Has the Bill Arrived?
Clarifying the Debate on Taxes, Spending and Debt

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This year, you’ll hear nearly every candidate running for any kind of national office – president, senator or representative – talk about taxes, government spending, and what to do about the federal budget. They’ll comment on how important the issue is and how much they care about a balanced budget. Some of them will offer specific ideas for keeping taxes under control, creating new programs or cutting waste. But they may not always talk about how they’re going to pay for their promises.

What they say will probably sound pretty good – they are politicians after all – but here’s a little backgrounder that can help you think through just how much to trust what they have to say and to help you evaluate which one is most likely to tackle this problem in ways you think will work.

Here’s what we have for you:

The Fix We’re in Now
The basic facts – the very least you need to know to get a grip on this issue

So What’s the Plan?
Three different directions the country could go in, complete with important pros and cons for you to think about (and argue with someone else about if you like)

Quotes to Consider
Americans don’t agree on much these days – certainly not about taxes and how to deal with the federal budget. Here are what some influential Americans have to say on the topic – quick and to the point

Starting Statistics
(and Ones You Need to Know)
You can let the numbers do the talking with our quick set of charts and graphs that will help you understand a lot more about what’s at stake, what’s possible and what’s pie in the sky

“This is the day after tax day, of course. See, this is the day that unites people, I think. It’s a day when wealthy Americans with money from big cities are just as bitter as Americans in small towns who are broke.”

— Jay Leno
Right now, the U.S. economy seems to be in shambles, and most Americans want the government to play some role in helping us get through this. But government’s ability to help out – whether by cutting taxes or stabilizing the financial system or helping Americans who are down on their luck – is severely hampered by its own dire economic condition.

For 31 out of the last 35 years, the U.S. government has spent more on programs than it has collected in taxes. This year, the red ink (that’s the deficit) could be close to half a trillion dollars.

When the government spends more money than it collects, it borrows to cover the cost. Over time, the U.S. government has accumulated a staggering $9.5 trillion federal debt. Right now, we spend more money each year on interest on that debt than we spend on the war in Iraq.

There’s simply no way the government can cut taxes, or even keep them at current levels, and still afford all the programs people say they want. Something’s got to give.

Budget experts across the political spectrum – liberals, conservatives and the government’s own auditors – say the country is facing huge additional expenses in Medicare and Social Security now that retiring baby boomers are beginning to leave the work force.

Medicare is the biggest problem. Not only does Medicare have to cover the needs of 78 million baby boomers, it also has to deal with health care costs that are rising much faster than the rate of inflation.

If we do nothing, the country’s debt will be growing faster than our economy in about 15 years, which means we won’t be able to keep up. By 2040, the country would need nearly every dollar it collects in taxes just to cover the costs of Medicare, Medicaid, Social Security and interest on the debt.

To protect Americans who rely on Social Security and Medicare and reduce the unsustainable costs of these programs, we need to start reforming them right away. Relatively small changes now will make a big difference later, but the longer we wait, the harder this will be for everyone.


**Federal spending**


The U.S. has been living beyond its means—way beyond its means. We’ve been running the government on credit and racking up a huge amount of debt. What’s more, we have some very big expenses ahead: the 78 million baby boomers who have been paying into Social Security and Medicare are beginning to start pulling money out. These facts have led experts inside and outside of government—both conservatives and liberals—to warn of an approaching “fiscal train wreck” unless we take measures to address the problem.

It’s not some hazy, far-off, inside-the-beltway problem. If the red ink keeps flowing and we don’t face up to some realistic choices on the budget and Social Security and Medicare, we could jeopardize the health of our economy and our standard of living. The choices we make now will affect the amount of your paycheck, whether you can get a college loan or home mortgage, whether interest rates are high or low and whether older Americans (maybe that’s you, or your parents or grandparents) can make ends meet and get the medical care they need. So here’s what we’re facing:

Where the Money Goes

To put the federal budget into perspective, consider your personal finances. When you make a household budget, you start with certain fixed expenses: rent or mortgage, utility bills, insurance, etc. What’s left over can be spent at your discretion. The same principle applies to the national budget, expected to total $3.1 trillion in 2008.

More than 40 percent of the federal budget goes to fixed expenses like Social Security, Medicare and Medicaid. The government is obligated by law to pay these “mandatory” programs. They’re also known as entitlements, because when you reach a certain age or drop below a certain income level, you’re entitled to them. The benefits are set by specific formulas, so they’re essentially on autopilot.

About 20 percent of the budget goes to defense. It’s a huge amount of money, but the defense budget took up an even larger share of the budget (over 25 percent) in the late 1980s.

Interest on the federal debt accounts for 9 percent of the budget. No way around that. The country has to pay it. Think of it as the equivalent to the minimum balance payment on your credit card.

What’s left over is called “non-defense discretionary” spending, which is essentially everything else, from parks to foreign aid. It’s this part of the budget that attracts the most debate, with politicians annually haggling over how much to spend and on what.

Federal budget: expenditures

Federal outlays by function, in billions, fiscal year 2007

Note: Federal outlays totaled $2.7 trillion in 2007.

Social Security and Medicare: Why the Experts Worry

One very big problem in the budget is federal spending on Social Security and Medicare, which is on the rise and is going to keep on rising for quite a while. Here’s what you need to keep in mind:

Social Security is a pay-as-you-go system. People working now pay taxes that are mostly used to pay benefits for people who are retired now. Now that the huge baby boom generation is getting older, the number of retired people is about to rise dramatically.

The first baby boomers have just started applying for Social Security. An estimated 10,000 people a day will become eligible for Social Security benefits over the next two decades.

In 2017, Social Security will start paying out more in benefits than it collects each year in payroll taxes.

There is a Social Security trust fund, which will run out in 2041, but since politicians have already borrowed money from it to cover other government expenses, that’s not as comforting as it sounds. Meeting Social Security’s expenses will put pressure on the government long before 2041.

Sometimes people say Social Security will go bankrupt in 2041, but that’s not exactly true. Workers will still be paying into the system, so it will still function, but it would only be able to pay three-quarters of the promised benefits.

Medicare, the giant health care program that covers the elderly and disabled, is facing a double whammy. Not only does Medicare face a rising tide of boomers, but it also gets hit by the rapidly rising cost of health care.

Projections say the Medicare trust fund will be exhausted in 2019, a mere 11 years away. At that point, the federal government would either have to cut benefits, raise premiums or shift money from other programs to cover the costs.

The worst-case scenario would be that the country keeps procrastinating. The entitlement programs, flying along on autopilot, could become just plain unaffordable or the government has no money left to do anything else. That would leave us in a horrendous position. Either we would have to start putting crushing taxes on working people to cover the cost or we would have to cut back on benefits for people who are frail and elderly. This is a choice we can avoid if we start making reforms to Social Security and Medicare right away.

Continues on next page

Fewer workers per Social Security beneficiary

Covered workers per Old-Age, Survivors and Disability Insurance (OASDI) beneficiary, 1950 – 2040

WHERE THE MONEY COMES FROM

So we know where the money goes once it comes in, but where does it come from? To pay the bills, the government relies on tax revenue from you, your neighbors and your employers. Here’s the big picture:

- 45.3 percent comes from income taxes. Although income taxes are always controversial, it’s worth noting that the top tax rates today are substantially lower than they were after World War II, really up through the mid-1980s. President Bush and Congress passed significant cuts in 2001 and 2003, but these are set to expire in 2010.

- 33.9 percent are payroll taxes for Social Security and Medicare. These are taxes paid by workers and matched by their employer.

- 14.4 percent comes from corporate taxes. Although the first images that come to mind may be big corporations like Exxon Mobil and Microsoft, it’s worth remembering that this category also includes small businesses and even “mom-and-pop” stores.

- The remainder comes mainly from taxes on alcohol, tobacco and gas. These excise taxes make up about 2.5 percent of the government’s revenues. States also collect taxes in these areas, so if you’re really steamed about taxes on gas or cigarettes, you probably need to blame both the feds and elected officials closer to home.

Both revenues and spending climbed to record levels in 2008. But we are still spending more than we take in – hence, the deficit. The White House projects the federal deficit will hit a record $480 billion in 2008 – and that projection may well be low, since it doesn’t take into account the full cost of the wars in Iraq and Afghanistan. The nonpartisan Congressional Budget Office projects that deficits will remain above $400 billion a year through 2010. The CBO projects the deficit will go down after that, but they estimate the government will be running deficits through 2018, even if we let the Bush tax cuts expire as planned in 2010.

What usually happens, however, is that the revenue isn’t enough to cover all the expenses – that’s considered a deficit. Every year that there’s a deficit, the government borrows money to cover its bills, often from banks and foreign countries such as China. The total tally of all the past deficits, plus interest, is called the national debt. We’ve added more than $3.5 trillion to the debt since 2001.
Another Day Older and Deeper in Debt

The national debt is remarkably similar to your personal credit card. Think of the debt as the total amount you owe. You have to make regular minimum payments, which is the interest. Every time you ring up a new charge (the deficit), you add to the total debt. So even if you stop making any new charges (eliminate the deficit), you still have this outstanding debt that requires interest payments. Interest payments on the national debt are the fifth-largest spending category in the federal budget, just behind the defense and the three major entitlement programs.

One other development that worries many people is that about a quarter of the national debt is now held abroad. Our top lender is Japan, but China is right behind. The top ten list also includes “oil exporting” nations and Caribbean banking nations. In some ways this is a compliment because it means that other countries consider U.S. Treasury bonds a good place to put their money. The risk is that, at some point, some of them may decide that they would rather put their money elsewhere, which could leave the U.S. government in a credit crunch. Some foreign policy experts also worry that this reduces our influence worldwide – we are less likely to really press the Chinese, for example, on intellectual property rights or global warming because we need them to keep lending us money.
The Time Has Come

The nation’s finances are actually a bunch of interconnected problems. The national debt has grown because of the government’s inability to balance its year-to-year budget. Social Security needs help because of the demographic pressure from the baby boomers, while Medicaid expenses are rising because of skyrocketing health care costs. And Medicare is in trouble because of demographics and health care costs together.

But while the solutions to each of these may be unique, each also has to be tackled as part of the larger problem.

The next president and Congress won’t be able to avoid some choices here. President Bush’s tax cuts are set to expire in 2010; whether some or all of them are extended will have a significant impact on the year-to-year budget. Republicans have argued that the tax cuts helped jump-start economic growth and contributed to an increase in revenues. Democrats say most of the tax breaks were skewed to the wealthy and instead spurred the record deficits.

Most experts also say that the sooner we start on reforming entitlement programs, the less painful the adjustments will be. Waiting until the crisis is upon us would require really drastic measures, either in terms of raising taxes or cutting benefits.

What happens in Iraq and Afghanistan will have an impact on the budget, too. Some people blame the wars for the skyrocketing national debt, but that’s only partly true, at best. The Congressional Budget Office estimates the government spent $651 billion on the “war on terror” between September 2001 and February 2008. During that same period the national debt swelled by about $3.2 trillion. The CBO estimates that, presuming we maintain a presence in both countries the war on terror could be as high as $1.7 trillion by 2017.

All this means that the future of our economy and way of life may be dramatically affected by the choices we make today for managing the nation’s finances. The debate over the budget is certain to play out in the 2008 election. The numbers are large and the problems daunting. Where do we begin?

Social Security and Medicare spending: a larger part of the federal budget

Federal outlays, in billions, 1970 and 2007

Note: Federal outlays totaled $195.6 billion in 1970 and $2.7 trillion in 2007.
SO WHAT’S THE PLAN?

The next American president and the new Congress will face some very difficult decisions about our nation’s financial future. For many years, the country has gone into debt rather than face up to the tough choice between raising taxes or cutting government programs that people like. Elected officials have also been stalling on making needed changes in Social Security and Medicare. It’s not popular to suggest raising taxes to provide more revenues for these programs, and it’s not popular to suggest cutting benefits or raising the age of retirement. But frankly, it’s getting late. The boomers are already starting to retire, and postponing action in this area will only make the problems worse. Here are three approaches that focus on what the next president and Congress should do.

**Approach One:**
Balance the budget as quickly as possible and make sure it’s balanced from here on out, including raising taxes to cover what we spend.

**Approach Two:**
Immediately focus on Social Security and Medicare, including raising taxes and fees to recipients and trimming benefits for recipients down the road.

**Approach Three:**
Keep taxes as low as possible, but reduce the size of government by making major cuts in popular areas such as defense, health care, education and higher education.

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**Federal deficit/surplus**
Federal deficit or surplus, in billions of current and constant 2000 dollars, 1970 – 2007

APPROACH ONE: BALANCE THE BUDGET AS QUICKLY AS POSSIBLE

Balance the budget as quickly as possible and make sure it’s balanced from here on out, including raising taxes to cover what we spend.

The first order of business has to be getting the nation’s checkbook in order. We live in a consumption-oriented culture, and the government is leading the spending parade. All our borrowing and spending has gotten out of hand, and we simply cannot continue to run deficits without paying the consequences. Every time we run a deficit, the government has to borrow money to make up the difference, and our national debt has reached enormous levels. We should not burden our children and grandchildren with the huge debts we were unwilling to pay.

This should be done by:

- Passing “pay-as-you-go” legislation, meaning that if a spending bill is passed, it must be offset by either a spending cut somewhere else in the budget or a raise in taxes to cover the new expenses.
- Letting all or at least some of the Bush tax cuts expire to help reduce the deficit.
- Setting long-term financial goals to pay down the debt.
- If we manage to run a surplus, using any extra funds to pay off the debt or bail out entitlement programs.
- Passing a balanced budget amendment to the Constitution. Most states have this and it simply makes it illegal to run a deficit and run up debt.

Arguments for:

- If government won’t take responsibility for its spending habits, then we need to remove the option of borrowing and creating more debt. Running deficits is irresponsible and dangerous.
- Why should the government run its financial house any differently from the way families and businesses run theirs? Your spending has to be in line with your income.
- Income taxes are at historically low levels. It’s time to raise taxes to stop the flow of red ink. That’s what we did in 1990, and combined with spending cuts, that’s what led to the budget surpluses of the late 1990s.

Arguments against:

- Forcing the government to maintain a balanced budget is like a financial straightjacket. There’s no wiggle room for wars, national emergencies or recessions, when we would really need extra funds.
- Deficits aren’t necessarily bad. The U.S. has run on deficits for several generations, and the economy has grown. Plenty of economists say deficits actually help spur economic growth.
- Raising taxes just gives government more money to waste. Why should taxpayers dig into their pockets while the budget is still fat with earmarks and unexamined billions in the defense budget?
- Balancing the budget is only part of the challenge. Unless we get a grip on the entitlements, particularly Medicare, we’ll never have our finances under control.

Growing number of Medicare beneficiaries
Past and projected enrollment in Hospital Insurance (HI) and Supplementary Medical Insurance (SMI), in thousands, 1970 – 2050

APPROACH TWO: IMMEDIATELY FOCUS ON SOCIAL SECURITY AND MEDICARE

Immediately focus on Social Security and Medicare, including raising taxes and fees to recipients and trimming benefits for recipients down the road.

Unless we act now, Social Security and especially Medicare will end up both breaking the budget and failing to serve the elderly when the baby boomers retire en masse. As Federal Reserve Chairman Ben Bernanke recently told Congress, the best time to get started addressing this problem was “10 years ago.” This simply cannot wait any longer. We shouldn’t change the rules for people who are already retired (or about to be), but we really have to make some changes or the programs will become unaffordable.

This should be done by:

- Reducing Social Security benefits for wealthy retirees and set higher fees and co-payments for higher income retirees on Medicare. These programs should provide security for middle-income and lower-income people—not extra spending money for affluent seniors.

- Raising the cap on Social Security taxes. Right now, payroll taxes are only collected on incomes up to $102,000 per year. That means that workers who make $200,000 and $300,000 a year are paying the same taxes as people who earn much less.

- Gradually pushing back the retirement age and phasing out the policy that lets people start collecting benefits at a lower rate at age 62. When Social Security began in 1935, life expectancy was about 61. Now, a child born in 2005 can expect to live to nearly 78.

- Allow Medicare to purchase drugs in bulk (and thus get cheaper rates). This is what the VA does and what other countries do to keep drug prices down.

Arguments for:

- Now is the best time to reform senior entitlement programs, while many of the baby boomers are still working and the number of seniors covered is relatively small.

- It’s more fiscally responsible to reduce benefits than to allow the programs to collapse entirely and leave nothing for our children.

- Social Security was conceived as a safety net. Reforms will keep the program financially sound so it can be there for future generations. Social Security should not provide extra income to affluent seniors who are fortunate enough to have very comfortable retirements.

- Baby boomers are living and working longer, and are in better health than when the entitlement programs began. Social Security is based on outmoded assumptions about who’s old. Why should people be encouraged to retire in their early and mid-60s?

Arguments against:

- We promised income and health security to the elderly, and we shouldn’t balance the budget on their backs—especially since elected officials borrowed from the Social Security Trust Fund.

- If we make wealthier Americans pay higher taxes for Social Security and we reduce the benefits they receive from the program, they may stop supporting it. Social Security needs broad political support.

- Focusing on cutting health care costs would be a much more effective strategy. Medicare is in much deeper trouble than Social Security, and that’s because health care costs are soaring.
APPROACH THREE: KEEP TAXES LOW, REDUCE THE SIZE OF GOVERNMENT

Keep taxes as low as possible, but reduce the size of government by making major cuts in popular areas such as defense, health care, education and higher education.

Federal spending has mushroomed since the 1970s, and government programs are rife with waste and mismanagement. Raising taxes to cover federal spending will just give government more of our hard-earned dollars to spend wastefully. Plus, keeping taxes low helps spur economic growth and allows Americans to keep more of their own money.

This should be done by:

- Extending the Bush tax cuts and reducing taxes on business – they are the engine of our economy.
- Cutting growth in government programs and carving out the waste and extra costs, such as outside contractors who charge the government billions of dollars each year.
- Eliminating earmarks and other “pork-barrel” add-ons to legislation that allow members of Congress to slip in funding for their pet projects without a vote.

- Shifting more domestic policy responsibilities – areas like Medicaid and education – to states.
- Having the private sector take on tasks like air traffic control and safety inspections. It can handle them more efficiently and at a lower cost.

Arguments for:

- By focusing on cutting waste, we’ll have a leaner budget to work with that will save money in the long run.
- Tax cuts spur the economy and help create jobs. If the economy is struggling, having a balanced budget won’t be all that comforting.
- The government should focus on truly national concerns, such as foreign relations and defense. The federal government doesn’t need to be in the health care or education business.

Arguments against:

- Ending earmarks and pork-barrel spending is important, but it doesn’t help that much when it comes to balancing the budget. Earmarks cost about $17 billion dollars in 2008. Meanwhile, the 2008 deficit is well over $400 billion.
- Over two-thirds of the budget goes to just five areas: defense, Social Security, Medicare, Medicaid and interest on the debt. The first four are broadly supported, and making cuts there will be extremely difficult politically. We have no choice in paying interest on the debt.
- Taxes are at historically low levels, and the benefits of the last round of tax cuts have gone disproportionately to very wealthy Americans. This plan means cutting government spending on health care and education to benefit the country’s more affluent taxpayers.

Top federal tax rates
Highest marginal individual income tax rate, 1970 – 2007

QUOTES TO CONSIDER

Think everyone agrees on the problem and what to do about it? Here’s a sampling of what some very different Americans have to say about the issue:

‘No government ever voluntarily reduces itself in size. Government programs, once launched, never disappear. Actually, a government bureau is the nearest thing to eternal life we’ll ever see on this earth!’
— President Ronald Reagan, TV Address, Oct. 27, 1964

‘The Social Security trust fund is what I call a fiscal oxymoron. It shouldn’t be trusted, and it’s not funded.’
— Pete Peterson, former U.S. Secretary of Commerce, 2005

‘The longer we wait, the more severe, the more draconian, the more difficult the adjustment is going to be. I think the right time to start is about 10 years ago.’
— Ben S. Bernanke, Federal Reserve Chairman, January 2007

‘Blessed are the young, for they shall inherit the national debt.’
— Herbert Hoover (1874 –1964), U.S. president

‘It is a popular delusion that the government wastes vast amounts of money through inefficiency and sloth. Enormous effort and elaborate planning are required to waste this much money.’

‘Raising taxes... won’t help balance the budget – it will slow the economic growth that is creating the new jobs of tomorrow and increasing revenue to the federal government. Keeping our economy strong and promoting fiscal responsibility will get the job done. Raising taxes won’t.’
— House Minority Leader John A. Boehner, February 2007
Some of the key sources for Taxes, Spending and Debt: Has the Bill Arrived? Are:

- Budget of the United States Government, Fiscal Year 2009
  Every number you could possibly want regarding the federal budget
  http://www.gpoaccess.gov/usbudget/

- The Long-Term Fiscal Outlook, December 2007; and
  The Budget and Economic Outlook: An Update, September 2008 Congressional Budget Office
  The problem as analyzed by the independent, nonpartisan agency set up to provide accurate budget numbers to Congress.

- The Nation’s Long-Term Fiscal Outlook, April 2008,
  U.S. Government Accountability Office
  An easy to read assessment of the trends and outlook on the budget from the government’s own auditor
  http://www.gao.gov/new.items/d08783r.pdf

- Facing Up to the Nation’s Finances
  A nonpartisan initiative to address the nation’s long-term fiscal problems; a joint effort by the Brookings Institution, Concord Coalition, Heritage Foundation, Public Agenda and Viewpoint Learning
  http://www.facingup.org

- Where Does the Money Go? Your Guided Tour to the Federal Budget Crisis, by Scott Bittle and Jean Johnson, Collins 2008