A COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET PROJECT

USBUDGETWATCH

The 12 Principles of Fiscal Responsibility for the 2012 Campaign

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About

U.S. Budget Watch

U.S. Budget Watch is an ongoing project designed to increase awareness of the important fiscal issues facing the country, from specific policy debates to comprehensive policy platforms by presidential candidates and presidents in office. U.S. Budget Watch seeks to bring attention to the fiscal consequences of presidential candidates' tax and spending policies and to help the public become informed about these issues.

U.S. Budget Watch is a project of the Committee for a Responsible Federal Budget, a non-profit organization committed to educating the public about issues that have significant fiscal policy impact. The Committee is a bipartisan group of leading budget experts, including many of the past directors of Congressional Budget Committees, the Congressional Budget Office, the Office of Management and Budget, and the Federal Reserve Board.

Through U.S. Budget Watch, the Committee intends to help educate voters, the media, and candidates regarding critical fiscal issues; to promote positive discussions on these issues; to insist on workable, comprehensive fiscal plans from candidates that can achieve broad support; and to assess the budgetary impact of candidates' campaign proposals.

U.S. Budget Watch neither supports nor endorses any candidate for office.

The Committee for a Responsible Federal Budget

The Committee for a Responsible Federal Budget is a bipartisan, non-profit organization committed to educating the public about issues that have significant fiscal policy impact. The Committee is made up of some of the nation's leading budget experts including many of the past Chairmen and Directors of the Budget Committees, the Congressional Budget Office, the Office of Management and Budget, the Government Accountability Office, and the Federal Reserve Board.

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Since 2003, the Committee for a Responsible Federal Budget has been housed at the New America Foundation. New America is an independent, non-partisan, non-profit public policy institute that brings exceptionally promising new voices and new ideas to the fore of our nation's public discourse. Relying on a venture capital approach, the Foundation invests in outstanding individuals and policy ideas that transcend the conventional political spectrum. New America sponsors a wide range of research, published writing, conferences and events on the most important issues of our time.

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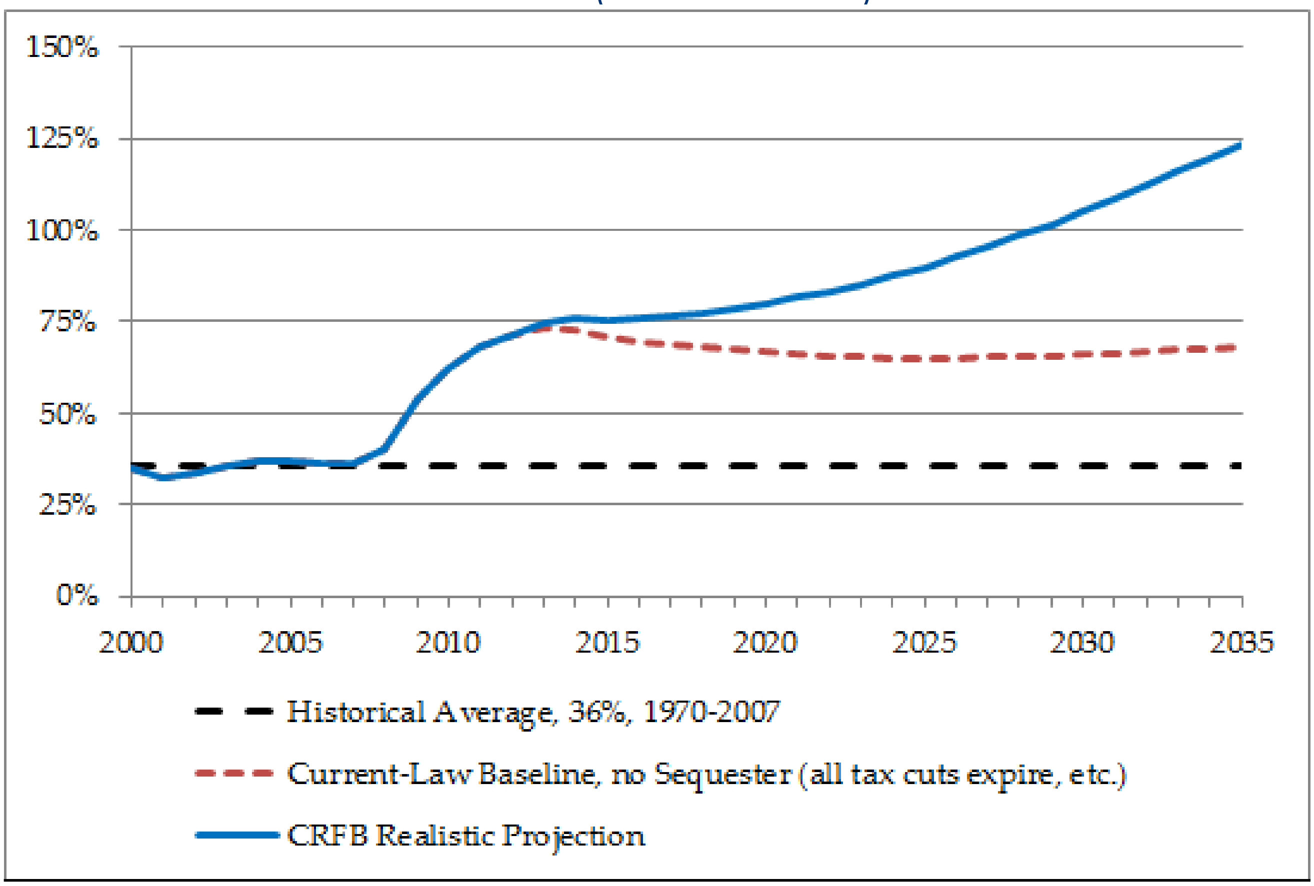
The 12 Principles of Fiscal Responsibility for the 2012 Campaign

1. **Make Deficit Reduction a Top Priority.**
2. **Propose Specific Fiscal Targets.**
3. **Recommend Specific Policies to Achieve the Targets.**
4. **Do No Harm.**
5. **Use Honest Numbers and Avoid Budget Gimmicks.**
6. **Do Not Perpetuate Budget Myths.**
7. **Do Not Attack Someone Else's Plan Without Putting Forward an Alternative.**
8. **Refrain From Pledges That Take Policies Off the Table.**
9. **Propose Specific Solutions for Social Security, Health Care Programs, and the Tax Code.**
10. **Offer Solutions for Temporary and Expiring Policies.**
11. **Encourage Congress to Come Up With a Budget Reform Plan as Quickly as Possible.**
12. **Remain Open to Bipartisan Compromise.**

The 12 Principles

The United States faces a number of serious fiscal and economic challenges. Federal budget deficits are projected for the foreseeable future, the economy continues to be weak, high unemployment persists, Social Security faces long-term financing concerns, health care spending is growing faster than the economy—putting immense pressure on the budget, tax policy is at a major crossroads, and our national debt continues to rise. Inattention to the ballooning national debt threatens to undermine the long-term state of the economy and could lead to a serious fiscal crisis.

FIG 1. Federal Debt Held By The Public (Percent of GDP)[1]



Simply put, our current debt trajectory is unsustainable. Historically, debt held by the public has averaged less than 40 percent of GDP since 1970. Today's debt is 68 percent of GDP and rising fast, particularly due to the retirement of the baby boom population and rapid health care cost growth. The United States is currently at a crossroads, where fundamental but thoughtful changes can be made now, or else far more painful ones can be made later.

[1] **CRFB Realistic Projections** assume the continuation of the 2001/2003/2010 income and estate tax cuts, annual AMT patches, a permanent freeze (rather than 27 percent cut) in Medicare physician payments, a gradual drawdown of troops in Iraq and Afghanistan, and a cancelation of the $1.2 trillion sequester scheduled to occur due to the failure of the Joint Select Committee on Deficit Reduction.

Our leaders will have to take concrete steps to confront these challenges, and some level of ideological sacrifice will be required. The sooner decisions are made, the better — both because it will give the public more time to adjust and because it will allow us to spread the sacrifices more broadly.

The 2012 campaign comes at a crucial time. Candidates can either illuminate these challenges by accommodating the needed national dialogue on how to confront them and by producing a mandate for real solutions, or they can obfuscate the issues by reducing them to sound bites and platitudes, exacerbating partisan divisions, and making harmful pledges and promises that endanger our long-term prospects for the sake of short-term political gain. The proclivity of candidates to propose grandiose (and costly) new initiatives in response to problems in order to attract votes rather than espousing policies that could alienate key constituencies such as revenue increases or spending cuts means that campaigns often degenerate into the obfuscation route.

Instead, candidates should take the responsible route and follow the 12 simple principles below.

1. Make Deficit Reduction a Top Priority.

The August 2011 Budget Control Act (BCA), which increased the debt limit and put in place discretionary spending caps, was a small step in the right direction toward fiscal sustainability, but not the grand solution which is so badly needed. With discretionary spending caps now in place through 2021, debt is still slated to rise to unsustainable levels under reasonable projections.

Based on our estimates, the debt will rise from 68 percent of GDP today to more than 81 percent by 2021 and over 120 percent by 2035 unless lawmakers make changes. Even with $1.2 trillion in new sequester cuts from the BCA – which are slated to go into effect in the beginning of 2013 as a result of the Super Committee's failure – the debt would still reach 77 percent of GDP by 2021 and would rise substantially further over the long run.

It is clear that the current debt path is unsustainable, and each candidate running for the presidency should put the nation's fiscal health at the top of his or her agenda.

Recognizing that there is a problem is the first step toward recovery, but candidates must go even further by making it a priority to fix the problem. Of course, there are a plethora of viable solutions for dealing with this problem, not just one "right" plan. Furthermore, the benefits from well-designed fiscal reforms are potentially quite large – more robust economic growth, more budgetary flexibility, lower interest costs, a reduced risk of a fiscal crisis – just as the consequences of inaction could be severe.

Candidates must recognize the benefits of preemptive action along with the consequences of inaction, and pledge to use their bully pulpits to focus attention on the problem through speeches, public forums, town hall meetings, and conversations with the press. They must also be ready to work with Congress to enact solutions.

2. Propose Specific Fiscal Targets.

Promises to "reduce the deficit" are important, but reassuring markets will require presenting a roadmap of how to do so. The first step in this is coming up with a set of goals – specific fiscal targets which a candidate plans to achieve. The target might include reaching a specific debt-to-GDP level, reducing the deficit by a certain amount, hitting a specific deficit target (for example, a balanced budget by a certain date), or specific revenue and spending levels. Targets should be comprehensible to the public, translatable into specific policy recommendations, and accountable against actual results.

Putting forth such targets can help to focus the public's and the political system's attention on the issue while bringing credibility and transparency to the often empty calls for fiscal responsibility on the campaign trail. A specific fiscal target can become a rallying cry to help gain public and political support for beginning the difficult process of getting on the path to fiscal sustainability.

3. Recommend Specific Policies to Achieve the Targets.

Candidates need to be specific about the policies they support. Specific spending reductions and/or revenue increases – not just generalized promises – will be necessary to put the debt on a downward path and to show voters what will be involved.

Ideally, candidates would present their own "budgets" to show the proposals they support and the amount those respective initiatives would cost or save. For example, a candidate could specify a list of tax changes and the fiscal consequences for each change, and a list of spending increases or cuts and the respective fiscal consequences.

4. Do No Harm.

A presidential campaign need not focus entirely on deficit reduction measures; after all, elections are about agenda-setting and this country still has many unmet needs. However, when candidates propose either new spending programs or tax cuts which will add to the deficit, they should show how they would pay for the initiatives as well.

Moreover, candidates should be equally detailed about how to pay for their initiatives as they are about how much they would spend on them. Rather than saying they would "freeze" a specific area of the budget or "close the tax gap," they should specify what programs they would reduce and/or what changes they would make to the tax code in order to finance their initiatives. Furthermore, offsets should be dedicated to paying for one policy only, and should not be double-counted for a second policy or for deficit reduction. It is important to be specific about costs and offsets so as to present the real types of trade-offs that will be involved.

5. Use Honest Numbers and Avoid Budget Gimmicks.

Budgeting decisions should be made transparently, and the consequences of tax and spending proposals should be clear. Politicians often find it convenient, however, to avoid this principle by employing budget gimmicks, which cloud the budget-making process, and to obscure the true costs or savings of their tax and spending polices. The temptation to use budget gimmicks is always present—albeit in different forms.

For example, *unspecified savings*, or "magic asterisks," have been popping up with more regularity. Obviously, candidates cannot and need not work out every single policy detail on the campaign trail; but when they state specific amounts of savings, they should be as specific as possible about the sources of those savings.

Another gimmick is relying on overly *optimistic economic projections* as a result of their policies. It is true that additional investments in high-value areas of the budget and certain tax reforms, among other policies, could improve economic growth. However, given the difficulties in accurately estimating these "dynamic" effects, candidates must refrain from relying on wildly overstated economic effects of their policies.

Timing gimmicks have also abounded in recent years, and can work both by excessively back-loading deficit reduction and by making new spending policies or tax cuts look less expensive than they really are. This can occur either by structuring new policies to be phased in very gradually or by having the bulk of their costs materialize in later years or even outside the budget window, respectively.

In addition, some gimmicks rely on baselines to hide deficit and debt effects. For example, some budget plans have counted savings which are already slated to take place, such as from the war draw-down, or have ignored costs which will surely occur, such as patches to the Alternative Minimum Tax (AMT).

Politicians need to commit to honest budgeting. Gimmickry may help to make plans look better, but it will not do anything to put the country on a more sustainable path.

6. Do Not Perpetuate Budget Myths.

Elected officials should be careful not to perpetuate budget myths. Too often, these myths are used to justify fiscally irresponsible actions or inaction. Some of the most common myths include:

- **Deficits and debt do not matter.** In fact, deficits constrain choices and bring into question policy and economic viability. Although high deficits may not be problematic (or could even be beneficial) in any given year, the historical and cross-country evidence suggests that high debt levels are indeed dangerous.

- **Tax cuts pay for themselves.** It is true that certain types of tax cuts – particularly those which reduce marginal rates – can have economic benefits that reduce tax revenues less in dynamic modeling than in static modeling.[2] However, a smaller decrease in revenues is still a decrease in revenues. There are no historical examples nor is there a theoretical basis to suggest that any major tax cut today could raise enough feedback revenue to fully offset itself.

[2] Dynamic models attempt to estimate the impact of budget reforms on macroeconomic variables not included in static models, such as economic output.

- **We can grow/recover our way out of debt.** It is true that today's deficits are bigger as a result of the economic downturn. However, even after the economy recovers, the deficit will still remain and will be growing. According to the Congressional Budget Office, less than one-third of the 2012 deficit is due to structural weakness; and despite CBO's projections that the economy will recover by mid-decade, their current policy projections still show debt growing by decade's end. After the recovery, faster-than-projected growth would certainly help the fiscal situation; but because the largest spending programs – Social Security and Medicare – tend to grow as the economy does, and even at faster rates, there is no plausible level of economic growth that can get us out of our fiscal problems.

- **We can solve our debt situation by cutting waste, fraud, abuse, earmarks, foreign aid, and/or the tax gap.** The real drivers of the debt have little to do with these issues, and instead are the result of growing entitlement costs and the failure of revenue to keep up. Improving government efficiency and better targeting discretionary spending can help improve the situation on the margins – and should be pursued in any event – but should not be seen as a panacea.

- **Medicare and Social Security are earned benefits and therefore should not be part of deficit reduction.** In reality, Medicare and Social Security are structured such that the taxes paid by participants are nowhere near sufficient to pay for the benefits they are scheduled to receive. In other words, beneficiaries receive far more than they ever paid in, even adjusted for inflation. Since current promises made by Social Security and Medicare are unsustainable, leaving these two programs untouched would require neglecting other important government priorities in areas such as education, defense, and infrastructure.

- **There is such a thing as a free lunch.** There is no magic bullet that can somehow maintain government benefits and services, maintain overall tax burdens, and put the debt on a sustainable path. To be sure, there are policies which can make government more efficient and help promote economic growth; but no policy change or programmatic reform can make everyone better off at the same time.

7. Do Not Attack Someone Else's Plan Without Putting Forward an Alternative.

Today's campaign environment does not always lend itself to presenting thoughtful solutions and engaging in constructive debate over their merits. It is much easier to criticize your opponents' ideas than to present fodder for others to attack. Sound fiscal policies that would improve the budget situation are particularly vulnerable since they involve taking things away from voters in the form of higher taxes and lower spending. It is much easier to win votes by promising the opposite.

Though it may be politically expedient, attacking reasonable ideas simply for political gain is counterproductive to addressing the country's fiscal problems. It will also make it more difficult to take such ideas under consideration after the election, when the winning candidate must transition from campaigning to governing.

Any politician who wishes to criticize an opponent's plan should be willing to propose his or her own practical solution to the problem. If politicians always offered counter-proposals after criticizing others, this would dramatically elevate the quality of the debate and give voters a real choice. Such a practice can bring to light options others may not have considered.

8. Refrain From Pledges That Take Policies Off the Table.

Pledges lock lawmakers and candidates into political rigidity, which will make solving our fiscal problems harder at a time when flexibility must be maximized. Pledges take options off the table and further constrain the policy process in what is an already difficult environment. Reducing the number of options available to lawmakers today to stabilize and reduce the debt threatens lawmakers with even fewer and much more severe deficit reduction measures in the case of a fiscal crisis down the road.

Past years have seen pledges to prevent changes to Social Security, changes to the tax code, and various other policy limitations. These pledges increase partisan tensions and often leave politicians beholden to narrowly-focused interest groups that do not represent the wishes and needs of the broader electorate.

Instead of a race to the bottom over what politicians promise not to do — a situation that can easily leave the country with leaders who have taken all the realistic possibilities for addressing these issues off the table — politicians should be racing to the top. We need solutions, not pledges.

9. Propose Specific Solutions for Social Security, Health Care Programs, and the Tax Code.

No serious fiscal or economic plan can ignore the largest drivers of the deficit – growth in federal health and retirement spending – nor can they avoid making serious changes to the tax code.

Currently, the **Social Security** program faces a substantial shortfall. Already, the program's costs have exceeded its dedicated revenue (even taking into account the general revenue transfer to compensate for the current payroll tax holiday); and cash flow deficits of 0.3 percent of GDP today are slated to grow to 1.4 percent of GDP per year by 2035. A year later in 2036, cumulative cash flow deficits will have been large enough to entirely deplete the program's trust funds, meaning that benefits will be immediately reduced by about 23 percent to match revenues. Rather than allow this situation to occur, candidates should propose some combination of benefit and/or revenue changes to make the program sustainably solvent over the next 75 years and beyond. At the very least, candidates who are unwilling to put forth their own plan should make clear their *intent* to make the program sustainably solvent, and an openness to consider the types of solutions necessary to achieve this goal.

Though reforming Social Security is important, the single largest driver of the government's long-term budget problems is **health care spending**. Under a reasonable set of assumptions, federal health spending will grow from 4.8 percent of GDP today to 6.5 percent by 2021, 9.1 percent by 2035, and 11.4 percent by 2050. Candidates must acknowledge the magnitude of the problem of health care cost growth and should ideally present their vision for bringing cost growth under control. Since there is no expert consensus on exactly how to control costs, however, it is reasonable for candidates to focus on more incremental policies to bring down costs, so long as they acknowledge that more will have to be done and remain open to further changes.

In addition to proposing entitlement reforms, policymakers should propose solutions for **reforming the tax code**. The current tax system is overly complicated, inefficient, anti-growth, and generally does a poor job generating revenue. One major reason for these problems is the pervasiveness of so-called "tax expenditures," the various deductions, credits, exclusions, and preferences which litter the code. These tax expenditures cost over $1 trillion a year – money which could go to lower rates or lower deficits – and often create serious distortions. By going after these tax expenditures or making wholesale changes to the tax code, candidates should seek to make the current tax system simpler, fairer, and more pro-growth while raising levels of revenue necessary to finance government spending without large increases in the debt.

10. Offer Solutions for Temporary and Expiring Policies.

The number and size of expiring provisions in the budget and tax code has ballooned in recent years. Almost every year, policymakers enact "patches" of the Alternative Minimum Tax (AMT) to prevent it from hitting middle-income earners, "doc fixes" to prevent a 27 percent drop in physician payment, and a series of "extenders" to prevent the expiration of various tax and health policies. On top of this, the 2001/2003/2010 tax cuts – which included rate reductions, credit expansions, estate tax changes, and various other tax cuts – are set to expire at the end of 2012. Taken together, permanently extending all of these policies could cost $4.5 to $5 trillion dollars over a decade.

Though they technically disappear under current law, candidates should recognize that they burden associated policies and decide how they want to address them. Depending on their policy preferences, candidates could choose to extend, reform, or let expire any of these policies. Whatever choices they make, candidates must ensure that their overall plan meets their fiscal goal even after the costs of these policies are factored in.

11. Encourage Congress to Come Up With a Budget Reform Plan as Quickly as Possible.

For every year and every month that passes without major budget reform to reverse the growing debt in favor of a path to sustainability, the debt gets worse and the solutions get harder. The Social Security cash deficit gets worse, federal health care spending grows, and hundreds of billions of dollars are added to the debt, on which Americans must pay interest possibly their entire lives.

Although candidates cannot control what the current Congress does, we should not wait for the election campaign to end before beginning to put the country on a sustainable fiscal path. Presidential candidates should therefore encourage the current Congress to address the debt situation as soon as possible, an outcome that will make governing easier – not harder – after the election.

12. Remain Open to Bipartisan Compromise.

The American political system has always been characterized by competing parties. Such competition has strengthened our democracy, providing voters with alternate visions and allowing them to express their preferences through elections. But in the past, even the most passionate political adversaries recognized that compromise was necessary at times, especially in moments when the country faced great challenges.

Both parties have played a part in getting us into the fiscal hole we now face, and both of them will need to offer solutions and work together in order to get us out.

The inability of our leaders to find common ground has seriously hampered the ability of our government to function. This is clearly seen in the failure in recent years to produce a federal budget. This most basic of responsibilities is essential to setting national priorities and ensuring effective governance.

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The 2012 election comes at a key moment for the United States. The leaders chosen by voters will grapple with critical issues that will play a crucial role in deciding the future of this country. It is imperative that this election present voters with a realistic assessment of the nation's economic and fiscal situation and of the choices available to us for how to proceed.

By following the twelve principles above, the presidential candidates can advance the debate on national priorities and solutions that we desperately need to set an affordable fiscal course.