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Balancing the Budget Within 10 Years: A Menu of Options

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President George W. Bush's fiscal year (FY) 2005 budget proposes cutting the budget deficit in half over five years. Yet lawmakers are under intense pressure to enact a budget resolution that balances the budget within the 2005–2014 period. This paper provides a menu of spending targets to accomplish that objective.

The Model

Before assessing the spending requirements of a balanced budget, it is necessary to calculate a revenue projection. Revenues are projected by beginning with the January 2004 Congressional Budget Office (CBO) baseline and then incorporating President Bush's FY 2005–2014 tax proposals, such as making the 2001 and 2003 tax cuts permanent, reforming the alternative minimum tax, and creating tax-free savings accounts.[1]

Two different revenue projections emerge:

- The first is based on revenues using a dynamic score of the President's tax cuts. Dynamic scoring acknowledges that tax relief strengthens incentives to work, save, and invest, and that the resulting economic growth and tax revenues offset a portion of the original revenue loss.
- The second is based on revenues using a static score of the President's tax cuts. Static scoring

1. Reform of the alternative minimum tax is projected through 2014, even though the President's budget proposal includes an estimate of revenue only through 2006.

Talking Points

- Most scenarios to balance the budget by 2014 require annual spending growth of approximately 4 percent or less.
- Over the past five years, mandatory spending has grown 7 percent annually, and discretionary spending has grown 10 percent annually.
- Any plan to balance the budget must reform runaway entitlements, such as the 2003 Medicare drug bill and the 2002 farm bill. Otherwise, it will be nearly impossible to balance the budget by 2014.

This paper, in its entirety, can be found at:
www.heritage.org/budget/bg1726.cfm

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assumes that tax policy does not affect economic behavior or growth. While very few economists would agree with static assumptions, lawmakers require the CBO to use them when projecting future tax revenues. (See the Appendix for spending and tax calculations.)

Using the CBO 2004 baseline estimate of $896 billion in discretionary outlays and $1,242 billion in mandatory outlays, it is possible to calculate the effects of various annual spending growth rates—both discretionary and mandatory.[2] Table 1 shows which rates of discretionary spending and mandatory spending would combine to balance the budget under dynamic scoring. Table 2 shows the results for balancing the budget under static scoring.

Table 1 B 1726

When the Budget Would Reach Balance
(Assuming Dynamic Scoring of Tax Revenues)

Annual mandatory spending increase	0%	1%	2%	3%	4%	5%	6%	7%
7%								
6%								
5%	2012	2013						
4%	2011	2011	2012	2014				
3%	2010	2011	2011	2012	2013			
2%	2009	2010	2011	2011	2012	2012		
1%	2009	2009	2010	2010	2011	2011	2012	
0%	2008	2008	2009	2009	2010	2011	2012	2013

Annual discretionary spending increase

Source: See Appendix

Table 2 B 1726

When the Budget Would Reach Balance
(Assuming Static Scoring of Tax Revenues)

Annual mandatory spending increase	0%	1%	2%	3%	4%	5%	6%	7%
7%								
6%								
5%								
4%	2012	2013						
3%	2011	2012	2013	2014				
2%	2010	2010	2011	2012	2014			
1%	2009	2009	2010	2011	2012	2013		
0%	2008	2008	2009	2010	2011	2012	2014	

Annual discretionary spending increase

Source: See Appendix

Results

Table 1 details the spending patterns that can balance the budget by 2014, assuming that tax revenues are scored dynamically. For example, a budget that expands discretionary spending by 3 percent annually and mandatory spending by 4 percent annually would achieve balance by 2014. Two observations are immediately evident:

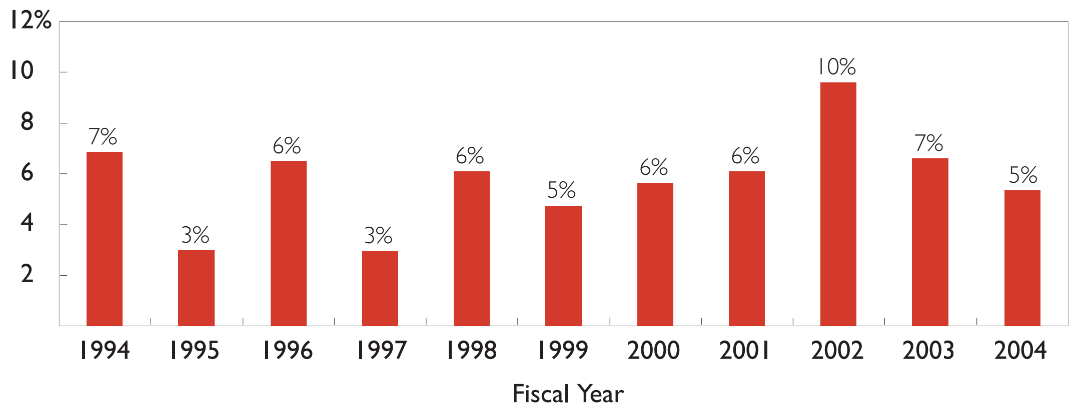
- Most scenarios to balance the budget by 2014 require annual spending growth of approximately 4 percent or less.
- The CBO baseline shows mandatory spending growing by 6 percent annually over the next decade. Yet Table 1 shows no scenario to balance the budget by 2014 with 6 percent annual mandatory spending growth. This confirms that any plan to balance the budget must reform runaway entitlements, such as the 2003 Medicare drug bill and the 2002 farm bill. Furthermore, without reform, the growth rate of mandatory spending will accelerate in coming decades.

Lawmakers will likely seek a budget resolution that balances the budget by 2014 even when revenues are scored statically. Table 2 shows the spending options to achieve the objective. Most combinations require mandatory and discretionary spending to grow by 3 percent or less per year.

2. Net interest costs are also incorporated into the model. Rather than consciously selected by lawmakers, these spending levels are a residual based on the effects of each policy. See Appendix for net interest cost estimates.

Chart 1 B 1726

Mandatory Spending Growth, 1994-2004

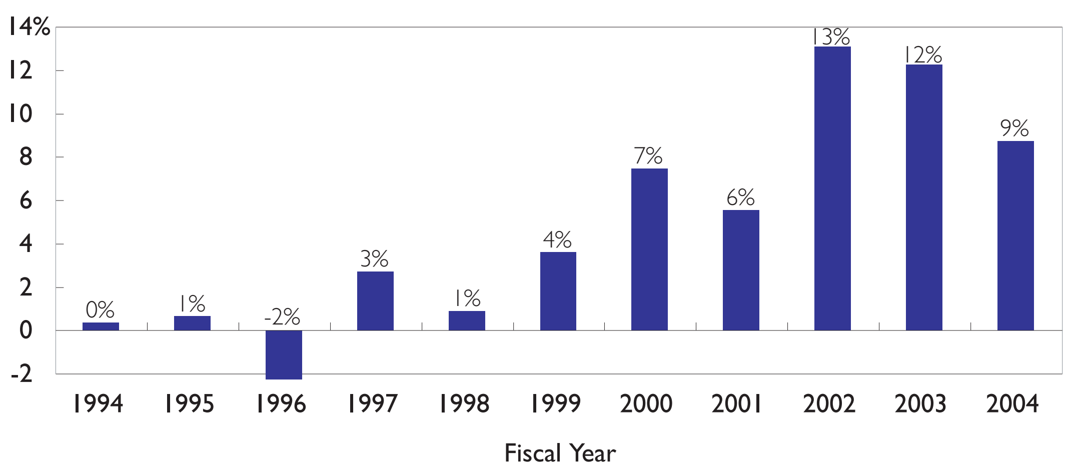


Note: 2004 is projected

Source: Office of Management and Budget.

Chart 2 B 1726

Discretionary Spending Growth, 1994-2004



Note: 2004 is projected

Source: Office of Management and Budget.

Difficult Decisions Required

By comparison, discretionary spending has averaged 10 percent annual growth and mandatory spending has averaged 7 percent annual growth over the past five years. (See Charts 1 and 2.)

Bringing spending growth all the way down from these high levels will require difficult decisions. However, recent spending hikes actually translate into more opportunities for savings. The 39 percent increase in discretionary spending since 2001 has left many agencies awash in cash, and they can afford to go for a few years without another major spending increase.

Mandatory spending is now at 11 percent of the gross domestic product ($11,144 per household) for the first time in American history.[3] Many of these bloated programs can afford much-needed reforms. Lawmakers can begin to move toward a balanced budget by settling on a lean spending course and then reforming the budget process to lock in those spending ceilings.

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3. See Brian M. Riedl, "$20,000 per Household: The Highest Level of Federal Spending Since World War II," Heritage Foundation *Backgrounder* No. 1710, December 3, 2003, at *www.heritage.org/Research/Budget/BG1710.cfm*.

Appendix B 1726

Appendix: The Data

1) Outlays at Various Annual Growth Rates

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Discretionary - 0% growth	$896	$896	$896	$896	$896	$896	$896	$896	$896	$896	$896
Discretionary - 1% growth	896	905	914	923	932	942	951	961	970	980	990
Discretionary - 2% growth	896	914	932	951	970	989	1009	1029	1050	1071	1092
Discretionary - 3% growth	896	923	951	979	1008	1039	1070	1102	1135	1169	1204
Discretionary - 4% growth	896	932	969	1008	1048	1090	1134	1179	1226	1275	1326
Discretionary - 5% growth	896	941	988	1037	1089	1144	1201	1261	1324	1390	1459
Discretionary - 6% growth	896	950	1007	1067	1131	1199	1271	1347	1428	1514	1605
Discretionary - 7% growth	896	959	1026	1098	1174	1257	1345	1439	1539	1647	1763
Mandatory - 0% growth	1242	1242	1242	1242	1242	1242	1242	1242	1242	1242	1242
Mandatory - 1% growth	1242	1254	1267	1280	1292	1305	1318	1332	1345	1358	1372
Mandatory - 2% growth	1242	1267	1292	1318	1344	1371	1399	1427	1455	1484	1514
Mandatory - 3% growth	1242	1279	1318	1357	1398	1440	1483	1528	1573	1621	1669
Mandatory - 4% growth	1242	1292	1343	1397	1453	1511	1572	1634	1700	1768	1838
Mandatory - 5% growth	1242	1304	1369	1438	1510	1585	1664	1748	1835	1927	2023
Mandatory - 6% growth	1242	1317	1396	1479	1568	1662	1762	1868	1980	2098	2224
Mandatory - 7% growth	1242	1329	1422	1522	1628	1742	1864	1994	2134	2283	2443
Net interest - balance by 2006	156	175	201								
Net interest - balance by 2007	156	178	211	233							
Net interest - balance by 2008	156	179	216	244	255						
Net interest - balance by 2009	156	180	219	251	267	271					
Net interest - balance by 2010	156	181	221	255	275	284	285				
Net interest - balance by 2011	156	181	223	259	280	292	297	300			
Net interest - balance by 2012	156	181	224	261	285	298	307	313	317		
Net interest - balance by 2013	156	182	225	263	288	303	313	322	329	329	
Net interest - balance by 2014	156	182	225	264	290	307	319	329	338	341	344

2) Revenues Under Various Assumptions

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
With a Static Score of the President's Tax Cuts	**1824**	**2037**	**2221**	**2327**	**2429**	**2532**	**2653**	**2784**	**2938**	**3087**	**3256**
Feedback revenues		3	9	12	13	20	27	109	171	177	183
With a Dynamic Score of the President's Tax Cuts	**1824**	**2040**	**2230**	**2339**	**2442**	**2552**	**2680**	**2893**	**3109**	**3264**	**3439**

All amounts in $billions.

Spending levels begin with the 2004 baseline, as calculated by the Congressional Budget Office.

Net Interest costs are listed only until the budget is balanced, because this paper does not address any changes to the spending trends (which would affect net interest) after the budget balances.

Revenue calculations from the President's tax cuts come from the President's 2005 budget proposal, supplemented in out years by CBO data.

Feedback revenues calculated by the Heritage Foundation.