

# WebMemo



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## How to Fix the Federal Budget

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It is time for Congress to rein in spending and fix our nation's budget crisis. The excesses from the recession drove spending up to \$3.5 trillion last year—borrowing 40 cents out of every dollar spent. The public debt is closing in on 70 percent of the economy and within the decade will exceed the tipping point of 90 percent, resulting in significant harm to economic growth and prosperity.

This short-term problem will be followed by a tidal wave of entitlement-driven spending as baby boomers flood into Social Security, Medicare, and Medicaid. Left unchecked, these programs will drive debt to nearly 200 percent of the economy. Unless Congress changes course on spending, every income tax rate will have to more than double, according to the Congressional Budget Office.<sup>1</sup> Every American, especially younger generations, would have a permanently lower standard of living. (See Chart 1.)

The nation is drowning in a sea of red ink, and the voters have rightly said, "Enough." We must tame federal spending and protect our children and grandchildren from crushing debt or taxes. The policies set forth below will achieve a stronger America, one where our families and businesses are much better off.

**Establish Spending Targets.** Set firm budget targets to light the path for returning to fiscal sanity by lowering spending and controlling the debt.

- Specific cuts to discretionary spending, at least \$170 billion in the next year.
- Cut total spending to no more than 20 percent of the economy, moving quickly towards a balanced

budget within a relevant budget window—without raising taxes.

**Fix the Budget Process.** The budget process allows entitlements—Social Security, Medicare, and Medicaid, the biggest parts of the budget—to grow with no limits or long-term constraints. Other parts of the budget are likewise unconstrained, so Congress should:

- Place firm caps on total spending, with strong Gramm–Rudman-type enforcement mechanisms to lock in cuts.<sup>2</sup>
- Increase transparency. Give the public the true picture of the nation's finances by disclosing the unfunded obligations of Medicare and Social Security front and center in the annual congressional budget resolution. Require a clear roll-call vote to increase these obligations.
- Score major policy proposals over both short-term and long-term time horizons.
- Take entitlement programs off budgetary autopilot with a true, long-term budget. This could be done through specific caps within each program.

**Provide for a Strong Defense.** Fully fund defense needs so our troops can defend America and our interests abroad. Priority should be given to modernizing and developing next-generation

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## National Debt Set to Skyrocket

In the past, wars and the Great Depression contributed to rapid but temporary increases in the national debt. Over the next few decades, runaway spending on Social Security, Medicare, and Medicaid will drive the debt to unsustainable levels.

Debt as a Percentage of GDP

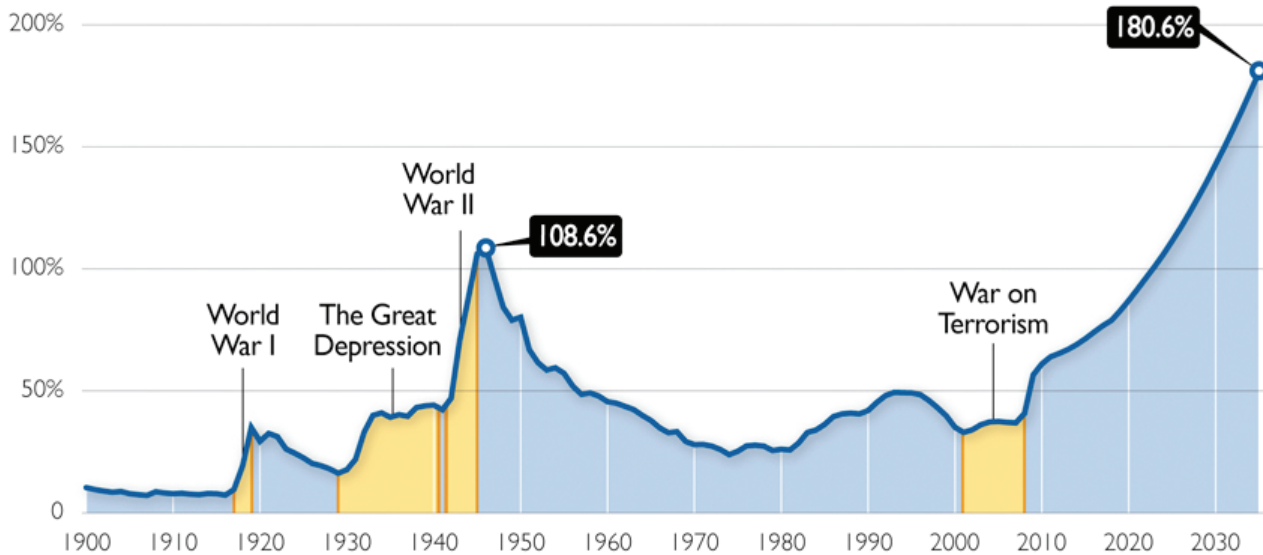


Chart I • WM 3134 [heritage.org](http://heritage.org)

equipment necessary to protect the nation and our interests from rapidly changing threats. Savings from military reforms, such as performance-based logistics, should be reinvested in the defense budget to help pay for these much needed improvements.

Specifically, the base Department of Defense budget should include \$560 billion in funding for 2012 and an average of \$720 billion over the next five years (to be adjusted for inflation). Funding for ongoing contingency operations should be in addition to this amount.

**Implement Broad Spending Reforms, Including Entitlements.** Beyond discretionary cuts, major programmatic changes are needed to bring federal spending under control.

Transformational changes are needed for the major entitlement programs Social Security, Medicare, and Medicaid.

- Increase the retirement age for Social Security and Medicare and the index for longevity.
- Move entitlement programs toward a real insurance model—aimed at increasing financial security rather than simply providing a stream of benefits. Each program should have firm spending controls and a limited budget.
- Gradually transform the Social Security benefit into a flat benefit that protects against poverty and is indexed to wages. Include an auto-enrollment savings system and voluntary personal accounts, which would be funded with eventual

1. Peter R. Orszag, Director, Congressional Budget Office, letter to Representative Paul Ryan (R-WI), May 19, 2008, at [http://www.cbo.gov/ftpdocs/92xx/doc9216/05-19-LongtermBudget\\_Letter-to-Ryan.pdf](http://www.cbo.gov/ftpdocs/92xx/doc9216/05-19-LongtermBudget_Letter-to-Ryan.pdf) (June 24, 2008).

2. Former Senators Warren Rudman (R-NH) and Phil Gramm (R-TX) authored legislation in the 1980s that imposed strong fiscal discipline on federal spending by imposing automatic cuts when spending exceeded targets.

savings from reforms. Existing benefits should be indexed to the Chained Consumer Price Index.

- Move Medicare to a premium support system with a fixed contribution and long-term budget controls, giving patients maximum freedom to make health care choices without subjecting doctors and patients to artificial price controls. Greater cost sharing should be added to the traditional fee-for-service Medicare program.
- Move Medicaid's healthy families into private health insurance. Then, convert the remaining program for the elderly and disabled into a capped allotment with greater flexibility to states to manage the program.

The Patient Protection and Affordable Health Care Act, or Obamacare, touted as a deficit reduction bill, is in reality a budget buster. It created new entitlements and will drive general health care costs up, not down.

- Repeal Obamacare and take steps to defund and block implementation of this law until Congress completes its repeal.

Welfare spending is approaching \$1 trillion annually, and the 70-plus welfare programs have encouraged a pattern of cyclical dependence among tens of millions of Americans.

- Establish fiscal constraints for all federal welfare spending: After unemployment returns to nor-

mal levels, roll back funding for all programs to pre-recession levels. Then cap this spending at the rate of inflation.

The reach of the federal government is too vast. Asset sales can bring relief to the overstretched budget and bring economic benefits to society by putting resources in the hands of the more productive private sector.

- Implement a plan to sell, over time, federal assets, such as land, mineral rights, and unused federal office buildings.

**Keep Taxes Low.** Tax hikes are the wrong answer to the budget crisis. To keep our economy strong and growing, taxes must be kept low and competitive with other nations, and policies that distort markets should be reformed.

- Make the 2001 and 2003 tax cuts permanent, including eliminating the death tax and permanently fixing the Alternative Minimum Tax.
- Reform corporate taxes and significantly reduce the rate.
- Reform the health insurance tax exclusion by turning it into a tax credit to assist with the purchase of health insurance.

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