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# ISSUE BRIEF

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## The Ryan Budget: Confronting the Nation's Spending Crisis

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In the few months since Washington's dramatic debt ceiling confrontation, America's fiscal situation has only worsened. Federal spending is set to soar past previous record-shattering levels, endangering the economic future of the nation. This is a moral issue because younger generations will be forced to bear either staggering levels of debt or crushing taxes, or both. It is also a political challenge to this nation's democracy as more and more Americans become dependent on government benefits while lawmakers seem unable to take decisive corrective action. The spending-driven debt crises of Greece and Italy are clear and compelling evidence that America must urgently change course. The only way to avoid a similar fate is to make bold, substantive changes in the size, scope, and purpose of the federal government.

This paper, in its entirety, can be found at **http://report.heritage.org/ib3546**

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Toward that goal, House Budget Committee chairman Paul Ryan (R–WI) has released a proposed federal budget resolution for fiscal year (FY) 2013 entitled *The Path to Prosperity: A Blueprint for American Renewal*. The plan lays out a comprehensive series of solutions to fix the nation's twin crises of spending and debt. It rolls back the spending excesses of the past, tackles entitlement programs, makes defense a priority, and undertakes an important growth agenda to unleash America's free enterprise system and get Americans back to work. This budget is not perfect; few consensus political documents can be. It should be bolder in implementing its entitlement reforms. It should strive for more aggressive spending reductions. It is slow to reach balance, largely the consequence of avoiding changes in Social Security and slowly phasing in health entitlement reforms. Still, this plan, like that passed by the House last year, substantially advances the serious and necessary conversation about securing America's future and its legacy of freedom, opportunity, and self government.

### Benchmarks for the Path to Prosperity

A budget contains many elements. It should provide a broad framework for spending and revenue priorities and for achieving balance. It must also set out at least thematically the fundamental policy reforms needed to achieve the fiscal objectives. A budget should be taken as a whole and measured in a comprehensive way—not by simply checking a series of boxes. Still, certain benchmarks can help guide the evaluation:

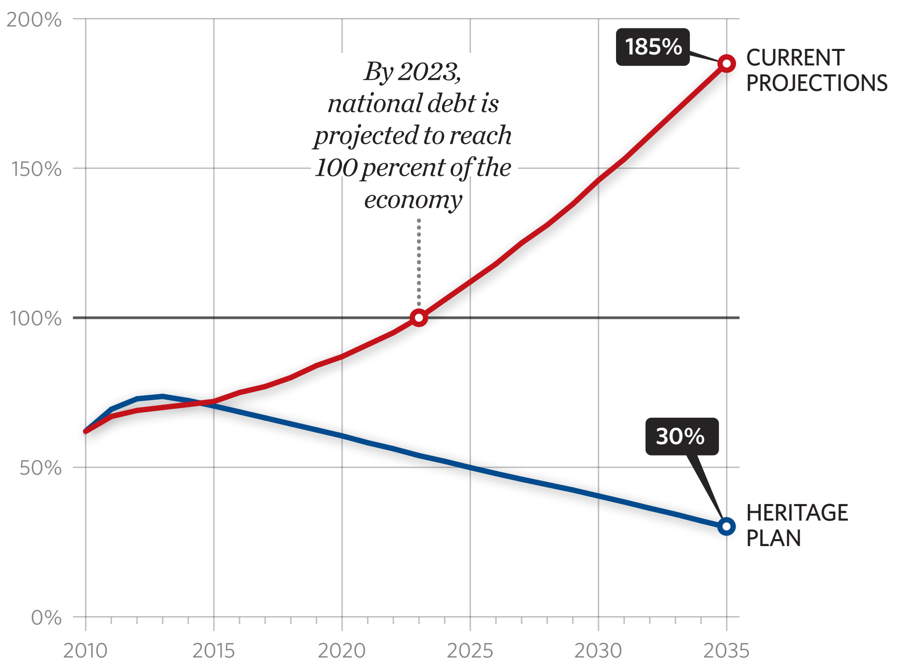
- **Does it begin decisive entitlement reform?** The main sources of spending growth are the major entitlement programs: Medicare, Medicaid, and Social Security. Any serious budget should offer substantive proposals to improve benefits and make these programs sustainable and affordable in both the short term and the long term. This must include the repeal of Obamacare.
- **Does it cut spending sharply and quickly?** Spending is the root of all other fiscal problems. So any budget should immediately and consistently rein in spending.
- **Does it avoid tax hikes?** Raising taxes on American families, businesses, and investors is the wrong solution. Higher taxes slow the

CHART 1

### The Heritage Plan Would Reverse Trajectory of Unsustainable Debt

*Without significant spending reforms, the national debt is projected to reach 185 percent of GDP by 2035. Under the Heritage plan, federal spending would be reduced by about half, which would dramatically lower the debt to 30 percent.*

PUBLICLY HELD DEBT AS A PERCENTAGE OF GDP




**Source:** Congressional Budget Office, *The Long-Term Budget Outlook*, June 2010, at *http://www.cbo.gov/publication/21546* (March 20, 2012); and calculations by the Center for Data Analysis based on data provided by the Peter G. Peterson Foundation.

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economy and cost jobs. Higher taxes also mean higher government spending.

- **Does it contain pro-growth tax reforms?** Fixing the budget mess and ensuring a vibrant economy requires a strong growth agenda. A simpler, pro-growth tax code would result in greater economic freedom and faster growth. Faster growth generates more revenues—without tax hikes—and naturally lowers spending on safety net and anti-poverty programs.

- **Does it ensure a strong national defense?** Defense is a core constitutional responsibility of the federal government, one that is necessary to preserve America's liberty and prosperity. It should be fully funded. Cutting defense spending is not a responsible solution to getting spending under control.

- **Does it move swiftly to a balanced budget?** The federal government should balance its budget by getting spending under control.

The best benchmark for measuring progress in fixing the budget mess is Heritage's *Saving the American Dream: The Heritage Plan to Fix the Debt, Cut Spending, and Restore Prosperity.*[1] The Heritage proposal features bold, sweeping changes to transform entitlement programs that guarantee America's seniors economic security in retirement and reins in their costs to make them affordable. It has major spending reductions in other parts of the budget and ensures full funding for national defense. It also features a bold, new pro-growth tax reform plan.

The Ryan budget does not meet all the goals of *Saving the American Dream*, but it takes strong steps toward a number of them.

## Entitlement Reform

Entitlements constitute nearly 60 percent of total federal spending, and their runaway growth—especially from Medicare, Medicaid, and Social Security—represents the greatest threat to the nation's fiscal and economic health. The Ryan budget begins to tackle Medicare, Medicaid, and other anti-poverty programs.

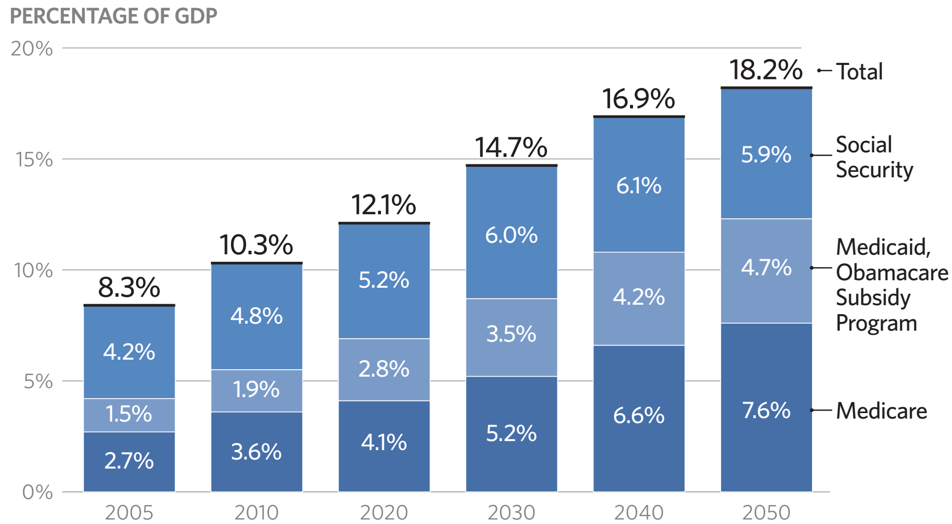
The budget calls for immediate entitlement spending reductions of

1. Stuart M. Butler, Alison Acosta Fraser, and William W. Beach, eds., *Saving the American Dream: The Heritage Plan to Fix the Debt, Cut Spending, and Restore Prosperity*, The Heritage Foundation, 2011, at *http://www.heritage.org/research/reports/2011/05/saving-the-american-dream-the-heritage-plan-to-fix-the-debt-cut-spending-and-restore-prosperity*.

CHART 2

## Entitlement Spending Will More Than Double by 2050

*Spending on Medicare, Medicaid and the Obamacare subsidy program, and Social Security will soar as 78 million baby boomers retire and health care costs climb. Total spending on federal health care programs will triple.*




**Source:** Congressional Budget Office, *The Long-Term Budget Outlook*, June 30, 2010, at *http://www.cbo.gov/publication/21546* (March 20, 2012).

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$18 billion in 2012–2013 and $331 billion over 10 years. These changes would be driven by the budget reconciliation process, with firm instructions to committees of jurisdiction to ensure that they really occur. About $70 billion of the reductions would go to partially offset automatic cuts known as "sequestration," which would devastate national defense. The remaining spending reductions would come from changes to rein in longer-term entitlement spending—especially in the government's health programs.

**Obamacare.** On health care, one of the most important policy changes in the Ryan budget is the repeal of Obamacare. Not only does Obamacare add trillions in new spending and billions in tax hikes that the country cannot afford; it expands on a failed price-control model for Medicare, massively broadens a broken Medicaid program, and introduces a new subsidy scheme that is financially unsustainable.[2]

**Medicare.** The House budget would transition the current Medicare program into premium support beginning in 2023. Premium support provides seniors with defined financial contributions from the government to apply to health care plans that they choose for themselves, in contrast to one-size-fits-all, government-funded, government-regulated, and government-controlled health care. Plan options would include traditional Medicare and would compete alongside private health plans in a market called the "Medicare Exchange." The government contribution would be based on a competitive bidding process. A senior could choose a more expensive health plan than the government contribution but would have to pay the difference.

The government's defined contribution in Medicare would be further adjusted by income, geography, and risk. For example, upper-income seniors would pay more than the standard premium, and lower-income recipients would qualify for additional assistance. Additionally, high-risk beneficiaries would secure greater payments to offset their higher costs, and a risk-adjustment mechanism would guarantee sicker Medicare patients access to medical care—and ensure continued plan participation and market stability in the new program. The market-based bidding and requirements that Medicare compete head-to-head with private plans for patients' dollars closely resembles Heritage's plan in *Saving the American Dream*.

Most experts agree that competition in health care would control costs. But to assure budgetary savings, the Ryan budget includes a cap on Medicare spending at the growth of gross domestic product (GDP) plus 0.5 percent. The budget also includes process reforms that disclose long-term

2. See The Heritage Foundation, "The Case Against Obamacare: A Health Care Policy Series for the 112th Congress," at *http://www.heritage.org/research/projects/the-case-against-obamacare*.

unfunded liabilities, forcing Congress to confront their growing costs. It also establishes mechanisms for controlling longer-term costs of entitlement programs, taking them off budgetary autopilot. At the same time, the Ryan budget calls for repealing Obamacare's rationing panel, the Independent Payment Advisory Board, which is important to do within the full repeal of Obamacare.

**Medicaid.** The Ryan budget replaces the open-ended financing arrangement with a fixed federal contribution to the states. In addition, the proposal offers states greater flexibility in designing their programs to better help those in need.

Putting Medicaid on a budget is a critical first step to fundamentally reforming Medicaid. The next step should be to help mothers and children out of the poorly performing Medicaid program and give them access and assistance to purchase private health insurance options while working with the states to develop a more patient-centered safety net for the poor elderly and those with disabilities.

**Other Health Care.** Elsewhere on the issue of health care, the Ryan budget notes the current tax treatment of health insurance, creates a variety of distortions in the marketplace, and recommends steps to address these flaws. Ideally, changes to the tax treatment of health insurance would replace the current tax structure with individual tax relief that helps consumers buy their own policies. This tax change is critical in moving toward a patient-centered, market-driven health care system.

## Entitlements: What Is Missing

The Ryan budget's effort to advance entitlement reform should be stronger. Implementation of Medicare premium support is delayed for 10 years—"grandfathering the grandparents," as Ryan puts it. This is one of the principal reasons the budget does not balance in the coming 10 years.

In addition, the budget contains no Social Security reforms, resorting instead to a mechanism that would trigger reforms. It does not include basic steps to rein in the cost of Social Security, such as gradually raising the retirement age or using a more realistic measure for cost-of-living increases. Such changes would be important steps to shoring up Social Security's finances.

## Growth-Oriented Tax Reform—Not Tax Hikes

The root of the government's deficit problem is excess spending, not a lack of revenue. The budget resolution recognizes that the economy cannot withstand the impact of impending tax hikes at the end of this year and stops the mammoth job-killing, anti-growth tax increases coming on January 1, 2013.

Instead, the budget resolution reduces the highest-in-the-world corporate tax rate from 35 percent to 25 percent and reduces the top individual income rate to the same level. The lower corporate tax rate would reverse the flow of jobs to foreign countries, and the lower individual income tax rate would improve incentives for workers and businesses to produce more and for investors and businesses to create new jobs.

Other positive features of the tax plan include abolition of the Alternative Minimum Tax and a move to a territorial business tax in place of our worldwide system. This kind of growth-oriented tax plan would help promote a stronger economy along with more wage and job growth.

The proposed tax reforms would have been far stronger, however, had they eliminated taxes on capital gains, dividends, and the death tax.

## Defense

A strong national defense is both a key responsibility of the federal government under the Constitution and essential to protecting Americans' liberties. As such, Ryan is certainly correct that America needs "a military that keeps America safe by letting national strategic priorities determine spending levels, not the other way around." However, Ryan's budget restores only about half the core defense funding cuts proposed by President Obama's over a 10-year period.

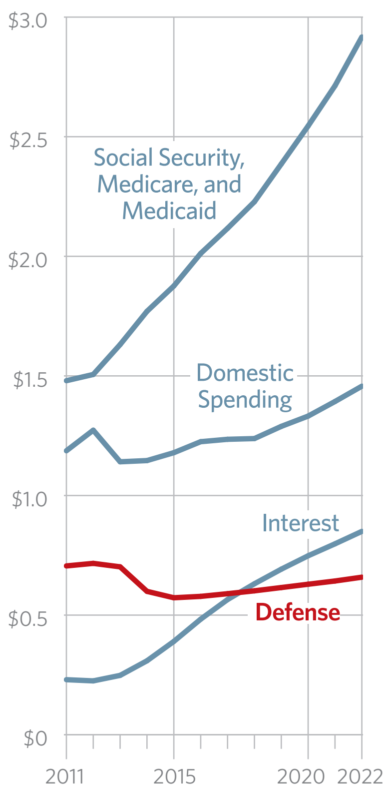
Congress needs to recognize that covering the full cost of the overseas contingency operations, including "resetting" the force drained by a decade of combat, will require funding that extends long beyond the end of the operations themselves.

Ryan's budget proposal takes some but not enough steps to begin to address the most immediate threat to maintaining the nation's military capabilities. This is the threat of the "sequestration" provision for defense in last year's Budget Control Act. President Obama, by

CHART 3

### Obama Budget Would Make Defense the Lowest Budget Priority

OUTLAYS IN TRILLIONS OF DOLLARS




**Source:** Heritage Foundation calculations based on data from Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2013*, February 13, 2012, at *http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/budget.pdf* (February 13, 2012).

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contrast, proposes to make defense the lowest budget priority of the federal government by later this decade and threatens to veto bills that defer defense sequestration.[3]

## The Numbers

When its collection of policies is boiled down to the numbers, the Ryan plan reduces budget deficits from $1.2 trillion this year (7.6 percent of GDP) to $166 billion (0.8 percent of GDP) in 2018, after which they tick up again to $287 billion (1.2 percent of GDP) in 2022. The budget begins to stabilize debt, reducing debt held by the public from 73.2 percent of GDP now to 62.3 percent in 2022.

The budget also proposes caps on total spending and on major categories of spending and requires periodic reviews of entitlement programs to take them off autopilot spending. The critical point, after all, is to reduce spending, which drives all other fiscal problems. Over the long term, the budget brings spending down from its unsustainably high level of 23.4 percent of GDP this year to 19.3 percent in 2018. Spending then edges back upward as more baby boomers retire—reaching 19.8 percent of GDP in 2022—but remains below 20 percent (the average of the past 50 years). By 2040, spending is down to 18.75 percent of GDP. As noted earlier, "grandfathering the grandparents" and not tackling Social Security makes it much more difficult to reduce spending more and thus balance the budget before the late 2030s.

The budget holds non-war discretionary spending in 2013 to $1.028 trillion, $19 billion below the Budget Control Act ceiling and $15 billion below the 2012 limit—which, if enacted by appropriations bills, would be a real cut from prior year spending.

## The Big Picture

Cutting spending is requisite to solving the nation's budget crisis. But setting numbers alone will not get the job done. Instead, each one of the elements described above is an integral component to a transformative budget. Ryan's budget, and any other budget, should be evaluated on how well it delivers on all these elements together. Ryan's budget takes strong strides in the right direction. It cuts spending, in the budget year and into the future—from both discretionary and mandatory accounts—provides substantive entitlement reforms, and avoids tax hikes. It also outlines a tax reform that would strengthen the economy and by implication further strengthen government finances through stronger economic growth.

There is a great deal more work to do, as the Heritage plan *Saving the American Dream* reflects. Nevertheless, the Ryan budget represents real progress toward tackling the nation's fiscal and economic challenges. But this progress will become reality only if Congress follows through with legislation that delivers these kinds of strong policy changes.

*—**Alison Acosta Fraser** is Director of and **Patrick Louis Knudsen** is the Grover M. Hermann Fellow in Federal Budgetary Affairs in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation. Nina Owcharenko, Curtis Dubay, and Baker Spring also contributed to this report.*

3. Baker Spring, "Obama's Defense Budget Makes Protecting America Its Lowest Priority," Heritage Foundation *Backgrounder* No. 2658, March 1, 2012, at *http://www.heritage.org/research/reports/2012/03/obamas-defense-budget-makes-protecting-america-its-lowest-priority.*