No. 11-05
February 2011

WORKING PAPER

THE 1 PERCENT SOLUTION

By Jason Fichtner

MERCATUS CENTER
George Mason University

The 1 Percent Solution

I. Introduction

The United States has a spending problem. For fiscal year 2010, the federal government spent approximately \$3.5 trillion, or almost 24 percent of GDP, while collecting \$2.2 trillion in revenue. The result was a \$1.37 trillion deficit. For fiscal year 2011, the Congressional Budget Office (CBO) estimates the deficit will increase to over \$1.5 trillion,[1] and the Office of Management and Budget (OMB) estimates that the deficit will be \$1.6 trillion.[2] While debt held by the public was approximately \$9 trillion in fiscal year 2010, or 62 percent of GDP, the national gross debt, which includes bonds such as those held in the Social Security trust fund, now stands at over \$14 trillion and is estimated to climb to over \$15 trillion in fiscal year 2011, which would amount to almost 100 percent of GDP.[3]

While some are calling for tax increases to generate new revenue, the CBO estimates that all taxpayers' rates would need to more than double in order to fund projected spending increases.[4] Rate increases of this magnitude would solve the deficit problem only to create a significant economic problem. With such large deficits and a national debt that is already above \$14 trillion, the International Monetary Fund recently issued a warning to the United States that it must control its deficits or the result will be slower economic growth and even more difficult financial and political choices in the future.[5]

This working paper lays out a general framework for how the nation can address its long-term fiscal challenges, without tax increases, to avert the coming fiscal crisis and balance the budget within the next decade. This paper does not provide a master plan identifying specific programmatic spending reductions in discretionary spending, such as defense and agriculture, nor in entitlement programs, such as Social Security, Medicare, and Medicaid. Entitlement spending on Medicare and Medicaid alone is estimated to continually increase as a share of the economy.[6] Controlling the increase in the runaway growth of health-care expenditures will require tough choices that many politicians seem unable to make, and that the public may or may not support. However, what is clear is that spending needs to be

---

1 Congressional Budget Office (CBO), *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, January 2011, http://www.cbo.gov/ftpdocs/120xx/doc12039/01-26_FY2011Outlook.pdf.
2 Office of Management and Budget (OMB), *Budget of the United States Government, Fiscal Year 2011*, and OMB, *Budget of the United States Government, Fiscal Year 2012*.
3 CBO, *Budget and Economic Outlook: FY 2011–2021*.
4 CBO, *The Long-Term Economic Effects of Some Alternative Budget Policies*, May 19, 2008, http://www.cbo.gov/ftpdocs/92xx/doc9216/Letter-to-Ryan.1.1.shtml.
5 "U.S. Must Reduce Deficit, IMF Warns," *Washington Post*, January 28, 2010.
6 CBO, *Budget and Economic Outlook: FY 2011–2021*, January 2011.

controlled. Delaying the tough choices necessary will only require even tougher and harder choices down the road.

This paper provides a framework to compare and evaluate other reform plans and, just as importantly, to stimulate discussion on how to control and reduce government spending. There are many ways to design a plan to reduce the debt and put the nation's fiscal house in order, and various fiscal commissions, task forces, and think tanks have issued reports and provided detailed reform options to reduce the debt.[7] These plans span the spectrum from relying primarily on tax increases or spending reductions to proposing a mix of both.

Instead, this paper provides a framework for evaluating all reform plans at the aggregate level by demonstrating that the focus needs to be on reducing spending, not increasing taxes. In recent testimony before the Senate Finance Committee, former CBO Director Doug Holtz-Eakin stated, "The dire long-term budget outlook is not the result of a shortfall of revenues . . . Instead, the problem is spending. Federal outlays in 2020 are expected to be 25.2 percent of GDP—about $1.2 trillion higher than the 20 percent that has been business as usual in the postwar era."

II. The Problem and Long-Term Fiscal Challenges

The spending addiction is clear when one looks at the past 10 years. The nation's long-term fiscal trends in federal revenues and outlays are detailed in the chart and table below. In nominal dollars, since fiscal year 2000, federal receipts range from a low of $1.782 trillion (16.2 percent of GDP) in 2003 to a high of $2.568 trillion (18.5 percent of GDP) in 2007 (a difference of $786 billion, or 44 percent). Similarly, expenditures over the past 10 years start from a low of $1.789 trillion (18.2 percent of GDP) in 2000 and steadily increase every year to a high of $3.456 trillion (23.8 percent of GDP) in fiscal year 2010 (a difference of $1.7 trillion, or 93.2 percent).

As a share of the economy, federal receipts have ranged from a low of 14.9 percent in 2010 to a high of 20.6 percent in 2000. On the other hand, federal outlays have ranged from 18.2 percent of GDP in 2000 and 2001 to a high of 25.0 percent in 2009. The reduction in tax revenues was partly due to the tax-reform laws of 2001 and 2003, as well as the recent recession, although tax revenues are expected to

[7] The Center for a Responsible Federal Budget prepared a side-by-side comparison of 12 plans that can be accessed at http://crfb.org/sites/default/files/CRFB_Summary_Table_of_Fiscal_Plans.pdf.

increase as the economy recovers. Nevertheless, it is obvious that even as the economy grows, spending is expected to rapidly outpace growth in most years.

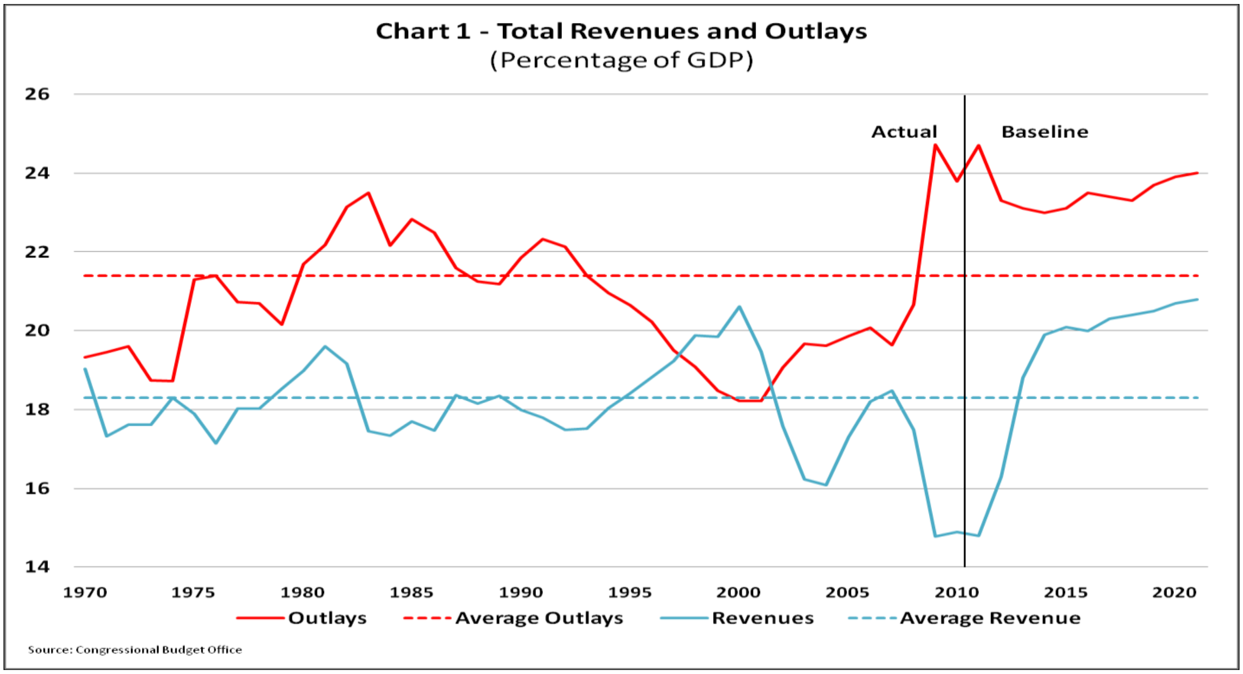


Table 1 - Revenues, Outlays & Gross Domestic Product (GDP)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
					In Billions of Dollars						
Total Revenues	2,025	1,991	1,853	1,782	1,880	2,154	2,407	2,568	2,524	2,105	2,162
Total Outlays	1,789	1,863	2,011	2,160	2,293	2,472	2,655	2,729	2,983	3,518	3,456
Total Deficit	**236**	**128**	**(158)**	**(378)**	**(413)**	**(318)**	**(248)**	**(161)**	**(459)**	**(1,413)**	**(1,294)**
% Change Revenues		-1.7%	-7.4%	-4.0%	5.2%	12.7%	10.5%	6.3%	-1.7%	-19.9%	2.6%
% Change Outlays		4.0%	7.4%	6.9%	5.8%	7.2%	6.9%	2.7%	8.5%	15.2%	-1.8%
					In Billions of Dollars						
GDP (Fiscal Year)	9,821	10,225	10,544	10,980	11,686	12,446	13,225	13,892	14,394	14,098	14,513
% Change		4.0%	3.0%	4.0%	6.0%	6.1%	5.9%	4.8%	3.5%	-2.1%	2.9%

Source: Congressional Budget Office.
CBO calculated GDP fiscal year numbers from seasonally adjusted quarterly national income and product account data from the Bureau of Economic Analysis.

The magnitude of the spending problem is even more obvious when one examines projected policy. The CBO's "Alternative Fiscal Scenario" is considered by many to be the most reasonable projection of fiscal policy.[8] Under these estimates, revenues—which have fallen considerably during the recession—are expected to return to their historical share of GDP (approximately 18 percent) within the next decade. Though federal spending has spiked over the past few years due to stimulus spending, federal spending is still projected to steadily increase for the next several decades. In other words,

[8] Unlike the "extended baseline scenario," the alternative fiscal scenario incorporates various changes to current law that are widely expected.

spending has permanently increased upward and, unless spending reforms are enacted, will never return to its historical average as a share of the economy. By 2035, total federal outlays will have increased by 10 percentage points to 35.2 percent. Under this scenario, the net-debt-to-GDP ratio will be 185 percent.[9]

Most economists agree that debt levels this high pose a significant problem for economic growth. Economists Carmen Reinhart and Kenneth Rogoff, for example, recently examined debt levels in 44 countries over the course of 200 years. They found that as debt-to-GDP ratios go from 30 to 90 percent, growth rates tend to halve.[10]

The long-term budget problem cannot be addressed without spending reductions. For one thing, any approach that involves tax increases alone would be prohibitively costly. The CBO estimates that tax rates would have to more than double to address the coming increase in spending.[11] These high tax rates would paralyze the economy. Robert Barro and Charles Redlick of Harvard University estimate that for each \$1.00 in new tax revenue, the economy tends to shrink by about \$1.10.[12] In other words, taxes not only take money out of the wallets of private individuals and the economy, they also reduce the size of what the economy could have been without the tax.

Of course, revenue might be increased to avoid such debt levels. However, raising taxes has economic costs. Economists Christina and David Romer recently examined over 60 years of U.S. tax data. After carefully controlling for other factors, they found that "a tax increase of 1 percent of GDP lowers real GDP by almost 3 percent." In other words, if we were to use tax increases to finance the projected 10 percentage point increase in spending as a share of GDP, by 2035, the real economy would be 30 percent smaller than otherwise, all else being equal.

Moreover, there is little reason to suppose that a revenue increase would solve the debt/deficit problem. Harvard economists Alberto Alesina and Silvia Ardagna have examined numerous instances of fiscal adjustments throughout the world. They find that those attempts to close deficits that have relied on

---

[9] CBO, *The Long-Term Budget Outlook*, June 2010 (revised August 2010), http://www.cbo.gov/ftpdocs/115xx/doc11579/06-30-LTBO.pdf.
[10] Carmen Reinhart and Kenneth Rogoff, "Growth in a Time of Debt," NBER Working Paper No. 15639, January 2010.
[11] CBO, *Alternative Budget Policies*, May 19, 2008.
[12] See Robert Barro and Charles Redlick, "Macroeconomic Effects of Government Purchases and Taxes" (working paper no. 22, Mercatus Center at George Mason University, Arlington, VA, 2010).

spending reductions have been far more successful than those that have relied on tax increases. Moreover, spending reductions are much less likely to lead to recessions than tax increases are.[13]

III. The 1 Percent Solution Framework

It is now time that the US government get its fiscal house in order. Taxes increases are not the solution. Tax increases are self-defeating by decreasing GDP growth which, in turn, can decrease tax revenue. Even allowing for a permanent extension of the 2001 and 2003 tax reforms, taxes are currently projected to increase to 18.5 percent of GDP as the economy recovers,[14] just above the national long-term average.

The economy is slowly recovering from a severe recession, and millions of American families have been forced to tighten their own budgets and get their fiscal houses in order. Americans have found ways to do more with less, pay down debt, and increase personal savings. If American families can do more with less, shouldn't the federal government also be able to get by with less? If the American household can do it, surely the federal government can find a way to save 1 percent—just one penny for every dollar.

This paper lays out several general strategies to reduce the growth of government and rein in spending. As a starting point for discussion, the Congress and the President should agree to reduce 1 percent from the federal budget each year until balance is reached. This 1 percent reduction would be a real cut in spending, not just a reduction in the rate of growth of government. Once a balanced budget is reached, then spending could again be allowed to grow, but at rates consistent with the growth in the overall economy so that relative fiscal balance is maintained.

A 1 percent reduction in spending does not necessarily mean a 1 percent across-the-board cut. Though an across-the-board reduction would accomplish the goal of reducing government spending and is shown below in this paper for illustration purposes, it is not proper budgeting. Proper budgeting requires setting priorities and making decisions—it is about making trade-offs between competing wants and limited resources. As former Massachusetts Governor Mitt Romney stated in the *Washington Post*, "Decide from the outset the amount that the government will spend for the year. Don't add up all the

[13] Alberto Alesina and Silvia Ardagna, "Large Changes in Fiscal Policy: Taxes Versus Spending" (Discussion Paper No. 2180, Harvard Institute of Economic Research, Cambridge, MA, 2009).
[14] Chris Edwards, "A Plan to Cut Spending and Balance the Federal Budget," Cato Institute, November 2010.

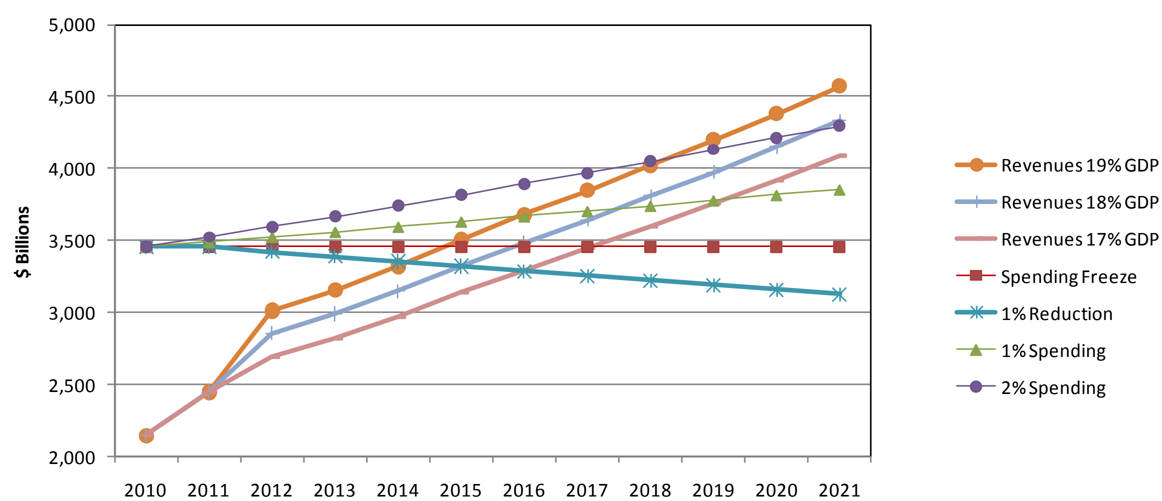
program requirements, departmental requests and political wish lists to calculate the total—that's surrendering, not budgeting."[15]

Further, proper budgeting acknowledges that while some areas of government spending might need more funding, other areas can absorb greater reductions. A 1 percent reduction goal sets forth an overall framework on the amount of total government spending to be reduced. It is up to the American people and their elected leaders to make the tough and necessary choices to achieve these results.

The fiscal problems facing the nation were not created overnight. Hence, appropriate solutions to balance the budget will not solve our fiscal problems overnight either. Commitment to fiscal reform must be for the long haul. Some might claim that a 1 percent reduction in spending is too draconian, that there is no way the government can get by with less. But that is just not the case.

In addition to the 1 Percent Solution Framework, other frameworks would also put the nation on track to balance the federal budget within 10 years, all without increasing taxes on the American people. As can be seen in the chart below, holding spending constant (nominal dollars) at fiscal year 2010 levels leads to a balance budget by 2018 under three different revenue scenarios. Assuming revenues increase up to 19 percent of GDP, holding spending at FY2010 levels would balance the budget by 2015; revenues at 18 percent of GDP (near the long-term historical average) would balance the budget by 2016; while a more conservative assumption of revenues at 17 percent of GDP would balance the budget by 2018.

Chart 2 - Balancing the Budget with Spending Restraint



Author's Calcuations. Revenues include the permanant extension of the 2001 and 2003 tax changes.
Revenue for 2010 is Actual; 2011 is CBO estimate; 2012 and forward are Author's Calculations

[15] Mitt Romney, "Obama Must Slay the Job-Killing Beast," *Washington Post*, November 2, 2010.

As is also detailed in the chart, if Congress and the President cannot agree to the ideal solution of reducing spending by 1 percent or even holding spending constant, then budget balance could still be reached by 2020 allowing for 1 percent growth or even 2 percent growth. Allowing for 1 percent growth would balance the budget in 2018, while allowing 2 percent growth would balance the budget in 2021. These figures assume a somewhat a middle-of-the-road revenue estimate of 18 percent of GDP (slightly below the long-term average)[16] and further assume that the Bush-era tax reforms of 2001 and 2003 and the AMT patch are made permanent for all taxpayers.

The chart provides a sensitivity analysis of the different outcomes of reducing spending and allowing for three different levels of revenue as a share of GDP (GDP estimates are provided by the Congressional Budget Office).[17] Even under a more conservative revenue estimate of 17 percent of GDP, the federal budget would balance in 2016 under a 1 percent reduction and by 2018 under a spending freeze at 2010 levels. Allowing for 1 percent growth, it would balance the budget around 2019. However, allowing for 2 percent growth with 17 percent revenue as a share of GDP would not balance the budget within the next decade.

Regardless of the economic assumptions used, the key is to act now. Allowing spending increases today delays the necessary spending reductions that need to take place and will only increase the magnitude of the spending reductions needed without tax increases to balance the budget within a 10-year period.

Table 2 - One Percent Reduction	*Actual*				*Projections*							
Begin in FY2012; Revenue 18% GDP	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Outlays												
Mandatory	1,451	1,595	2,093	1,910	1,910	1,891	1,872	1,853	1,834	1,816	1,798	1,780
Discretionary	1,041	1,135	1,238	1,349	1,349	1,336	1,322	1,309	1,296	1,283	1,270	1,258
Subtotal	2,492	2,730	3,331	3,259	3,259	3,226	3,194	3,162	3,130	3,099	3,068	3,037
Net interest	237	253	187	197	225	264	325	394	459	527	592	646
Total Outlays	2,729	2,983	3,518	3,456	3,484	3,490	3,519	3,556	3,589	3,626	3,660	3,683
GDP				14,513	15,034	15,693	16,400	17,258	18,195	19,141	20,033	20,935
Total Revenues	2,568	2,524	2,105	2,162	2,228	2,555	2,952	3,106	3,275	3,445	3,606	3,768
Deficit (-) or Surplus	**(161)**	**(459)**	**(1,413)**	**(1,294)**	**(1,256)**	**(935)**	**(567)**	**(450)**	**(314)**	**(181)**	**(54)**	**85**

Notes: FY2011 Outlays are held to FY2010 Level, Interest estimate is CBO for FY2011 so Total Outlays is slightly higher in FY2011 than FY2010
One percent reduction begins in FY2012, based off of FY2011 Outlays for Mandatory (non-interest) and Discretionary spending
Total Outlays includes CBO estimated interest on the debt - no adjustment is made for interest payments. If interest cost rise/decline, other reductions/increases w ould be made to achieve one percent total reduction
To be conservative: (1) Total Revenues are assumed to be equal to CBO estimates for FY2011 & FY2012 and then at a level equal to 18 percent of GDP for FY2013 forw ard; and
(2) interest payments, w hich increase rapidly in future years, are held to current CBO estimates
GDP estimates are from the Congressional Budget Office, January 2011

[16] Nick Gillespie and Veronique de Rugy argue that the budget can be balanced without tax increases by targeting federal government spending at 19 percent of GDP in order to be in line with the long-term average revenue as a share of GDP near 18 percent. See their "The 19 Percent Solution: How to Balance the Budget Without Increasing Taxes," *Reason*, March 2011.

[17] CBO, *Budget and Economic Outlook: FY 2011–2021*.

The table above illustrates a potential path toward a balanced budget by 2018, allowing for revenues at 18 percent of GDP. Again, 18 percent of GDP is slightly below the long-term average. In this example, no adjustment is made for interest rates. While mandatory (non-interest) and discretionary spending are reduced by 1 percent each year, beginning in FY 2012, no adjustment is made for interest payments. If spending is reduced, then the debt will not grow as fast as currently estimated and, hence, all else equal, interest payments would be lower than estimated in future years. However, interest payments are maintained at CBO's estimated levels in order to err on the conservative side.

Yet, if spending is reduced by 1 percent per year, then presumably interest payments will also be less than estimated. Continuing with a 1 percent reduction framework with revenues at 18 percent of GDP, and allowing for a reduction in CBO's estimated interest payments, the budget would be balanced one year earlier in 2017, as shown in the table below.

Table 3 - One Percent Reduction with Allowance for Reduction in Interest Payments	Actual				Projections							
Begin in FY2012; Revenue 18% GDP	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Outlays												
Mandatory	1,451	1,595	2,093	1,910	1,910	1,891	1,872	1,853	1,834	1,816	1,798	1,780
Discretionary	1,041	1,135	1,238	1,349	1,349	1,336	1,322	1,309	1,296	1,283	1,270	1,258
Subtotal	2,492	2,730	3,331	3,259	3,259	3,226	3,194	3,162	3,130	3,099	3,068	3,037
Net interest	237	253	187	197	225	255	310	373	428	477	499	514
Total Outlays	2,729	2,983	3,518	3,456	3,484	3,482	3,504	3,535	3,559	3,576	3,567	3,552
GDP				14,513	15,034	15,693	16,400	17,258	18,195	19,141	20,033	20,935
Total Revenues	2,568	2,524	2,105	2,162	2,228	2,555	2,952	3,106	3,275	3,445	3,606	3,768
Deficit (-) or Surplus	**(161)**	**(459)**	**(1,413)**	**(1,294)**	**(1,256)**	**(927)**	**(552)**	**(428)**	**(284)**	**(130)**	**39**	**217**

Notes: FY2011 Outlays are held to FY2010 Level, Interest estimate is CBO for FY2011 so Total Outlays is slightly higher in FY2011 than FY2010
One percent reduction begins in FY2012, based off of FY2011 Outlays for Mandatory (non-interest) and Discretionary spending
Total Outlays includes CBO estimated interest on the debt for FY2011 - to reflect lower spending and debt accumulation, adjustments are made for interest payments from FY2012 forward
To be conservative: (1) Total Revenues are assumed to be equal to CBO estimates for FY2011 & FY2012 and then at a level equal to 18 percent of GDP for FY2013 forward
GDP estimates are from the Congressional Budget Office, January 2011

Still, even with these frameworks, many will claim that the government cannot get by with less. But critics cannot argue with reality. In 2010, and for the first time since adopting budget reform rules in 1974, both chambers of Congress failed to pass an annual budget resolution, the overall budget framework used to pass annual appropriation bills. Therefore, to fund government operations for the 2011 fiscal year, beginning October 1, Congress passed a continuing resolution (CR) allowing the government to continue spending at FY 2010 levels until December 3.[18] Another CR was passed allowing the

[18] The first Continuing Resolution actually appropriated $8.2 billion less than FY 2010 as a result of changes to funding levels for Census Bureau and military base closing programs. The second Continuing Resolution appropriated $1.16 billion above FY 2010 levels for changes in funding for the Veteran Benefits Administration and small business loans. See http://www.appropriations.senate.gov/news.cfm?method=news.view&id=4841b7f6-bbac-486b-959f-43b1979a60ff.

continuation of these funding levels through March 4. At the time this working paper was written, the Congress was still debating the funding levels for the remainder of fiscal year 2011.

Because of these CRs, the government is actually spending near last year's discretionary funding levels and almost eight percent less than President Obama's FY2011 requested budget. If the CR is extended to maintain 2010 fiscal year spending over the entire 2011 fiscal year, an option under consideration in the current Congress, the government would spend approximately $110 billion less in discretionary spending in just one year than was proposed.[19] If Congress could reduce spending below 2010 fiscal year levels then even more savings could be achieved.

It turns out the government can get by with less. If the government can hold spending constant for the first five months of the fiscal year (almost half of the full fiscal year) without the sky falling down, why not just one percent for the long haul?

IV. Why We Need to Act Now

According to the CBO, the U.S. deficit for fiscal year 2010—which ran from October 1, 2009, to September 30, 2010—was about $1.3 trillion.[20] This deficit constituted 8.9 percent of GDP, and is over 200 percent larger than the $431 billion deficit the CBO had estimated as recently as September 2008.[21]

Unfortunately, the future looks no brighter. In 2010, the President submitted his FY 2011 budget and proposed raising taxes by $3 trillion over the next decade—including a $743 billion health-care reform tax, an $843 billion cap-and-trade energy tax, a $968 billion tax on small businesses and upper-income families, and a $468 billion tax on corporations.[22] And yet even with these $3 trillion in proposed new taxes, revenue still would not keep up with all the new spending. As a result, the OMB projected that the debt held by the public would more than double, from $7.5 trillion in 2009 to $18.6 trillion by 2020.[23] The CBO released updated estimates in January 2011 and now estimates that debt held by the public will reach $17.4 trillion and that gross debt will exceed $23.9 trillion.

---

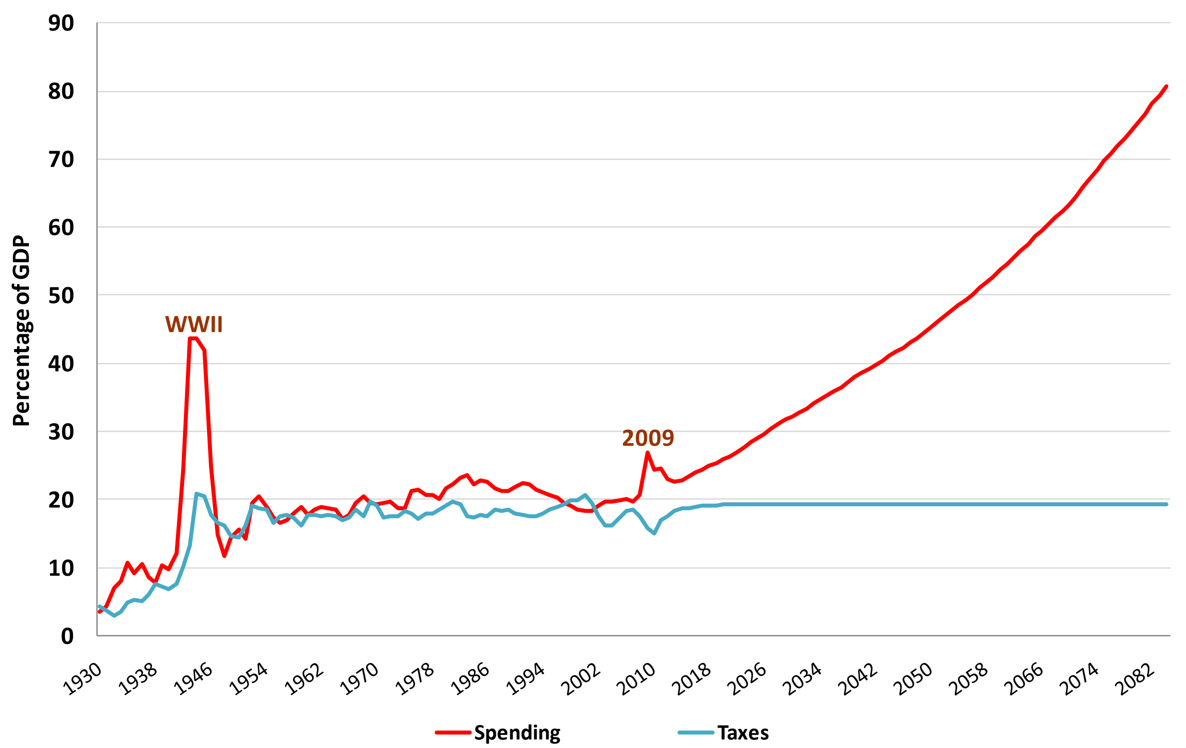
[19] Federal outlays totaled $3.456 trillion in FY 2010. President Obama's FY 2011 budget proposed FY 2011 spending at $3.834 trillion, or a difference of $378 billion. OMB, *Budget of the United States Government, Fiscal Year 2011* and OMB, *Budget of the United States Government, Fiscal Year 2012*.
[20] CBO, *Budget and Economic Outlook: FY 2011–2021*.
[21] Source for 2008 and 2009 deficit figures: author's calculations and OMB, *Historical Tables: Table 1.1.* CBO 2008 projections of the FY 2009 budget at CBO, *Budget and Economic Outlook: An Update,* September 2008, http://cbo.gov/ftpdocs/97xx/doc9706/09-08-Update.pdf.
[22] OMB, *Budget of the United States Government, Fiscal Year 2011*.
[23] Ibid., 146.

As the following table details, the CBO expects increasing spending over the next 10 years.

Table 4 - CBO's Baseline Budget Outlook														
	Actual 2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2016	2012-2021
						In Billions of Dollars								
Total Revenues	2,162	2,228	2,555	3,090	3,442	3,651	3,832	4,075	4,275	4,489	4,712	4,963	16,570	39,084
Total Outlays	3,456	3,708	3,655	3,794	3,975	4,202	4,491	4,691	4,885	5,185	5,451	5,726	20,117	56,055
Total Deficit	**-1,294**	**-1,480**	**-1,100**	**-704**	**-533**	**-551**	**-659**	**-617**	**-610**	**-696**	**-739**	**-763**	**-3,547**	**-6,971**
On-Budget	-1,371	-1,548	-1,186	-792	-621	-641	-752	-706	-693	-768	-798	-808	-3,992	-7,765
Off-Budget	77	68	86	88	87	90	94	90	82	73	59	45	445	794
Debt Held by the Public at the End of the Year	9,018	10,430	11,598	12,386	12,996	13,625	14,358	15,064	15,767	16,557	17,392	18,253	n.a.	n.a.
						As a Percentage of GDP								
Total Revenues	14.9	14.8	16.3	18.8	19.9	20.1	20.0	20.3	20.4	20.5	20.7	20.8	19.1	19.9
Total Outlays	23.8	24.7	23.3	23.1	23.0	23.1	23.5	23.4	23.3	23.7	23.9	24.0	23.2	23.5
Total Deficit	**-8.9**	**-9.8**	**-7.0**	**-4.3**	**-3.1**	**-3.0**	**-3.4**	**-3.1**	**-2.9**	**-3.2**	**-3.2**	**-3.2**	**-4.1**	**-3.6**
Debt Held by the Public at the End of the Year	62.1	69.4	73.9	75.5	75.3	74.9	75.0	75.2	75.3	75.8	76.2	76.7	n.a.	n.a.
Source: Congressional Budget Office.														
Note: GDP = gross domestic product; n.a. = not applicable.														
a. Off-budget surpluses comprise surpluses in the Social Security trust funds and the net cash flow of the Postal Service.														

However, if spending is not reduced, the nation's long-term fiscal imbalance will explode. The CBO also projects an exponential increase in spending over the next 50 years, as shown in the following chart.

Chart 3 - Long-Term Spending Unsustainable



Author's Production based on date provided by Office of Management and Budget, Congressional Budget Outlook, Long-Term Budget Outlook, June 2010

The frameworks provided earlier would balance the budget within 10 years without tax increases. Critics of these proposals might argue that it is unrealistic to expect the government to find real programmatic reductions in spending of 1 percent per year, or even be able to control the rate of growth to 2 percent or less. Those claims are unfounded. Several detailed plans have already been put forward demonstrating how the federal government can achieve fiscal balance.[24] For example, Chris Edwards at the Cato Institute has developed a plan that would balance the budget within 10 years.[25] Congressman Paul Ryan (R-Wisc.), the Chairman of the House Budget Committee, has a detailed plan to slowly reduce the growth of government, reform Medicare and Medicaid, and reform the tax code.[26] Additional plans are highlighted in the appendices.

However, as demonstrated earlier, this nation does not have a revenue problem—it has a spending problem. Congress and the President should find a way to reduce overall spending by 1 percent per year to avoid a fiscal train wreck and put the nation back on a fiscally responsible track. Failing that, the budget can still be balanced within a decade by keeping the growth of government spending to 2 percent or less.

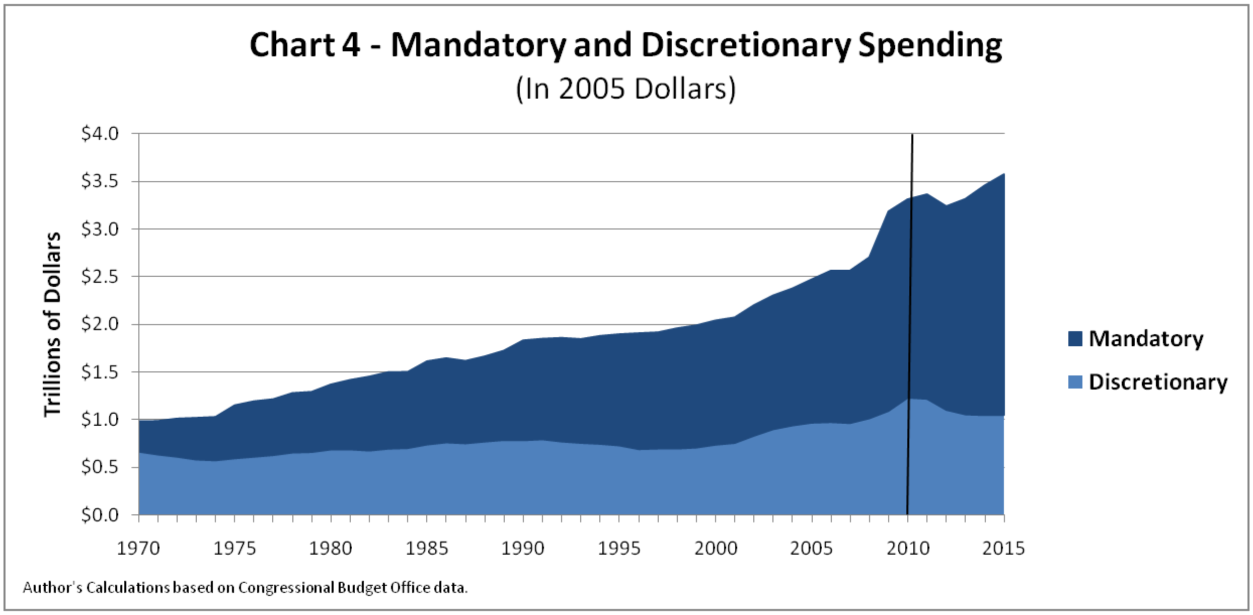
Critics might say that while a 1 percent solution sounds good in theory, getting policy makers to agree to real spending cuts would be problematic. Further, as mentioned previously, critics might argue that an across-the-board reduction of 1 percent is not a real policy option because an across-the-board cut avoids the necessary hard choices of deciding which government programs are actually necessary, which programs should get more funding, and which programs should get less.

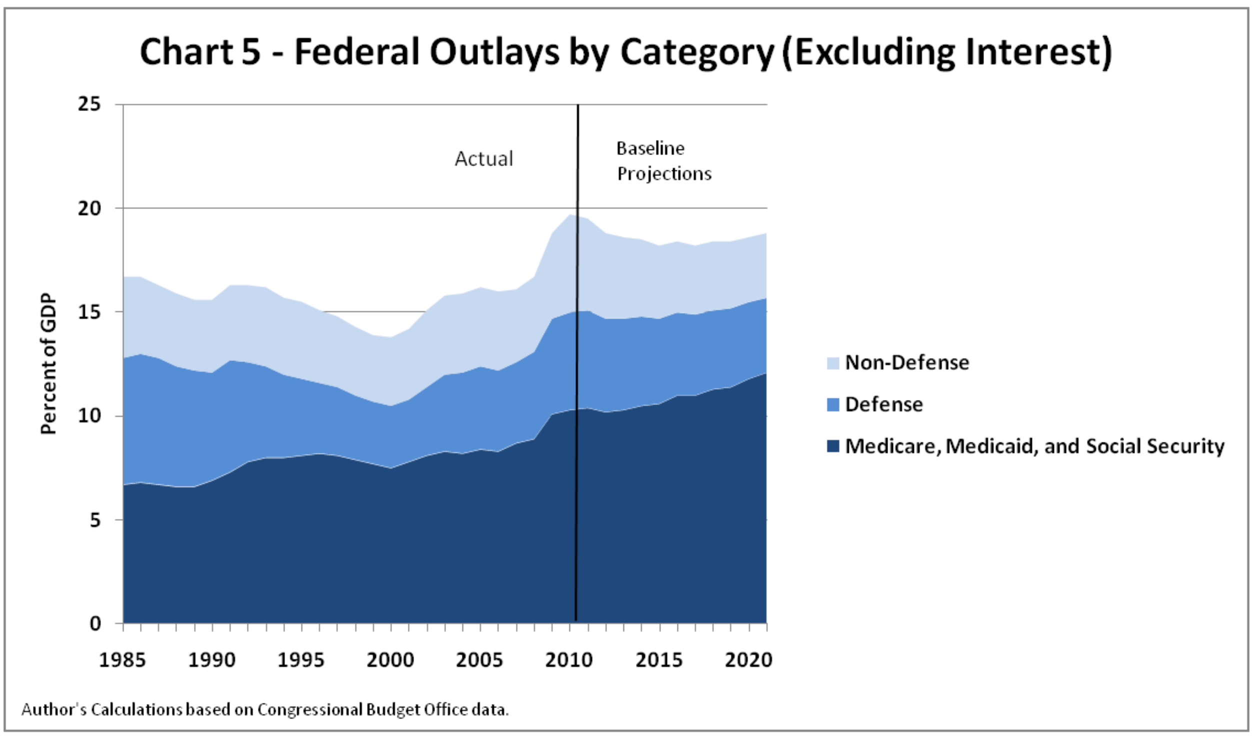
It is important to point out again that while spending reductions could be across-the-board, it is desirable that policymakers target budget decisions so that some programs get larger reductions while other programs get smaller ones. Some programs might require increases in funding. Again, the goal is to reduce overall spending by 1 percent. This does not require an across-the-board cut of 1 percent to every government program. However, in total, the federal government would be required to get by with 1 penny less for every dollar it spent the previous year.

Additionally, entitlements are the biggest fiscal problem facing the nation. The growth in entitlement programs such Social Security, Medicare, and Medicaid is rapidly increasing.

---

[24] Center for a Responsible Federal Budget prepared a side-by-side comparison of 12 plans. It can be accessed here: http://crfb.org/sites/default/files/CRFB_Summary_Table_of_Fiscal_Plans.pdf
[25] Edwards, "A Plan to Cut Spending."
[26] Congressman Paul Ryan, "The Roadmap Plan," http://www.roadmap.republicans.budget.house.gov/Plan/.

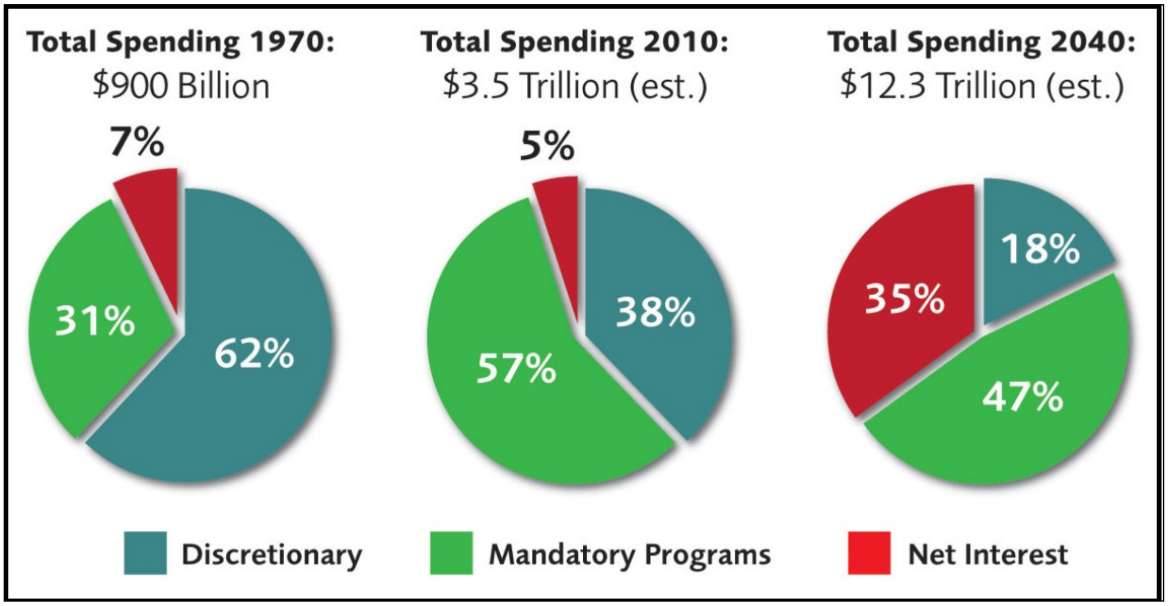




Addressing the runaway growth in health-care expenditure increases appears to be a necessary part of any prudent fiscal-reform plan. Further, it might not be necessary for an annual aggregate 1 percent reduction per year if significant and meaningful reductions to future spending on health care can be achieved. What is clear though is that if entitlements are not reformed, they will eventually swallow up

47 percent of the entire federal budget by 2040. If interest payments on the debt are included, total mandatory spending would equal 82 percent of the budget.

Chart 6 – Total Federal Spending



Source: Author's Calculations based on data from the Congressional Budget Office and Office of Management and Budget.

Additionally, government budgeting is directly opposite of the way American families budget. While American families determine what they can afford to spend based on their income, the federal government adds up all that it wants to spend and then borrows above and beyond what it can afford to pay with tax revenues. While the goal of a balanced budget is ideal, what is most important is that the federal government sets forth, and lives by, specific budget caps.

As an example, the average post-World War II annual tax burden has been approximately 18 percent of GDP, while average spending has been higher, at around 21 percent of GDP (see first chart). To live within the government's means, a target could be set that would cap federal spending at 18 percent or 19 percent of GDP.[27] While some allowance might have to be made on an as-needed basis for wars and/or emergencies, setting and enforcing a budget cap at a level near the historical average for revenue collection would force the federal government to live within its means, just like American families must do.

[27] Gillespie and de Rugy, "19 Percent Solution."

V. Fiscal Reform Plans: Commissions, Task Forces, and Think Tanks

In February 2010, President Obama established the National Commission on Fiscal Responsibility and Reform (Fiscal Commission) to find solutions to the deficit and to start paying down America's debt. "Everything is on the table," President Obama declared, after signing the executive order creating the commission. Yet many politically connected advocacy and interest groups draw a line in the sand at spending cuts on Social Security, Medicare, and other favored government programs. Cutting spending, these groups argue, will hurt the poor and eviscerate the middle class.

The Fiscal Commission released its report in December 2010. In the report's preamble, the commission states the cold, hard truth up front: "The problem is real. The solution will be painful. There is no easy way out."[28] The commission proposed decreases in spending and increases in tax revenues, achieving nearly $4 trillion in deficit reduction through 2020. Additionally, if the commission's recommendations were implemented, the deficit would fall to 2.3 percent of GDP by 2015. Further, debt held by the public would decrease to 60 percent of GDP by 2023 and 40 percent by 2035. Though the commission's recommendations do put the nation back on fiscal track, the plans would be accomplished in part with tax increases that still would not balance the budget until 2035.

Reducing the deficit and the national debt can be accomplished through proper budgeting and by aligning spending with tax revenues that match the long-term average. It does not require tax increases, which would harm economic growth. For example, Nick Gillespie and Veronique de Rugy argue that the budget can be balanced without tax increases by targeting federal government spending at 19 percent of GDP in order to be in line with the long-term average revenue as a share of GDP near 18 percent.[29]

But failure to act soon to reform the nation's spending and social programs only guarantees that any future reforms will be drastic and extremely painful. There are many possible alternatives to responsibly reduce government spending. The New York Times published an online, interactive tool to allow anyone to pick and choose among a variety of options to balance the budget.[30] Users can focus on

[28] The National Commission of Fiscal Responsibility and Reform, *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform*, December 2010, http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf.
[29] Gillespie and de Rugy, "19 Percent Solution."
[30] "Budget Puzzle: You Fix the Budget," *New York Times*, November 13, 2010, http://www.nytimes.com/interactive/2010/11/13/weekinreview/deficits-graphic.html.

spending reductions, tax increases or a mix of the two. Also, various groups have come out with their own deficit reduction plans. A comparative summary of these plans is provided in Appendix I.[31]

Solving the nation's fiscal problems solely through spending reductions will require difficult budget decisions. This paper provides an aggregate framework for getting to a balanced budget. However, many specific reductions have already been identified in the reform plans put forward by the individuals and groups listed in appendix 1. In appendix 2, a few spending reduction plans are discussed in more detail to illustrate how fiscal balance can be achieved without tax increases.

Finally, in addition to the *level* of taxation and spending, we must reform the *way* we tax and spend. The country is saddled with an uncompetitive tax system that discourages saving, investment, and domestic job creation. Along with a serious debate on how to reduce government spending, America needs a thoughtful discussion on fundamental tax reform. We need to prioritize long-term economic growth and focus on where government spending can be reduced, including the fiscal challenges posed by rising health-care expenditures, Social Security, and Medicare.

VI. Conclusion

This working paper is intended to provoke thoughtful policy discussions on how to rein in government spending and restore the nation to fiscal balance. Regardless of the framework ultimately decided upon to reduce government spending and bring our deficit and debt levels back to responsible levels, all of these plans have something very important in common that is summed up well by Bill Galston and Maya MacGuineas in their plan: "Because we have waited so long to address our fiscal problem, changes that would have been relatively small and easy a decade ago are now larger and harder—and far more urgent. We need to credibly commit to budget reforms as quickly as possible and phase them in as soon as economic circumstances allow."[32]

[31] Center for a Responsible Federal Budget's side-by-side comparison of 12 plans.
[32] Bill Galston and Maya MacGuineas, "The Future is Now: A Balanced Plan to Stabilize Public Debt and Promote Economic Growth," September 30, 2010, http://www.brookings.edu/~/media/Files/rc/papers/2010/0930_budget_deficit_galston/0930_public_debt_galston.pdf.

VII. Acknowledgments

The author wishes to thank Jacob Feldman, Nick Tuszynski and Jakina Debnam for invaluable assistance with researching, editing, and providing content for this paper. My thanks also go to my Mercatus colleagues who reviewed drafts of this paper and provided many helpful suggestions to improve it.

VIII. Appendix 1

Summary Table of Fiscal Plans						
Major Areas of Each Plan	**Fiscal Commission Co-Chair Proposal**	**Representative Paul Ryan's Roadmap**	**Debt Reduction Task Force (Domenici-Rivlin)**	**Galston-MacGuineas Plan**	**Center for American Progress 50/50 Plan**	**CATO's "Downsizing Government" Plan**
Links	Co-Chair Proposal	Paul Ryan's Roadmap	Domenici-Rivlin	Galston-MacGuineas Plan	50/50 Plan	CATO's Plan
Defense	• Cap 2012 spending at 2010 levels, 1% cut from 2013–2015, then limit growth to inflation • Enforcement mechanism for caps	N/A	• 5-year freeze, then limit growth to GDP • Enforcement mechanism for caps	• Cut unneeded weapons systems • Reform military pay and TRICARE • Reform contracting • Scale back R&D • Create war	• Cut overhead • Cut military personnel stationed in Europe and Asia • Various weapons cuts • Reform military pay and TRICARE	• Enact Preble/Friedman reforms: numerous acquisition reductions, RDT&E reductions, reform military pay and health care, overhead savings, reduce the size of the Army, Marines, and nuclear arsenal
Domestic Discretionary	• Cap 2012 spending at 2010 levels, 1% cut from 2013–2015, then limit growth to inflation • Enforcement mechanism for caps • Move the Transportation Trust Fund to mandatory • Budget for disasters	• Freeze nondefense, nonstimulus at 2009 levels until 2020 • Starting in 2020, spending growth assumed to be limited to CPI plus 0.7% • Rescind all unused ARRA funds	• 4-year freeze, then limit growth to GDP • Enforcement mechanism for caps	• Freeze for 3 years, then grow with inflation, starting in 2011	• Cut energy supply programs • Cut international security assistance • Cut federal highway assistance • Cut immigration and customs enforcement • Cut Federal Aviation Administration • Cut NIH funding • Cut international development and	• End rail subsidies • Eliminate Department of Housing and Education • State and local grant cuts in many departments • Eliminate SBA, CPB, Job Corps, among others • End energy subsidies • Various others

Major Areas of Each Plan	Fiscal Commission Co-Chair Proposal	Representative Paul Ryan's Roadmap	Debt Reduction Task Force (Domenici-Rivlin)	Galston-MacGuineas Plan	Center for American Progress 50/50 Plan	CATO's "Downsizing Government Plan"
					humanitarian assistance • Cut immigration and customs enforcement) • Cut NASA • Various others	
Social Security	• Slow benefit growth for high- and medium-income workers • Increase early and normal retirement ages and index for longevity (but create "hardship exemption") • Index COLAs to chained CPI • Include newly hired state and local workers after 2020 • Increase payroll tax cap to cover 90 percent of wages by 2050 • Create new minimum and old-age benefits	• Slow benefit growth for high- and medium-income workers • Index normal retirement age to longevity until it reaches 70 • Create optional personal accounts of 2% for the first $10,000 and 1% of income between that and payroll tax cap, eventually increasing to 8 percent up to the inflation-adjusted level, and 4 percent of payroll above that, for those under 55 • Use general revenue to replenish trust funds • Create new minimum benefit	• Slow benefit growth for high-income workers • Index benefits to longevity • Index COLAs to chained CPI • Include newly hired state and local workers • Increase cap to 90% • Create new minimum and old-age benefits	• Slow benefit growth for high- and medium-income workers • Increase normal retirement age and index for longevity • Index COLAs to chained CPI • Include newly hired state and local workers • Create new minimum and old-age benefits • Create mandatory add-on accounts • Reduce and make the payroll tax more progressive (replace revenues with some of the proceeds from energy tax)	• Remove cap on employer side of Social Security • Index COLAs to chained CPI	• Price index initial benefits • Increase retirement age by two months after 2010 until it reaches 70 for those born after 1971, increasing one month every other year after that
Health Care	• Reform the "doc fix" and pay for it by: ➢ Increase Medicare cost sharing ➢ Tort reform • Replace SGR with modest reductions and make new schedule • Expand successful payment reform	• Allow interstate purchasing, small business pools, and state-based exchanges • Tort reform • If 45% or more of Medicare funding is from general revenues, a 1% reduction in provider payments applies, starting in 2020 • Increase Medicare cost	• Tort reform • Increase Medicare cost sharing • Reduce payments to Rx companies • New premium support (vouchers) program • End Medicaid matching system	• Create a non-open-ended budget for health care • Tort reform • Increase Medicare cost sharing • Reduce new health-care subsidies from health-care reform law • Strengthen IPAB • Index eligibility age	N/A	• Block grant and freeze Medicaid spending • Cut Medicare payment error rate by 50% • Increase Medicare premiums • Repeal health-care reform legislation • Tort reform • Increase Medicare

Major Areas of Each Plan	Fiscal Commission Co-Chair Proposal	Representative Paul Ryan's Roadmap	Debt Reduction Task Force (Domenici-Rivlin)	Galston-MacGuineas Plan	Center for American Progress 50/50 Plan	CATO's "Downsizing Government Plan"
	pilots • Strengthen IPAB • Identify an additional $200 billion in savings • Establish long-term target for total health-care spending and limit health-care cost growth after 2020 to GDP+1%	sharing • Create a new system of vouchers to replace Medicare and Medicaid. Medicare vouchers would grow by 2.7 percent over the long-term, but Medicaid vouchers would grow at an undetermined rate • SCHIP population eligible for health-care tax credit		for Medicare to longevity		deductibles
<u>Other Mandatory</u>	• Index programs to chained CPI • Reform military and civil service retirement • Reduce farm subsidies • Reduce student loans • Various others	• Starting in 2020, spending growth is assumed to be limited to CPI plus 0.7% • Improve job training	• Reform military and civil service retirement • Index programs to chained CPI • Reform farm subsidies • Various others	• Reform military and civil service retirement • Index federal salaries to private-sector wage growth • Reform farm subsidies • Various others	• Reform military and civil service retirement • Index programs to chained CPI • Reform farm subsidies • Cut veteran's disability compensation • Cut Universal Service Fund	• Cut agriculture subsidies • Cut workforce by 10% • Freeze federal pay for three years • Reform federal retirement benefits
<u>Tax Expenditures</u>	**Option 1 (Zero Plan):** • Eliminate all tax expenditures as starting point **Option 2 (Wyden-Gregg Style):** • Eliminate some tax expenditures (some business tax expenditures, S&L deduction, cafeteria plans, others); limit others (mortgage deduction, charitable deductions, health exclusion,	• Eliminate health-care exclusion with refundable credit as part of health reform • Clear out nearly all of the existing tax deductions and credits	• Eliminate most tax expenditures • Eliminate employer health exclusion • Restructure tax benefits for low-income families with an earnings credit equal to 21.3% of first $20,300 of earnings • Restructure tax benefits for families with children with universal $1,600 credit per child • Eliminate standard	• Gradually reduce tax expenditures by 10%, index to inflation, divide proceeds between lower tax rates and deficit reduction • Examples: o Reduce home mortgage deduction from $1 million to $500,000 and eliminate for vacation homes o Repeal health-care exclusion and replace with credit	**Eliminate:** • Deduction for business meals and entertainment • Exemption of credit union income • Capitals gains treatment of certain income from sales of agricultural items • Special Blue Cross/Blue Shield deduction • Exception from passive loss rules for $25,000 of rental loss • Various others	• Cut EITC by 50% • Eliminate refundable portion of Child Tax Credit

Major Areas of Each Plan	Fiscal Commission Co-Chair Proposal	Representative Paul Ryan's Roadmap	Debt Reduction Task Force (Domenici-Rivlin)	Galston-MacGuineas Plan	Center for American Progress 50/50 Plan	CATO's "Downsizing Government Plan"
	others) • Triple standard deduction • Permanently extend R&D tax credit **Option 3 (Trigger):** • Enact tax reform by 2012 or impose gradually growing across-the-board haircut for certain tax expenditures		deduction and personal exemptions	o Phase out the deduction for state and local taxes o Consolidate tax breaks for education • Consolidate tax breaks for saving	**Reduce:** • Exclusion of interest on life insurance savings • Exclusion of interest on private purpose bonds	
<u>**Tax Reform**</u>	• Assumes 2001/2003 tax cuts under $250,000 extended • Index all of tax code to the chained CPI • Increase gas tax by $0.15 starting in 2013 • Eliminate AMT, Pease, PEP **Option 1 (Zero Plan):** • Lower individual and corporate income tax rates to 8%, 14%, and 23% (26% corporate) and increase rates if any tax expenditures are added back • Tax capital gains and dividends as normal income **Option 2 (Wyden-Gregg Style)** • Lower income tax rates to 15%, 25%, 35%, and 26% (corporate) • Move to a territorial tax system	• Cap total revenue at 19% GDP • Assumes all 2001/2003 tax cuts extended • Offers individual taxpayers a choice: current tax system or new Simplified Tax: 10% rate for <$50,000 single filers ($100,000 for joint filers) or 25% rate for >$100,00 single filers ($200,000 joint filers) • Eliminate taxes on estates, dividends, capital gains • Repeal AMT • Increase standard deduction • Eliminate corporate income tax and replace it with a business consumption tax of 8.5% on goods and services	• Assumes 2001/2003 tax cuts under $250,000 extended • Payroll tax holiday • Reduce income tax rates to 15% and 27% (and 27% corporate) • Repeal AMT • Index all of tax code to the chained CPI • Tax capital gains and dividends as ordinary income (top rate of 27%), with $1,000 exclusion for capital gains • Introduce a 6.5% "Debt Reduction Sales Tax" or VAT • Adjust excise tax on alcoholic beverages to $0.25/oz • New tax on manufacture and importation of sweetened beverages	• Institute a carbon tax (some proceeds go to reduce payroll tax) • Assumes 2001/2003 tax cuts under $250,000 extended • Revenue-neutral corporate tax reform to broaden base and lower rate • Index all of tax code to the chained CPI	• 2% surtax on income $1,000,000-$10,000,000 • 5% surtax on income $10,000,000 and above • Assumes 2001/2003 tax cuts under $250,000 extended • $5 per barrel tax on foreign imported oil	• Assumes all 2001/2003 tax cuts extended • Eliminate tax increases in health-care reform legislation

Major Areas of Each Plan	Fiscal Commission Co-Chair Proposal	Representative Paul Ryan's Roadmap	Debt Reduction Task Force (Domenici-Rivlin)	Galston-MacGuineas Plan	Center for American Progress 50/50 Plan	CATO's "Downsizing Government Plan"
	Option 3 (Trigger): • Enact tax reform by 2012 or impose gradually growing across-the-board haircut for certain tax expenditures					
Budget Process	• Institute fiscal goals of primary balance by 2015 and debt stabilization thereafter • Enact discretionary caps and create firewall between defense and non-defense, with enforcement mechanisms • Cap revenues at 21% of GDP • Annual review to determine if budget on sustainable path; if not, lawmakers required to fill gap • Budget for disaster funds; tougher limits and transparency for emergencies • Move to biennial budgeting • Supermajority enforcement for spending and revenues • Weak economy would suspend process	• Establish binding cap on total government spending as a percent of GDP • Every five years, evaluate to see if spending will increase at an "out of control" manner, faster growing programs would be slowed by no more than 1% • 3/5 majority required to increase taxes	• Enact discretionary caps on defense and nondefense spending, with enforcement mechanisms • Apply PayGo to revenues and mandatory spending • Move to biennial budgeting • Enact explicit long-term budgets for entitlement programs	• Institute fiscal goal of 60% debt–GDP by 2020 • Enact nondefense discretionary cap • Enact cap and PayGo rules for tax expenditures	N/A	N/A

Major Areas of Each Plan	Fiscal Commission Co-Chair Proposal	Representative Paul Ryan's Roadmap	Debt Reduction Task Force (Domenici-Rivlin)	Galston-MacGuineas Plan	Center for American Progress 50/50 Plan	CATO's "Downsizing Government Plan"
Fiscal Metrics 20/20	Spending **22.0%** Revenue **20.5%** Debt **65%** Long-Term Debt (2035) **43%**	Spending **22.5%** Revenue **18.5%** Debt **69%** Long-Term Debt (2035) **93%** (2080) **0%**	Spending **23.0%** Revenue **21.5%** Debt **60%** Long-Term Debt (2035) **52%**	Spending **22.0%** Revenue **21.5%** Debt **60%**	N/A	Spending **18.5%** Revenue **18.5%** Debt **61%**

Source: The Committee for a Responsible Federal Budget.
http://crfb.org/sites/default/files/CRFB_Summary_Table_of_Fiscal_Plans.pdf

IX. Appendix 2

Solving the nation's fiscal condition solely on spending reductions will require difficult budget decisions. This paper provides an aggregate framework for getting to a balanced budget. However, many specific reductions have already been identified in the reform plans put forward by the individuals and groups listed in appendix 1.

This appendix discusses a few spending-reduction plans in more detail to illustrate how fiscal balance can be achieved without tax increases. The following is not to imply endorsement of any particular method by which fiscal balance can be achieved. This is merely and illustration to show that some plans have already identified the spending reductions necessary to balance the budget. Additionally, while not always an apples-to-apples comparison, other plans contain pieces that when combined together can balance the budget without tax increases.

Table 5 - One Percent Reduction	Actual				Projections							
Begin in FY2012; Revenue 18% GDP	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Outlays												
Mandatory	1,451	1,595	2,093	1,910	1,910	1,891	1,872	1,853	1,834	1,816	1,798	1,780
Discretionary	1,041	1,135	1,238	1,349	1,349	1,336	1,322	1,309	1,296	1,283	1,270	1,258
Subtotal	2,492	2,730	3,331	3,259	3,259	3,226	3,194	3,162	3,130	3,099	3,068	3,037
Net interest	237	253	187	197	225	264	325	394	459	527	592	646
Total Outlays	2,729	2,983	3,518	3,456	3,484	3,490	3,519	3,556	3,589	3,626	3,660	3,683
GDP				14,513	15,034	15,693	16,400	17,258	18,195	19,141	20,033	20,935
Total Revenues	2,568	2,524	2,105	2,162	2,228	2,555	2,952	3,106	3,275	3,445	3,606	3,768
Deficit (-) or Surplus	(161)	(459)	(1,413)	(1,294)	(1,256)	(935)	(567)	(450)	(314)	(181)	(54)	85

Notes: FY2011 Outlays are held to FY2010 Level, Interest estimate is CBO for FY2011 so Total Outlays is slightly higher in FY2011 than FY2010
One percent reduction begins in FY2012, based off of FY2011 Outlays for Mandatory (non-interest) and Discretionary spending
Total Outlays includes CBO estimated interest on the debt - no adjustment is made for interest payments. If interest cost rise/decline, other reductions/increases would be made to achieve one percent total reduction
To be conservative: (1) Total Revenues are assumed to be equal to CBO estimates for FY2011 & FY2012 and then at a level equal to 18 percent of GDP for FY2013 forward; and
(2) interest payments, which increase rapidly in future years, are held to current CBO estimates
GDP estimates are from the Congressional Budget Office, January 2011

Total outlays in FY2010 were \$3.456 trillion, of which \$1.910 trillion was mandatory spending, \$1.349 trillion was discretionary spending, and \$253 billion was spent on interest payments. As noted earlier in the paper, by merely holding spending constant at the same nominal level as FY2010 would balance the budget between 2015 and 2018, depending on whether revenues as a share of GDP are 19 percent, 18 percent or 17 percent.

As the table above shows (and as shown earlier), assuming revenue of 18 percent of GDP, the federal government would collect \$3.768 trillion in revenues in 2018. Allowing for the more conservative \$646 billion CBO estimate for FY 2018 interest payments (as discussed earlier in this paper), the federal government would need to spend less than approximately \$3.122 trillion in order to achieve fiscal balance in FY 2018, or reduce nominal outlays so they are 4.2 percent below FY2010 nominal levels. However, according to CBO estimates, federal spending in FY 2018 will reach $4.885 trillion, including interest payments. Subtracting the $646 billion in FY 2018 interest payments would equate to federal spending of approximately $4.239 trillion, or $1.117 trillion above the $3.122 trillion needed to achieve fiscal balance in FY 2018. Hence, to balance the budget within the next decade, a little over $1 trillion in spending reductions must be identified.

Chris Edwards identifies $1.1 trillion in spending reductions in his reform plan, "A Plan to Cut Spending and Balance the Federal Budget."[33] Edwards does this by saving $56.9 billion annually in the Department of Agriculture by ending farm subsidies ($28.7 billion), ending rural subsidies ($2.6 billion), and reducing food subsidies ($25.6 billion). The Department of Commerce is reduced by $2.4 billion, the Defense Department by $150 billion and the Department of Education by $94 billion. The Department of Energy is reduced by $20.3 billion, the Department of Housing and Urban Development by $53.1 billion, the Department of Justice by $4.9 billion, the Department of Labor by $6.7 billion and the Department of Transportation by $12.1 billion.

Edwards also reduces entitlement spending by reducing Social Security by $93.0 billion by indexing initial benefits to prices instead of wages ($60 billion) and raising the retirement age ($33 billion). Additional reforms to Medicare and Medicaid would reduce outlays in the Department of Health and Human Services by $421.5 billion through block-granting Medicaid ($87 billion), increasing Medicare premiums ($40.1 billion), and other reforms. He also proposes reducing the Earned Income Tax Credit and to end the refundable portion of the Child Tax Credit for $46.5 billion in spending reductions. Other reforms, including reductions to the Environmental Protection Agency and Small Business Administration would reduce spending by $94.4 billion. In total, Edwards identifies $1.1 trillion in spending reductions. Enough to balance the budget by 2018.

Though not listed among the plans described in appendix 1, Nick Gillespie and Veronique de Rugy point out in their plan, "How to Balance the Budget Without Raising Taxes: The 19 Percent Solution," that the budget could be balanced by 2020 by holding spending to 19% of GDP. This would "mean $1.3 trillion in cuts over the next decade, or about $129 billion annually out of ever-increasing budgets averaging around $4.1 trillion. Note that these are not even absolute cuts, but trims from expected increases in spending."[34]

---

[33] Edwards, "A Plan to Cut Spending."
[34] Gillespie and de Rugy, "19 Percent Solution."

In the table below, Gillespie and de Rugy suggest the following reductions in order to achieve their $1.3 trillion in spending reductions relative to the CBO Alternative Baseline:

Table 6. Reductions Necessary Relative to CBO Alternative (Billions of 2010 Dollars)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
National Defense	$25.3	$23.8	$22.6	$22.0	$21.3	$20.7	$20.3	$19.7	$19.3	$18.7
Non-Defense Discretionary	$25.3	$23.8	$22.6	$22.0	$21.3	$20.7	$20.3	$19.7	$19.3	$18.7
Medicare	$20.0	$20.8	$21.6	$21.5	$21.5	$21.0	$21.1	$21.2	$21.3	$21.9
Medicaid	$9.5	$9.6	$9.7	$10.7	$11.6	$12.9	$13.7	$14.0	$14.2	$13.9
Social Security	$25.7	$27.0	$27.3	$27.1	$26.5	$25.8	$25.8	$25.8	$25.8	$25.8
Other	$22.9	$23.7	$24.9	$26.1	$27.1	$27.5	$28.0	$28.3	$29.3	$29.6
Total Annual Reductions	$128.7	$128.7	$128.7	$129.3	$129.3	$128.7	$129.2	$128.7	$129.2	$128.7
New Annual Spending	$3,521.8	$3,292.1	$3,275.1	$3,337.8	$3,409.6	$3,504.8	$3,562.7	$3,625.1	$3,690.9	$3,761.3
Projected Annual Spending Without Any Reduction	$3,650.5	$3,549.5	$3,661.2	$3,853.2	$4,054.2	$4,278.1	$4,465.2	$4,656.3	$4,851.4	$5,050.5

Source: "The 19 Percent Solution: How to Balance the Budget Without Increasing Taxes," Nick Gillespie and Veronique de Rugy. Reason Magazine. March 2011.

In "A Thousand Cuts: What Reducing the Federal Budget Deficit Through Large Spending Cuts Could Really Look Like," the Center for American Progress (CAP) released a report with options to reduce spending that would bring the budget into "primary balance" by 2015.[35] Primary balance is when revenues equal outlays, not including interest payments on the debt. CAP determined that $255 billion would have to be reduced to achieve primary balance. CAP achieves primary balance by reducing farm subsidies by 75 percent, or $11.3 billion. CAP shows savings to Social Security of $12.0 billion, or 1.4 percent by changing how cost-of-living adjustments are based from the CPI-W to the Chained CPI-U. In totally, CAP describes $56.7 billion in mandatory spending reductions.

By eliminating the F-35 Joint Strike Fighter ($4.8 billion) and additional reductions to the V-22 Osprey, CVN-80 aircraft carrier, R&D and other smaller reductions, CAP is able to reduce defense spending by $108.7 billion. Nondefense discretionary is cut $89.2 billion with most of the reductions coming from the Federal Highway Administration ($29.6 billion), international security assistance ($8.2 billion) and a 20 percent reduction in spending for the Federal Aviation Administration ($3.6 billion). In its report, CAP goes on to identify specifically where reductions to these programs and agencies would come from, though CAP cautions that "…cuts involved in this plan are extraordinarily deep."[36]

These plans are just three examples illustrating the reductions that can be made in order to balance the budget within the next decade without tax increases. Again, while not always an apples-to-apples comparison, other plans contain pieces that, when combined together, can balance the budget

[35] The Center for American Progress, "A Thousand Cuts: What Reducing the Federal Budget Through Large Spending Cuts Could Really Look Like," September 2010, http://www.americanprogress.org/issues/2010/09/thousand_cuts.html.
[36] Ibid.

without tax increases. All of these plans have been discussed and debated in the public domain. The Center for A Responsible Federal Budget prepared a side-by-side comparison of twelve plans and can be accessed online here: http://crfb.org/sites/default/files/CRFB_Summary_Table_of_Fiscal_Plans.pdf