

# ISSUE BRIEF

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## What the FY 2014 Budget Should Do

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With the government's spending and debt crisis drawing nearer, the congressional budget for fiscal year (FY) 2014 marks a critical moment for the country. The chance to turn back Washington's unyielding and unsustainable growth, led by the Obama Administration's progressive ambitions, is shrinking. The budget must play a key part in restoring the principles that made America an exceptional nation. To do so, it should:

- Achieve balance within 10 years and stay in balance;
- Fully fund national defense;
- Reform the major entitlement programs with real policy changes that improve the programs, eliminate their shortcomings, and make them affordable;

- Repeal Obamacare;
- Reduce non-defense discretionary spending; and
- Adopt growth-oriented tax reform capped at the historical level of taxation.

The Heritage Foundation's budget plan, *Saving the American Dream*, achieves these aims and serves as a good benchmark for Congress's budgetary efforts.<sup>1</sup>

**Get to Balance and Stay in Balance.** If left on its current course, total government spending—\$3.6 trillion this year—will continue to swallow up more than a fifth of the nation's economic output for at least the next 10 years, rising to ever higher levels thereafter. Even with the President's \$618 billion tax increase, spending will continue to grow faster than revenue, producing chronic deficits and keeping debt held by the public at around three-fourths the size of the entire economy or greater.

Debt could approach 90 percent of gross domestic product (GDP) if Congress breaches the spending levels of the Budget Control Act and/or fails to uphold the amounts of sequestration reductions.<sup>2</sup> These

levels of debt will inevitably put a drag on the nation's economy, threatening to leave future generations worse off than their predecessors—a morally unacceptable outcome. Beyond this decade the outlook worsens, with the potential that debt could near twice the size of the economy within a generation.<sup>3</sup>

This is more than a fiscal matter, however. As government expands, it increasingly intrudes on the primary institutions of civil society: families, communities, churches, charities, vocations, and so on. These are the real sources of Americans' values and America's prosperity. A principal aim of limiting government is to let these institutions flourish.

Balancing the budget without raising taxes would halt government's relentless growth; keeping it in balance would maintain an ongoing check on the size and scope of government. Realistically and mathematically, staying in balance would require strong, substantive reform of entitlement programs.

On the other hand, if heavy borrowing remains a constant and acceptable element of government finance, government will always spend more than it would otherwise. That is why a balanced budget is also the proper condition for governing.

This paper, in its entirety, can be found at <http://report.heritage.org/ib3872>

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**Fully Fund Defense.** Even without the \$43 billion sequestration that started March 1, the national defense budget under President Obama was contracting.<sup>4</sup> The reductions are occurring at a time when U.S. forces need modernization and replenishment following years of overseas combat operations. With or without sequestration, the President's defense budgets are clearly inadequate for current and future needs.<sup>5</sup>

Without doubt, the Pentagon suffers its share of wasteful and inefficient spending, and defense savings can be achieved. Nevertheless, the strength of U.S. forces is a critical element of global peace. Its budget should be built on sound strategic principles that keep the United States secure and capable of deterring threats from abroad—such as the nuclear ambitions of North Korea and Iran.

**Reform Entitlement Programs.** Entitlement reform—especially in Medicare, Medicaid, and Social Security—is indispensable to controlling spending and balancing the budget. By 2025, these three programs, along with Obamacare

and interest on the debt, will consume the full historical average of annual federal revenue (18.5 percent of the economy) and keep rising from there.<sup>6</sup> In dollar terms, annual spending on Social Security and the health entitlements will more than double in the next decade—from \$885 billion this year to \$1.85 trillion in 2023. The longer Washington waits to begin reforms, the more difficult the changes will be.

Some potential reforms—such as raising and matching up the eligibility ages for Social Security and Medicare and adopting a more realistic measure for cost-of-living adjustments—enjoy bipartisan support and should be adopted quickly.<sup>7</sup> Beyond that, the budget should call for transitioning Medicare into a patient-centered premium-support model in which seniors would receive a subsidy to help purchase insurance from the private market. This would free seniors from government-run Medicare and promote competition that would restrain insurance costs without price-fixing. The next five years is sufficient time for such a transition.

The Medicaid program also needs reform—but real policy reform, not merely a block grant handoff to state governments. As with Medicare, the principal aim should be to mainstream individuals and families out of Medicaid and into the private insurance market while retaining a safety net for the most vulnerable. Both programs should also be put on a budget to restrain their overall spending and should reflect the “broader goals of establishing patient-centered, market-based solutions that reduce dependence on government health care.”<sup>8</sup>

Other anti-poverty entitlements should be reformed as well to help recipients toward supporting themselves, which will result in savings. Congress should, for example, restore and strengthen work requirements in Temporary Assistance for Needy Families, which the Obama Administration has tried to unravel, and then expand these requirements to other programs, such as food stamps and housing.<sup>9</sup> Ultimately, total spending in the government's roughly 80 antipoverty programs should be capped. The main point,

1. See Alison Acosta Fraser, William W. Beach, and Stuart M. Butler, *Saving the American Dream: The Fiscal Cliff and Beyond*, Heritage Foundation *Backgrounders* No. 2750, December 11, 2012, <http://www.heritage.org/research/reports/2012/12/saving-the-american-dream-the-fiscal-cliff-and-beyond>.
2. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2013 to 2023*, February 2013, <http://www.cbo.gov/sites/default/files/cbofiles/attachments/43907-BudgetOutlook.pdf> (accessed March 9, 2013).
3. Congressional Budget Office, *The Long-Term Budget Outlook*, June 2012, [http://www.cbo.gov/sites/default/files/cbofiles/attachments/06-05-Long-Term\\_Budget\\_Outlook\\_2.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/06-05-Long-Term_Budget_Outlook_2.pdf) (accessed March 9, 2013).
4. See Baker Spring, “Strong Defense and Fiscal Responsibility: It's Possible,” The Heritage Foundation, *The Foundry*, March 6, 2013, <http://blog.heritage.org/2013/03/06/strong-defense-and-fiscal-responsibility-its-possible/>.
5. See Baker Spring, “Obama's Budget Makes Protecting America Its Lowest Priority,” Heritage Foundation *Backgrounders* No. 2658, March 1, 2012, <http://www.heritage.org/research/reports/2012/03/obamas-defense-budget-makes-protecting-america-its-lowest-priority>.
6. CBO, *The Long-Term Budget Outlook*, June 2012.
7. See J. D. Foster and Alison Acosta Fraser, “Six Bipartisan Entitlement Reforms to Solve the Real Fiscal Crisis: Only Presidential Leadership Is Needed,” Heritage Foundation *Backgrounders* No. 2748, November 30, 2012, <http://www.heritage.org/research/reports/2012/11/six-bipartisan-entitlement-reforms-to-solve-the-real-fiscal-crisis-only-presidential-leadership-is-needed>.
8. See Nina Owcharenko, “Medicaid Reform: More Than a Block Grant Is Needed,” Heritage Foundation *Issue Brief* No. 3590, May 4, 2012, <http://www.heritage.org/research/reports/2012/05/three-steps-to-medicaid-reform>.
9. See Robert Rector, “Obama's End Run on Welfare Reform, Part Two: Dismantling Workfare,” Heritage Foundation *Backgrounders* No. 2731, September 26, 2012, <http://www.heritage.org/research/reports/2012/09/obamas-end-run-on-welfare-reform-part-two-dismantling-workfare>.

however, is to help beneficiaries of these programs support themselves. Extending dependence on government is not compassionate; promoting self-sufficiency is.

### **Repeal Obamacare Now.**

The coverage component of the President's costly and intrusive takeover of Americans' health care starts next year with its exchange subsidies and Medicaid expansions—the heart of the program. These provisions will increase federal spending by \$1.8 trillion over 10 years.

The opportunity to turn back from this unpopular law and establish patient-centered, market-based health care is closing. Obamacare must be repealed, and Congress should then start the process of truly reforming Americans' health care and coverage.

**Reduce Non-Defense Discretionary Spending.** Although entitlements are where the big money is, Congress should continue reducing non-defense discretionary spending. This category has surged 78 percent since 1992, after adjusting for inflation, reflecting how far the federal government has overreached its proper role.

A prime example is education, where increased federal spending and regulation has burdened local school districts and sapped their creativity.<sup>10</sup> Similarly, Washington has long overstayed its welcome in transportation, where again states and localities should take back their initiative.<sup>11</sup>

Apart from these large opportunities for savings, Congress should free

taxpayers from supporting the myriad activities Washington never had any business assuming. For example, at a time when hundreds of television stations are available, it is astonishing that the federal government still feels a need to support a Corporation for Public Broadcasting.

### **Growth-Oriented Tax Reform.**

If the FY 2014 budget really restrains spending and reforms entitlements, it should be capable of balancing with federal tax revenue at no more than the historical average of 18.5 percent of GDP. It is noteworthy that the budget surpluses of 1998 through 2001 occurred as federal spending plunged to 18.2 percent of GDP, compared with 22.2 percent today.

An important part of what happened in those years was that the economy, expanding at a rate of 4 percent per year or greater, effectively *outgrew* government. Balancing future budgets will also require strong economic growth—which calls for growth-oriented tax reform.

Tax reform does not mean closing tax preferences (“loopholes”) to raise revenue. True tax reform is revenue neutral. Any revenue raised by eliminating tax preferences should be offset by lowering tax rates. The code should encourage saving and investment, the essential elements of sustainable, long-term growth.<sup>12</sup>

**Budget Benchmarks.** There are many budgets designed to address the unsustainable spending and debt challenges that face the nation. The Heritage plan, *Saving the American Dream*, will serve as a useful benchmark for evaluating and comparing

these budgets and those that will be developed in the coming weeks and months. Highlights of *Saving the American Dream* include:

- Swiftly overhauls entitlement programs, including Social Security, to guarantee economic security to seniors while making the programs affordable;
- Repeals Obamacare;
- Fully funds defense;
- Rolls back discretionary spending;
- Rolls back recent tax increases with a sweeping, growth-oriented tax reform plan and caps taxes at the historical average of 18.5 percent;
- Balances the budget in less than 10 years, without raising taxes, and keeps the budget in balance thereafter; and
- Stabilizes and reduces the debt burden to 30 percent of GDP within a generation.

**Congress Must Act Now.** As Congress has mismanaged budgeting for the past several years, the opportunity to alter government's disastrous fiscal course has narrowed. It still remains, however, an opportunity. The imperative to rein in spending, eliminate deficits, and reduce debt to manageable levels should focus the federal government on the limited responsibilities it must

10. See Lindsey M. Burke, “Reducing the Federal Footprint on Education and Empowering State and Local Leaders,” Heritage Foundation *Backgrounder* No. 2565, June 2, 2011, <http://www.heritage.org/research/reports/2011/06/reducing-the-federal-footprint-on-education-and-empowering-state-and-local-leaders>.

11. See Ronald D. Utt, “‘Turn Back’ Transportation to the States,” Heritage Foundation *Backgrounder* No. 2651, February 6, 2012, <http://www.heritage.org/research/reports/2012/02/turn-back-transportation-to-the-states>.

12. J. D. Foster and Curtis S. Dubay, “Attacks on Tax Reform Miss the Mark,” Heritage Foundation *Issue Brief* No. 3755, October 11, 2012, <http://www.heritage.org/research/reports/2012/10/presidential-candidates-tax-reform-proposals-obama-vs-romney>.

meet and can do well. They should drive Congress to adopt substantive policy reforms, return activities to state and local governments and the private sector, and limit government so the institutions of civil society can prosper. All these will help support America's exceptional character. The process should start with the budget resolution for FY 2014.

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