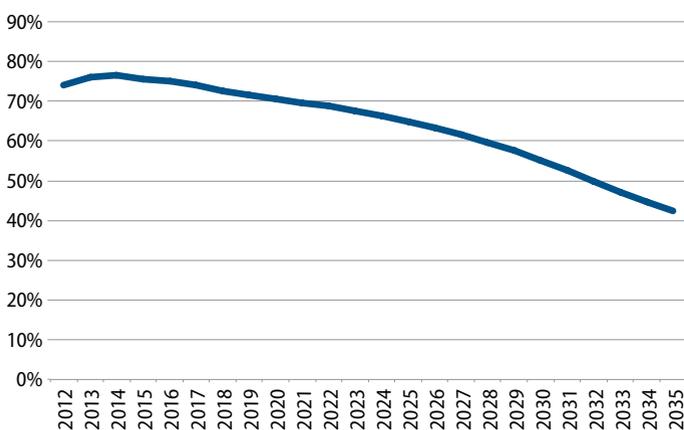
Our path from deficit to surplus

Federal budget deficit, as percent of gross domestic product, from 2012 to 2035 under the Center for American Progress plan



Shrinking the debt

Publicly held debt as a share of GDP, from 2012 to 2035, under the Center for American Progress plan



Source: Authors' calculations.

counterproductive—stalling growth and worsening our fiscal problems. Our most important national objective in the near term is to create jobs and get the economy back on track.

For these reasons our plan is implemented in two distinct stages. The first stage hits a meaningful, but achievable, interim budget target of “primary balance” in 2015—with revenues equal to spending except for interest payments on the debt. Starting in 2017 our plan enters a second phase aimed at achieving full balance while making needed investments.

Projections using nonpartisan Congressional Budget Office-based methodologies reviewed by independent analysts show our plan fully balancing the budget by 2030.¹ (see Figures 1 and 2) It is our belief that the economic growth gained in the early years through deficit reduction, investments, and other measures will, in fact, lead to a balanced budget earlier than that year. Outlined below are the spending and revenue policies we use to achieve our objectives.

Spending

The federal government makes investments that are important to our economy, provides services to the public, and carries out a variety of activities necessary to a well-functioning society. Our spending plan is designed to do those things well, do them efficiently, and do them at the appropriate level of public expenditure.

The CAP spending plan:

- Makes significant new investments in key areas such as education, infrastructure, science, technology, and energy research, as well as areas that strengthen our middle class
- Reduces spending while making it more efficient, maintaining public services that businesses and the public rely on, and ensuring our national defense through a reconfigured national security budget
- Strengthens the social safety net where needed
- Brings under control the most substantial spending challenge facing the country: health care

The plan reduces spending from about 27 percent of gross domestic product in 2030 in the extended Congressional Budget Office baseline—the official, nonpartisan projection of our fiscal future—to under 24 percent of GDP. By 2035 spending is down to about 23 percent of GDP.

Investing to promote economic growth and a strong middle class

Starting in 2017 the CAP plan makes significant new investments in scientific research, all levels of education, clean energy technologies, and transportation and infrastructure—areas where nations around the world are making substantial commitments. Our plan makes major investments in strengthening the American middle class. All of these investments are necessities if the United States wants to avoid being surpassed as the country with the greatest opportunities, the best jobs, and the most powerful economy. They are essential if we want our nation to continue to be where the great ideas and the most innovation comes from, and remain a nation where entrepreneurs thrive and build successful businesses, large and small.

Investments such as these are the foundation of a strong 21st century economy. The country that leads in basic scientific research obviously has a huge advantage in innovation and technology. The country that can rely on domestically produced renewable energy isn't exposed to the risks associated with relying on imports, keeps funds at home that would otherwise go abroad, and gets a leg up on what will be one of the most important industries of this century. And the country that invests in its middle class produces educated, productive, and creative workers; a strong domestic market; a motivated workforce; and a population from which the greatest innovators and entrepreneurs emerge.

The investments we make include a doubling of spending on science, technology research, and renewable energy; large boosts in K-12 education, pre-K, and Pell grants; and a 20 percent hike in transportation and infrastructure spending.

Responsibly restraining discretionary spending

The CAP plan includes separate spending limits on a unified security budget and on nonsecurity discretionary spending. Our unified security budget includes the distinct budgets of defense, homeland security, and international affairs—the budget areas that comprise the means by which we implement our national security policy.

Beginning in 2016, we set the limit on the unified security budget at about \$700 billion. This is approximately the same overall level, adjusted for inflation, as it was in 1986 at the height of the Cold War. From there, the cap rises at the rate of inflation plus 1 percentage point.

Our limits on nonsecurity discretionary spending are set at specific levels designed to adequately fund the public services on which the public and businesses rely, assum-

ing they are provided more efficiently than in the past, and to make the investments described above. Overall, discretionary spending will make up about 6 percent of GDP in 2035, compared to 6.2 percent of GDP in the CBO baseline.

Shifting nonhealth mandatory spending

The CAP plan reduces agricultural subsidies and constrains the growth in many other programs while allowing room for investments and patching holes in the social safety net. The safety-net steps include increasing participation in the Supplemental Nutrition Assistance Program to 85 percent of eligible people, increasing the Supplemental Security Income benefit, increasing housing assistance by 20 percent, and boosting funding for children's programs.

These steps plus our investments in education will reduce the poverty rate to below 7 percent from its current level of over 14 percent. Preventing destitution is a moral obligation but pulling people off the economic sidelines into the mainstream serves national economic goals as well.

CAP has previously released a Social Security plan in our report, "Building It Up, Not Tearing It Down: A Progressive Approach to Strengthening Social Security," which has a number of benefit adjustments that net to a reduction in outlays in 2030 from 6.0 percent of GDP to 5.8 percent.²

Containing health care cost growth

Rising costs and an aging population make health care a major driver of our long-term deficits. Therefore, a key challenge in any deficit reduction plan is to lower these costs without sacrificing care for the millions of Americans who rely on public programs. Any approach that relies solely on savings from Medicare and other public programs without addressing rising health care costs economywide will only shift costs onto individuals and families, hurt the quality of care, or both. Co-pays will go up while providers leave the programs or make up lost revenue by raising private market rates on businesses and families.

To avoid that outcome, our plan brings down the costs of health care for everyone, not just those of the federal government. In this effort the Affordable Care Act, passed last year, is our most valuable tool. The new health care law has dozens of mechanisms, reforms, and pilot programs designed to bring down the costs of care, while

improving the quality. The law also encourages the private sector to follow the public sector's lead, and incentivizes public-private partnerships that bring down costs broadly. Backstopping all of this is the Independent Payment Advisory Board, whose mission it is to ensure that target savings are realized.

In our plan, aggressive implementation of the new health reform law, along with some enhancements to its existing cost-control mechanisms, will result in dramatically lower health expenditures, both for the federal government and overall. But predicting the exact effect of the myriad test programs and reforms in the new health law is fraught with uncertainty. Thus we also include a failsafe mechanism that would ensure significant savings.

Our failsafe would be triggered if, starting in 2020, total economywide health care expenditures grow at a rate faster than the economy. Should that happen then we would empower the Independent Payment Advisory Board to extend successful reforms in Medicare and other public programs to insurance plans offered in the health care exchanges and then potentially to all health care plans, such that the target is met. This will ensure that costs are constrained across the health care sector, preventing cost-shifting and maintaining access for all.

The effect of these reforms, along with our failsafe, will be to hold federal health spending to 7.8 percent of GDP in 2035, compared to 9.8 percent in the CBO baseline. As importantly, they will lower the overall cost of health care thus ensuring that reductions in Medicare do not result in providers leaving the program and costs aren't shifted from the public to the private sector.

Revenue

In the spending part of our plan we have constrained the areas of greatest growth, cut unneeded spending, and increased spending that is necessary to the future of our economy. Overall, our plan cuts spending by more than \$13 trillion below current projections over the next 25 years. But even after all our spending cuts, without some revenue enhancement, there would still be more spending than revenue. Compared to the CBO baseline we would still have a average deficit of 3.0 percent of GDP between 2017 and 2030.

When the economy is running well and we are at peace, running deficits unnecessarily weakens our nation. Thus, our plan raises additional revenue to balance the budget. It does so, however, in a way that simplifies a grotesquely complicated tax system. Our plan closes loopholes, eliminates special tax breaks that create unfair disparities among taxpayers, realigns the incentives of the tax system to better serve our econ-

omy and planet, cuts income taxes for middle-income taxpayers, and takes steps to address the inequality that undermines our national prosperity.

Individual income tax

Our plan makes the individual income tax simpler and fairer. It introduces a flat 15 percent rate for couples with incomes under \$100,000.³ Many loopholes, deductions, and exemptions are eliminated, but the ones middle-class families most rely on are replaced by better-targeted credits. Thus, while taxpayers will no longer have the option of “deductions” from income such as for mortgage interest and charitable contributions, they will be able to instead receive a direct reduction in their taxes through a credit equal to 15 percent of these costs.

In addition, there will be a large flat “alternative credit” that taxpayers can choose instead of the itemized credits. This alternative credit works similarly to the current standard deduction. For 90 percent of Americans, choosing the alternative credit instead of the itemized credits will both lower their overall tax bill, and make filing simple and easy.

Most middle-class and lower-income taxpayers will pay lower income taxes under our proposal. These tax reductions will, on average, more than offset any higher taxes resulting from our new energy taxes described below. Tax rates are lower at most levels of taxable income. Overall, factoring in all the changes to the personal income tax in our plan, only those in the top 5 percent of the income spectrum will, on average, pay higher taxes. All other income groups, on average, will pay less or the same.

For the wealthy, loopholes are closed and the top tax rate is restored to the level it was at under President Clinton during the 1990s economic expansion. A temporary surtax of 5 percent is added for ordinary income over \$1 million. The surtax expires once the federal budget is balanced. The top rate will still be lower than during most of the postwar period, including the country’s greatest period of economic growth. The top tax rate for capital gains income (income from selling investments) is set at the level signed into law by President Reagan. The reforms make taxes simpler for the rich as well as the middle class by obviating the need for the alternative minimum tax and various high-income phase-outs.

After years of successive tax cuts and rapidly increasing income (even as the income of typical Americans has stagnated or fallen) the wealthiest Americans can afford to pay more. Under our plan, the average *after-tax* income of the richest 1 percent of Americans will *still* be over 40 percent *higher* than it was in 2001. The richest 5 percent will still have over 30 percent higher income.

Finally, once our plan achieves budget surpluses in excess of 1 percent of GDP, the alternative credit is raised substantially to simplify tax filing for still more people and further reduce middle-income taxpayers' tax bills—while maintaining a federal budget in balance or small surplus. This is projected to occur in 2033.

Reducing greenhouse gas emissions and reliance on foreign oil by pricing carbon pollution and levying an oil-import fee

Our plan addresses the risks and economic damage from our heavy reliance on foreign oil and the dangers of climate change by establishing a price on emissions of carbon dioxide and other greenhouse gases, and introducing an oil-import fee of \$5 per barrel. Under our plan, greenhouse gas emissions will be reduced by 42 percent of 2005 levels by 2030, and 83 percent of 2005 levels by 2050. For low- and middle-income taxpayers, any resulting rises in energy prices are offset by the benefits of reduced income taxes. And, in the case of those who do not owe personal income tax, often the elderly, a rebate program accounted for in our spending proposals provides an offset.

Financial transactions tax

Our plan imposes a modest fee on financial transactions, including trading in stocks, bonds, and derivatives. The tax is applied at a very low rate—less than two-tenths of a percent on stock trades. We believe the purpose of Wall Street is to raise capital for the productive sectors of the economy and that excessive financial speculation is counterproductive toward this purpose and harmful to stable growth in general. A financial transactions tax discourages unnecessary rapid turnaround speculation and improves incentives for long-term investment while raising revenue. Our proposal is modest compared to financial transactions taxes imposed in other financial centers, including the United Kingdom and Singapore.

Other revenue reforms

There are a number of other tax changes in the CAP plan. Among them:

- Remove the cap on the employer side of the payroll tax as described in the CAP Social Security plan. Currently the payroll tax to fund Social Security is only applied to earned income up to \$106,800. Our proposal removes that cap but only on the part of the Social Security tax paid by the employer not the part paid by the employee.

- Restore the estate tax to approximately pre-Bush tax-cut levels, but indexed for inflation.
- Adopt several revenue proposals in President Obama’s 2011 and 2012 budgets.
- Eliminate some industry-specific tax expenditures that are effectively government spending administered through the tax system, including those for the oil industry.
- Other revenue measures including an Internet gambling tax and Superfund excise tax.

Overall, our plan raises revenues in 2030 by less than 2 percent of GDP compared to the baseline. Total revenue drops to 23.8 percent of GDP by 2035, just half a percentage point above the baseline.

Conclusion

The plan described in this report will boost the economy and meet societal obligations while balancing the budget. It is also a realistic plan. That isn’t to say that it could pass Congress and be signed by a president today. No effective plan for long-term fiscal responsibility could at this point in the debate. That should not give us too much worry. There are many steps we can make now toward a responsible fiscal future with a strong economy and a healthy society. We have offered recommendations for such steps in other reports. Our goal in producing this vision for the long term is to offer a final destination that ensures our nation is as successful as it has ever been while fulfilling all of its responsibilities.

We believe our plan is not only a good one but also one that is not far off from where the country will go. In the end, the country will neither tolerate extreme spending cuts nor the most of dramatic tax increases. In the end, the country will seek a balance—and that is what we offer here—a combination of spending and revenue reforms to see our way to a balanced budget by 2030 and beyond.

In the pages that follow we will present in greater detail the spending and revenue reforms we outlined in this introduction and summary. As we’ll demonstrate, our plan is a fair, effective, and efficient way to restore our federal budget to balance by 2030 while ensuring our nation remains the most competitive, innovative, and prosperous in the world.

The Center for American Progress is a nonpartisan research and educational institute dedicated to promoting a strong, just and free America that ensures opportunity for all. We believe that Americans are bound together by a common commitment to these values and we aspire to ensure that our national policies reflect these values. We work to find progressive and pragmatic solutions to significant domestic and international problems and develop policy proposals that foster a government that is “of the people, by the people, and for the people.”

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