



Budgeting for Growth and Prosperity: A Long-Term Plan to Balance the Budget, Grow the Economy and Strengthen the Middle Class

Center for American Progress

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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 this goal 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 the federal government effectively playing these roles American 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. Investments in the middle class are investments for a successful American economy.

The public sector's contribution to the economy we envision, however, goes beyond balanced budgets and investment. 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.

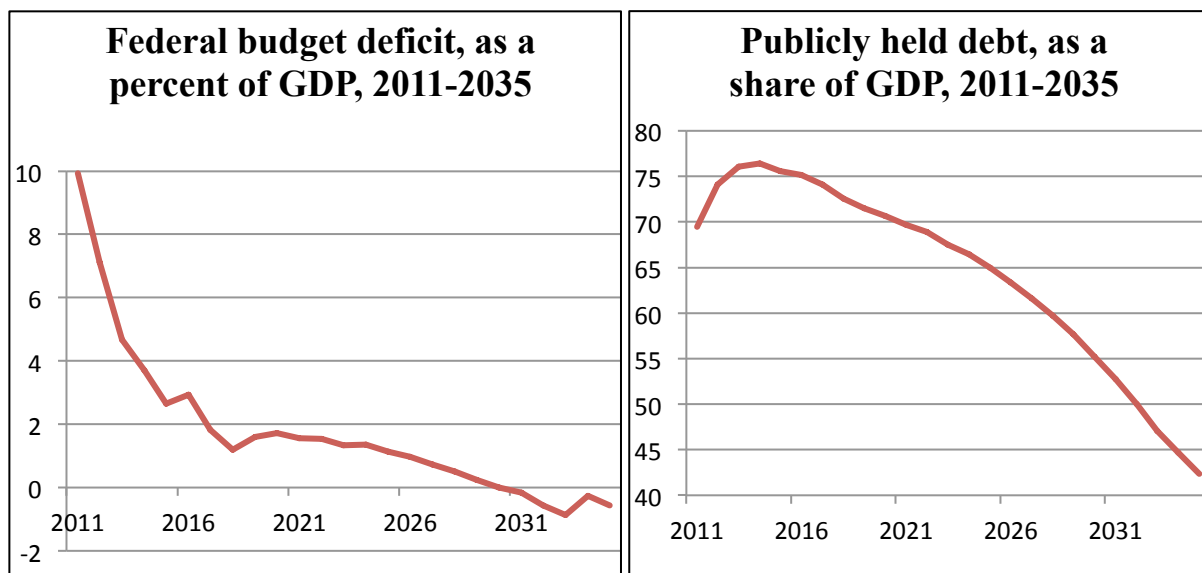
Our economic success also depends on our government providing the public services on which the nation relies in ways that are both effective and efficient. Finally, the tax system should offer incentives and disincentives that enhance economic growth and should address the growing inequality that undermines 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:

national security, public safety and health, preventing destitution, and honoring our commitments, including those to the elderly and disabled.

Our plan is also designed with an eye on the political journey our nation will have to take to achieve substantial deficit reduction, allowing 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 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 builds over time. The first stage hits an interim budget target of “primary balance” in 2015, with revenues equal to spending except for interest payments on the debt. Our path to primary balance gets the nation out of the deficit danger zone in a timely way without choking off economic recovery. Our plan for reaching primary balance is described in the Center for American Progress report “The First Step: A Progressive Plan for Meaningful Deficit Reduction by 2015.”



In 2017 and beyond, our plan puts in place the much more aggressive deficit reduction measures described below, and by 2030, our plan results in a fully balanced budget. Furthermore, 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.

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 (1) makes significant new investments in key areas such as education, infrastructure, science, technology, and energy research, as well as areas that strengthen the middle class, (2) reduces spending while making government more efficient, maintaining public services that businesses and the public rely on, and ensuring our national defense through a reconfigured national security budget, (3) strengthens the social safety net where needed, and (4) brings under control the most substantial spending challenge facing the country: health care. The plan reduces spending from about 27 percent of GDP in 2030 in the extended baseline 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 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 has 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.

Restraining discretionary spending while providing important services for the public and businesses

The CAP plan includes separate spending limits on a unified security budget and on non-security 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 one percentage point.

Our limits on non-security discretionary spending are set at specific levels designed to adequately fund the public services on which the public and businesses rely, 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 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,” that 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.

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 economy-wide 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 PPACA, 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, we would empower the IPAB 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 7.4 percent of GDP in 2030, compared to 8.7 percent in the 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 that 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 for 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 baseline, we would still have a deficit of 2.5 percent of GDP in 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, closes loopholes, eliminates special tax breaks that create unfair disparities among taxpayers, re-aligns the incentives of the tax system to better serve our economy and planet, cuts income taxes for middle-income taxpayers, and takes steps to address the inequality that undermines our national prosperity.

Personal income tax

Our plan makes the personal income tax simpler and fairer. It introduces a flat 15 percent rate for couples with incomes under \$100,000.⁴ 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 “deductions” from income for mortgage interest, charitable contributions, etc., they will 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 taxpayers will pay lower income taxes under our proposal. 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.

⁴ Bracket amounts for singles are half of those for joint filers; amounts for heads of households are three-quarters those for joint filers.

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 post-war period, including the country’s greatest period of economic growth. The top rate for capital gains 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 phaseouts.

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% higher than it was in 2001. The richest 5 percent will still have over 30 percent higher income.*

Personal Income Tax Change as a % of Income		
	Relative To:	
Income Group	Pre-Bush Tax Levels	Bush Tax Levels
Bottom 20%	-2.9%	-2.9%
Second 20%	-5.5%	-4.6%
Middle 20%	-4.9%	-3.7%
Fourth 20%	-2.6%	-1.4%
Next 15%	-1.2%	0.0%
Next 4%	-0.1%	+0.7%
Top 1%	+4.1%	+6.4%

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 with a price on carbon and 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 imposing a price on emissions of carbon dioxide and other greenhouse gases, and 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 harmful. An financial transaction tax (FTT) discourages unnecessary speculation while raising revenue. Our proposed FTT is modest compared to those imposed in other financial centers, including the United Kingdom and Singapore.

Other

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, 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. That drops to 23.8 percent of GDP by 2035, just half a percentage point above the baseline.

CONCLUSION

Budgets reflect values. A family budget that puts money away for the parents’ retirement and the children’s education, makes donations to the family’s church and favorite charities, and buys insurance against future risks, reflects different values than a family budget that prioritizes fancy clothes and flashy cars over saving and planning. Similarly, a business that strives to update to the latest technology and upgrade the skills of its workforce is approaching its business very differently from one that forgoes research and development in favor of short-term profits.

The long-term budget plan outlined here reflects the values of the Center for American Progress. We believe that investments are critical for our national well-being, that we have obligations we must meet, and that we have to pay for what we spend. The country can, of course, choose a different path—the seemingly simple path of lower taxes, underinvestment, and abandoning our obligations. But the thrill of lower taxes would be a transitory one as, one way or another, the bills come due—lost competitiveness, broken promises, bad jobs, a weak economy.

Instead, we offer a plan that includes revenues that are fair alongside investments that will build the country we want for the future while keeping our commitments. That will, indeed, be an America making progress.

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Percent of GDP	2021	2035
Revenues	22.3	23.8
Spending	<u>23.8</u>	<u>23.2</u>
Deficit (-)	-1.6	0.6
Debt Held by the Public	69.7	42.3
