COUNCIL *on* FOREIGN RELATIONS

Renewing America

Progress Report and Scorecard

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Balance Owed: Federal Debt and Deficits

INTRODUCTION

The U.S. government faces an unsustainable long-term debt trajectory. Following the Great Recession of 2008–2009, the federal government accumulated significant new debt, with the ratio of debt to gross domestic product reaching levels not experienced since the 1950s. This debt growth was sharper in the United States than in most other large rich countries. In 2000, the United States had a lower debt burden than most other G7 members, but by 2015 it had nearly caught up to the G7 average. The good news is that U.S. annual budget deficits have fallen from highs of over $1 trillion annually from 2009 to 2012, or nearly 10 percent of GDP, to $435 billion in 2015, about 3 percent of GDP. But while the U.S. debt-to-GDP ratio is projected to be relatively flat in the near term, it will grow rapidly again in about a decade as entitlement spending rises with the aging population. By 2040, the ratio is projected to reach unprecedented peacetime levels. Among the G7 countries, only Japan is projected to have a higher debt-to-GDP ratio than the United States.

The danger posed by U.S. debt is not an outright default, which is highly unlikely, but rather a gradual slowing of the economy. Public debt consumes capital that may be more productively invested elsewhere. And if investors perceive that investing in U.S. debt is becoming riskier, they could charge higher interest rates. This would make it more expensive for the U.S. government to borrow. It would also raise market interest rates, making borrowing more expensive for home buyers, businesses, and consumers. For now, investors remain bullish on U.S. debt. But the consensus is strong among economists and policymakers that the long-term trend of debt growing at a faster rate than the economy is not sustainable.

Although Congress and the Obama administration have made progress in reducing annual budget deficits, they have not taken steps to bend the long-term debt curve, which would require significant reforms to cut spending or increase taxes. Spending on entitlement programs such as Medicare and Social Security, which are becoming increasingly costly, has been left mostly untouched while discretionary spending, which was set to decline anyway, has been slashed. Although these discretionary cuts did lower the current deficit, they did little to alter the long-term debt trend.

Entitlement reform is politically difficult because the programs are broadly popular. But other large rich countries are making dramatic reductions in their entitlement programs, even though they do not share the United States' advantages of a younger population, wealthier elderly who depend less on government support, and more room to raise taxes. Although both Democrats and Republicans agree that the U.S. government's current debt situation is untenable, the country is still far from agreeing on the best path to a sustainable fiscal policy.

PROS AND CONS OF GOVERNMENT DEBT

Government debt is not necessarily a problem. It provides the private market with liquid, risk-free investments and, at least in the case of U.S. debt, acts as a marker to gauge the riskiness of other investments. As with any kind of debt—public, personal, or business—whether it is prudent depends in large part on how the borrowed money is spent. Debt gives governments some spending cushion in unexpectedly difficult times, such as during an armed conflict or a recession when tax revenues fall and unemployment insurance claims rise. Government borrowing and spending can help maintain economic growth at times when private-sector investment or consumer spending is weak. Although it is true that future taxpayers will foot the bill for current debt obligations, governments can borrow to invest in ways that promote future economic growth. If debt is owned by domestic savers instead of foreigners, the direct net effect on a nation's wealth is not as significant because the debt is a future transfer from domestic taxpayers to domestic bondholders. Interest payments leave the country only if debt is foreign owned. And if the economy experiences strong growth, a debt burden can actually grow more manageable because more resources are available to draw on to pay it off.

But there is also a downside to taking on too much debt or allowing debt to grow too fast. Investors charge a higher interest rate if they believe buying government debt is increasingly risky—if, for instance, inflation is expected to rise or they question a government's ability to pay back the loan. Higher interest rates from investors make borrowing money more expensive for governments, worsening the debt situation. As a result, interest rates across the country rise, increasing the costs of mortgages, corporate loans, and credit card debt, all of which slow the economy. According to standard macroeconomic theory, government debt "crowds out" private investment; in other words, the debt absorbs private investment that would be more productively spent elsewhere. Studies suggest that higher debt levels correlate strongly with slower economic growth.[1] However, one influential study found that the debt trajectory is what matters, with debt having no effect on economic growth if the debt-to-GDP ratio is declining.[2]

The most sustainable debt situation therefore is one in which the overall debt level is low or, if it is high, it at least represents a steady or declining share of the economy. Debt reduction can also have a downside, however: spending cuts or tax increases can slow an economy, reversing any macroeconomic advantage from debt reduction. A slower economy can place greater demands on public services and reduce tax revenues, worsening the debt situation. Debt obligations placed on future taxpayers should be weighed against service or entitlement obligations to current and future citizens. But debt that grows faster than an economy's ability to pay it off cannot continue to accrue forever. At some point, a policy change is needed to place public debt on a more manageable trajectory.

WHERE THE UNITED STATES STANDS

For most national governments in modern history, including the United States, the norm has been to run annual budget deficits. The U.S. federal government has posted a deficit nearly every year since 1940, except for a few pockets in the late 1940s and late 1990s. Thanks to strong economic growth and small budget deficits, the huge public debt accumulated during World War II gradually fell as a share of GDP through the 1970s. Deficits spiked in the 1980s following the Reagan tax cuts and

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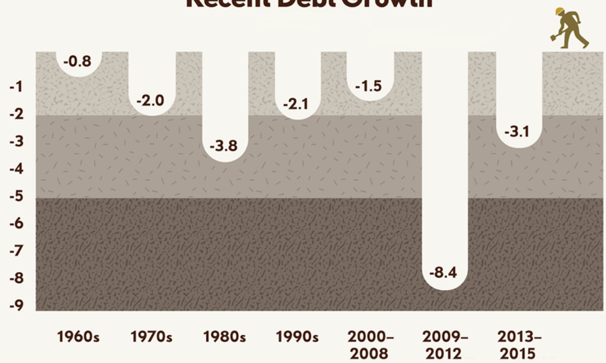
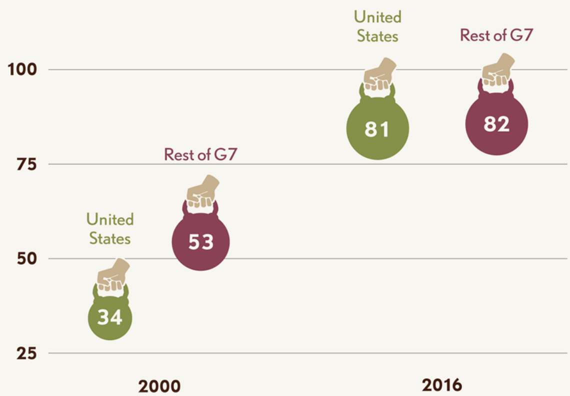
Recent Debt Growth



Average annual deficits as a percentage of GDP

Following the Great Recession of 2008–2009, the federal government ran historically large annual deficits.



Net public debt as a percentage of GDP

The United States was in a relatively better debt position compared with other big wealthy countries in 2000, but this is no longer the case.

spending increases, but then declined in the 1990s, the result of a combination of spending cuts, tax hikes, and a booming economy.

RECENT PAST (2009–2013): BIG DEBT GROWTH AFTER THE GREAT RECESSION

It was not until the Great Recession that budget deficits again became a serious concern, driven mostly by the weak economy.[3] From 2009 to 2012, the average annual deficit level was 8.4 percent of GDP, far exceeding average deficits of previous decades.[4] In 2000, U.S. public debt was 34 percent of GDP. As recently as 2007, it was still about 35 percent. By 2016, it had more than doubled to 81 percent, higher than any period since the early 1950s.[5]

The U.S. debt-to-GDP ratio has increased more than in most other large rich countries. The United States began the 2000s with a lower debt-to-GDP ratio than the average for other G7 countries.[6] Since then, U.S. levels have increased by more than twice the average rate of the rest of the G7 countries. The United States is now in a similar debt position to European countries like France that have long had higher public debt.

PRESENT AND NEAR FUTURE (2014–2025): HIGH BUT RELATIVELY STEADY DEBT

Despite the huge deficits caused by the recession, the federal government is set to have reasonably healthy finances over the next decade. By 2014, the deficit had fallen to 3 percent of GDP, which is close to the forty-year historical average.[7] A recovering economy has certainly helped boost federal finances. But so too have legislative changes since 2011, particularly cuts to discretionary spending and some small tax increases. Relative debt levels, however, are projected to increase a few percentage points by 2025. Relative debt levels will thus remain extremely high compared with the U.S. historical norm.

LONG-TERM FUTURE (BEYOND 2025): UNSUSTAINABLE DEBT GROWTH

The danger zone for U.S. debt is in the long term. By 2040, if current laws remain unchanged, public debt is projected to reach nearly 110 percent, equal to the highest levels reached during World War II.[8] Under more realistic policy and economic assumptions, it could reach 175 percent or higher.[9]

Driving these trends will be growth in entitlement spending programs such as Medicare, Medicaid, and Social Security, without a commensurate increase in tax revenues to pay for them. Entitlement spending has been increasing for decades, but it will grow even more rapidly as baby boomers draw from their old-age entitlements with fewer workers to pay for them. Medicare's cost growth will be greatest of all, not only because the elderly will be more numerous, but also because individuals are consuming more health-care services and health-care prices are rising, even if not as fast as in previous projections because health-care cost growth has recently slowed. Interest payments, too, will require a larger share of the budget to pay for past debt obligations, though the growth here will be more gradual. Revenues are projected to rise, mostly because of bracket creep, where inflation should move more incomes into higher tax brackets, but these higher revenues will not be enough to cover the spending increase.

Before the recession, the United States had one of the lightest debt burdens in the G7; by 2040, it is projected to have one of the heaviest. Beyond 2025, if current trends continue, U.S. debt-to-GDP levels are set to rise above nearly every other large rich country, with the sole exception of Japan.[10] The United States will not fare much better compared with all thirty-four members of the OECD; it is on pace to have the second-highest relative debt, again behind Japan.[11]

MORE FOREIGN-OWNED U.S. DEBT AND CHINA'S GROWING ROLE

Foreigners have a significant stake in U.S. debt that is much larger than it was in the past. Although growth in the share of foreign-owned U.S. debt has flattened during the 2010s, it is still higher than it was in 2000. Roughly half of U.S. debt available for purchase is currently owned by foreigners.[12] China and Japan are the largest owners by far; China in particular has been buying U.S. debt with zeal. The Chinese share of foreign-owned U.S. debt in 2015 was 21 percent—nearly four times what it was in 2000.[13] China has replaced Japan as the single largest investor in U.S. debt.

The geopolitical implications of foreign-owned U.S. debt are unclear. The United States may be more vulnerable if U.S. and Chinese

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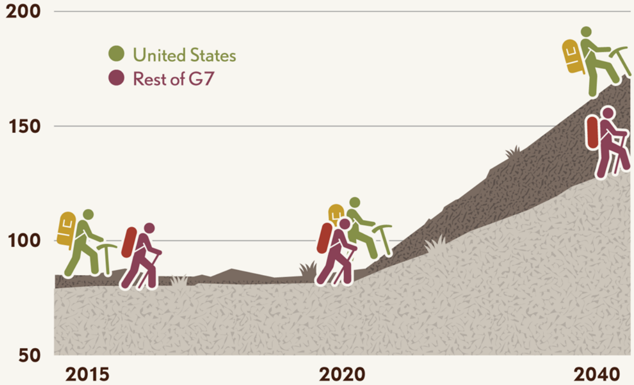
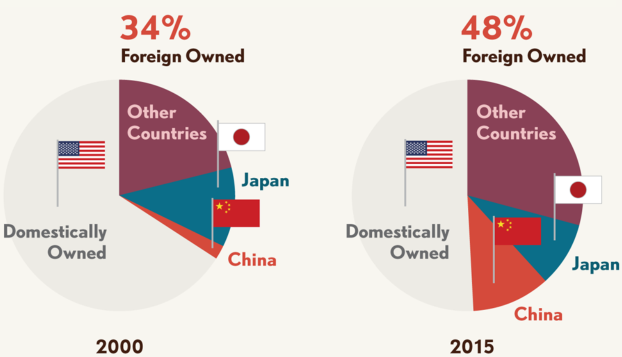
Long-Term Debt Problem



Net public debt as a percentage of GDP

Although U.S. debt as a share of GDP will be steady in the near term, it will skyrocket in the long term to levels higher than average for peer countries.



Share of U.S. public debt that is foreign owned

An increasing share of U.S. debt is being owned by foreigners, with uncertain geopolitical consequences.

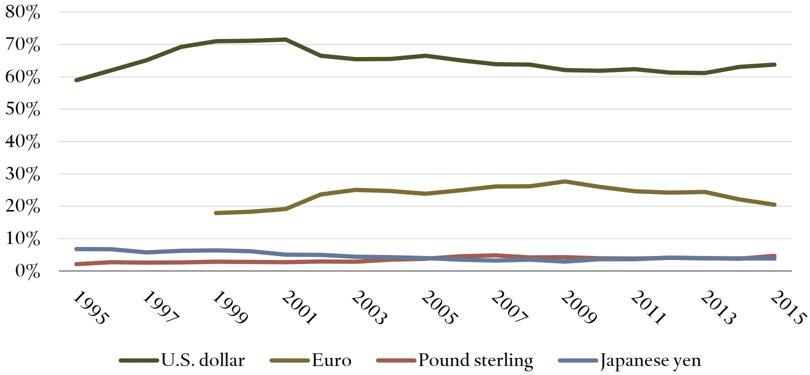
ambitions clash in the future. But because other countries own U.S. debt, they are also vulnerable to U.S. government policy. With so much Chinese money placed in U.S. debt, for example, China is eager to see the U.S. dollar remain stable and U.S. debt as a reliable investment. There are also mutual benefits—Chinese purchases of U.S. dollars have helped keep its currency weaker, promoting its exports, while the strong demand for U.S. debt abroad has undoubtedly kept U.S. interest rates lower than they would be otherwise.

U.S. DEBT EXCEPTIONALISM?

The United States can probably shoulder higher absolute and relative debt levels better than any other country. Its economy is the world's largest, its per-capita GDP is among the highest, and it issues the world's main reserve currency. U.S. debt is denominated in U.S. dollars, and other countries buy U.S. debt to stock up their dollar reserves in part to protect their currencies against speculative outflows. The demand for dollars abroad thus creates demand for U.S. debt. About 30 percent of U.S. debt is owned by foreign governments in their currency reserves.[14] The other advantages of U.S. debt for investors are that it is liquid, meaning that it can be sold quickly, and it is deep, meaning that because so much U.S. debt is in circulation investors can buy and sell large amounts without affecting the price. The strong demand for dollars abroad also means that the U.S. government is in an enviable and unique position among indebted countries: it can print more dollars without worrying as much about inflation. Indeed, the Federal Reserve Bank's recent monetary policy, called quantitative easing, pumped massive amounts of new dollars into the economy with no appreciable effect on inflation. If anything, economists warn inflation may be too low.

Although investors know the U.S. debt trajectory is unsustainable, they are clearly banking on the U.S. government eventually getting its fiscal house in order. Governments are not losing faith in the stability of the dollar. The share of global reserves in dollars is down some from its peak in 2000, but the dollar is still the preferred reserve currency by a hefty margin (see figure 1).[15] The interest rate investors are receiving is still at historic lows, though this could be because of economic uncertainty elsewhere rather than improvements in the U.S. situation (see figure 2).[16] Whatever the reason, investors continue to consider U.S. debt to be among the world's safest bets, and it has never been cheaper

FIGURE 1. PERCENTAGE OF WORLD'S ALLOCATED FOREIGN EXCHANGE RESERVES, BY CURRENCY



Source: IMF.

FIGURE 2. INTEREST RATE FOR U.S. TEN-YEAR TREASURY BONDS

Source: U.S. Federal Reserve.

for the U.S. government to borrow money. Given that net interest payments as a share of GDP are back at the levels of the 1970s, roughly 1.5 percent, taking on more debt would appear to be affordable for the United States.[17]

But the U.S. government should not assume this solid investor confidence will last forever; most economists expect interest rates to rise. According to CBO estimates, under the current debt trajectory, the U.S.

GDP would be 2 percent smaller in 2040 because of debt's crowding-out effect on investment.[18] Former White House Chief of Staff Erskine Bowles, who chaired a government panel on federal debt, put it perfectly: "We face the most predictable economic crisis in history."[19] But lowering debt will be harder than in the past. Debt will be as high as during the era just after World War II, but the United States cannot count on the same conditions that helped draw down that era's debt. Economic growth in coming decades is not expected to be anywhere near as strong as the period from 1950 to 1980. The country's population is much older, making entitlement spending both more socially necessary and politically harder to cut.

That most other OECD countries are in a similarly high-debt position is no consolation if everyone will experience slower economic growth. The effects will spread across the global economy as rich-world investors and consumers spend less money than they otherwise would.

WHAT HAS BEEN DONE SO FAR

Following the gaping deficits caused by the Great Recession and growing public concern over the debt burden, it seemed possible that leaders of both parties would come together on the tough decisions needed to fix future government finances. Yet for all the rhetoric over the past several years, the U.S. government has failed to solve the long-term debt problem.

CRISES: FISCAL UNCERTAINTY AND DEBT-CEILING SHOWDOWNS

Since 1917, Congress has set the absolute level, or dollar amount, of debt the federal government can take on. If the U.S. government reaches the debt limit and Congress fails to raise it, the U.S. Treasury would no longer be able to pay the bills, including on interest payments, causing a debt default.[20] Debt-ceiling adjustments are so normal that it is estimated that the ceiling has been raised nearly eighty times since 1960 and spread evenly among presidencies.[21]

Although no other country has chosen to adopt such a system, a debt ceiling arguably has an upside. It could in theory impose some form of fiscal accountability, requiring the government to take action visible to public scrutiny before it borrows more. Deficit-reduction negotiations may be more likely because of the debt ceiling; confrontations over raising the debt ceiling in 1997 and 2011 did lead to austerity measures. It may also make changes to entitlement programs easier to enact because entitlement (or mandatory) spending falls outside the annual appropriations process but is subject to the debt limit.

However, the period from August 2011 to February 2014 was an era of fiscal uncertainty unmatched in modern times. During that two-and-a-half year stretch, four debt-ceiling standoffs brought the country within days of default when the Republican-led House refused to raise the debt limit without concessions from the president. At the end of 2012, the country nearly plunged off a fiscal cliff that would have triggered tax hikes and spending cuts, although last-minute bills tempered the tax increase and delayed the cuts for three months. Then, a government shutdown ensued in the fall of 2013 because Congress could not agree on a budget in time. According to one analysis, the fiscal uncertainty level since 2011 is 50 percent higher than the 1986–2010 period.[22] This affects business and consumer behavior; companies and households are less likely to take risks and more likely to sit on their cash. The fiscal uncertainty since 2010 may have shaved off a cumulative 1 percent of real U.S. GDP, or about $150 billion every year.[23]

To be sure, U.S. creditworthiness weathered the fiscal storm relatively unscathed. There was no big sell-off of U.S. debt when, during the initial debt-ceiling crisis in August 2011, one of the three major credit rating agencies downgraded U.S. debt for the first time. Nevertheless, fiscal uncertainty and debt-ceiling crises can only harm the attractiveness of U.S. debt and the dollar as the reserve currency.

MAKING THE WRONG CUTS: SLASHING DISCRETIONARY SPENDING

In an effort to end the debt ceiling crisis, a supercommittee, split evenly between both parties, was formed in 2011 to craft a carefully calibrated austerity package that would have cut $1.5 trillion from projected debt levels over ten years. Built into the deal were stiff consequences called sequestration if the supercommittee could not agree to a package. Sequestration required across-the-board cuts totaling $1.2 trillion over eight years, almost entirely to discretionary spending. The consequences were designed to be so unpalatable to both parties that

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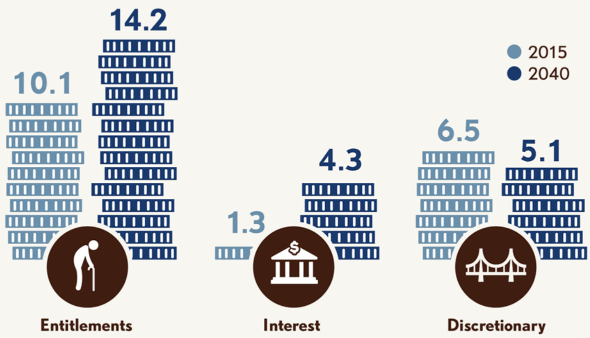
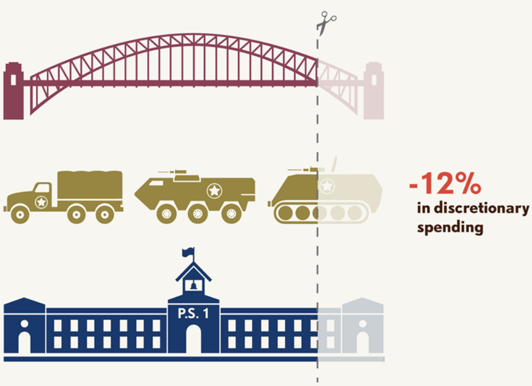
Entitlements vs. Investments



Federal spending categories as a percentage of GDP

Entitlement programs and interest payments on public debt are driving increases in federal spending.



For the period 2011–2024

But recent debt-reduction measures have primarily affected discretionary spending, most of which goes toward investments that promote economic growth.

members of the supercommittee would have no alternative except to act as responsible stewards. But in the end, the supercommittee accomplished nothing, and spending cuts that few policymakers wanted or thought wise as actual policy came into effect in 2013. Budget deals in 2014 and 2015 have moderated the cuts in the short-term, but left the original sequestration cuts largely in place after 2016.

The target of the sequestration, discretionary spending, is not the current or future cost problem in the federal budget. Discretionary spending—which, in contrast to mandatory spending like entitlements, is the part of the federal budget appropriated every year by Congress—is just one-third of all federal outlays. It is this portion of the budget that goes toward infrastructure, education, research and development, and other government spending that promotes future economic growth.

The other two options for decreasing deficits—cutting entitlements or increasing tax revenues—were largely left off the table. For the 2011–2025 period, recent deficit-reduction legislation will have the cumulative effect of reducing entitlements by less than 1 percent, increasing tax revenue by nearly 2 percent, and decreasing discretionary spending by 12 percent.[24]

Yet entitlements will account (along with interest payments) for nearly all new federal spending in the future. Medicare has been cut somewhat, but nothing close to the amount that was sheared from education or defense. Entitlement funds disproportionately go to older Americans and this applies to projected federal health-care spending even after the Affordable Care Act fully kicks in.[25] Whereas in 2010 spending on entitlements and discretionary programs was roughly equal, by 2040 nearly three-times more will be spent on entitlements than on discretionary programs.[26]

Getting U.S. public debt on a sustainable path will require more sacrifice from the American public. Just to slow debt growth to the rate of GDP growth (or a steady debt-to-GDP ratio) from today through 2040, changes to current policy would have to be dramatic: cut entitlements by 10 percent or cut discretionary spending by 24 percent or increase tax revenue by 6 percent, or some combination of the three.[27] Adjustments to actually lower the debt-to-GDP ratio would be even more painful.

Ideally, the debt-reduction burden would be shared by all Americans. But one thing is certain—less generous entitlement programs and tax increases will need to be part of any balanced solution.

PUBLIC OPINION: FOR A BALANCED BUDGET, BUT AGAINST SACRIFICES TO BALANCE THE BUDGET

Changes in entitlement programs and tax increases, however, collide with an American public that largely wants neither. Almost as a rule, Americans support a balanced federal budget. But public opinion moves decisively in the other direction when Americans are asked about the specific actions necessary to balance the budget.[28]

Entitlement programs are broadly popular. Although most Americans understand that entitlements have a financing problem, they oppose making them less generous. When given the choice between preserving entitlements and reducing the deficit, Americans prefer the status quo. A solid majority, or 69 percent, would rather keep entitlements as they are and incur the debt consequences, whereas only 23 percent say the country should take steps to reduce the budget deficit that would include entitlement cuts.[29] It is understandable that older Americans are more inclined than their younger counterparts to want to preserve entitlements. But even so, most Americans age eighteen to twenty-nine, who will foot the future debt interest bill, still favor entitlement preservation over debt reduction. Perspectives differ depending on party affiliation: Republicans are more likely than Democrats to favor making deficit reduction a priority.

There may be a "tax more" option. Americans do appear to favor increasing taxes on the rich, though Democrats more so than Republicans.[30] It is unclear, however, whether Americans would favor raising their own taxes to cover their entitlement expenses. This suggests a fundamental disconnect between the services Americans want and what they are willing to pay in taxes to fund them.

A SMARTER PATH: GRADUAL CHANGES THAT AFFECT LONG-TERM COSTS

Some liberal economists believe debt reduction should not be an urgent policy priority.[31] The debt crisis, they argue, is not immediate. With a still-weak economy, the government should continue to spend more than it receives in tax revenues to spur consumer spending. Short-term austerity can be counterproductive if it harms economic growth. Sequestration, they argue, was a foolish form of austerity because it cooled an already weak economy in the short term, disinvested in

Balance Owed

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Painful Choices

-10% Entitlements — or — **-24%** Discretionary — or — **+6%** Taxes

For the period 2011–2025

To keep the current level of debt steady as a share of GDP through 2024, policy changes today would have to be dramatic.

But such policy changes will be difficult, since Americans prefer keeping the status quo.

long-term economic growth, and failed to make a serious dent in the long-term debt situation.

But there are ways to sensibly reduce debt. The longer the country waits to make adjustments, the more dramatic any reform will have to be. Act now and reform can be more gradual, spreading the burdens of service cuts and tax hikes more equally across generations. It would give the public and the economy more time to adapt to the change, with potentially positive spillover effects. Raising the retirement age for today's young people, for example, would encourage more private savings and longer work lives. A CBO study confirms that gradual reforms would produce more net benefits for the economy and could better cover existing entitlement promises than sudden tax increases or a sudden cut in benefits.[32]

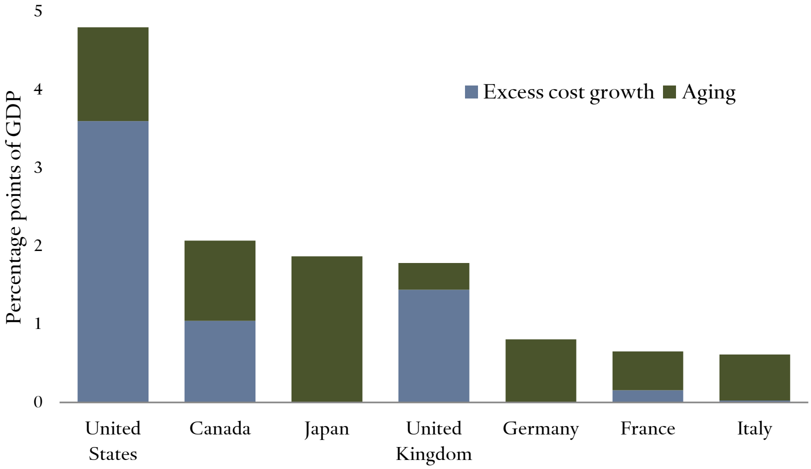
The politics of reform may be easier to manage if a crisis hits. But the public will be better off if the tough, long-term debt-reduction decisions come sooner rather than later and are guided by prudent planning rather than reaction to a crisis.

PEER COUNTRIES: DOING MORE TO TACKLE ENTITLEMENT-COST GROWTH

Over the last decade, other G7 countries have made more dramatic changes to their pension programs than the United States has to Social Security.[33] Germany and Japan have put automatic stabilizers into their public pension systems so that the pension benefits rise or fall automatically with the country's ability to afford them. Italy linked pension age eligibility to life expectancy, while France indexed part of its public pension system to price inflation. These changes amount to huge spending cuts by 2040 compared with previous law—roughly 30 percent in France, 40 percent in Germany and Japan, and nearly 50 percent in Italy.[34] Some of the reforms were delayed because of the recession. Nonetheless, the public broadly understands that future benefits should be cut, and the push for reform has come equally from the Left and the Right. The United States, meanwhile, has not managed to pass a major Social Security reform in thirty years.

Other G7 countries have also done a better job of keeping health-care costs under control (see figure 3). Germany, Italy, and Japan, whose populations are among the oldest in the world, are projected to have almost no growth in public health-care costs, apart from costs related to unavoidable population aging.[35] The United States has long had the

FIGURE 3. PROJECTED INCREASE IN PUBLIC-HEALTH SPENDING, 2013–2030



Source: IMF (2013).

fastest-growing health-care costs (private and public) in the rich world. Though cost growth has slowed in recent years, this is mostly because of the recession rather than a structural change in the health-care cost curve. At least for public health-care costs, the high cost-growth trend is expected to return in coming decades—and a disproportionate share of that growth will come from preventable excess costs.

Yet the United States enjoys certain advantages compared with other G7 countries that should make changing entitlement programs easier (see table 1).[36] First, its population is younger, which means more working-age people will continue paying into Social Security. And though the poverty rate among the elderly is higher in the United States than other G7 countries, the average older American is wealthier than his or her counterparts in other countries. The elderly tend to have longer work lives and depend less on public pensions. The United States has a mature private pension system, and the share of elderly income coming from private pensions is higher than in any other OECD country. The United States also has more room to raise taxes. If the country decided to tax itself enough to pay for all projected federal outlays in 2040, even without making any cuts to entitlement benefits, the tax burden in comparison with the size of the economy would still be below the current

TABLE 1. UNITED STATES COMPARED WITH THE REST OF THE G7 IN 2040: YOUNGER POPULATION, WEALTHIER ELDERLY, MORE TAX ROOM

	2040 *United States*	*Rest of G7*
Elderly share of the total population	26%	35%
Elderly to non-elderly total income ratio	1.4:1	1:1
Tax revenues (as percentage of GDP) needed to cover the total increase in elderly benefits	41%	48%

Source: Center for Strategic and International Studies (2012).

level of most European countries. And economists expect economic growth to be stronger in the United States than in nearly every other G7 country.

Other G7 countries may have been forced to act sooner than the United States on entitlement reform. They have much more expensive old-age entitlement systems, and they have been dealing with older populations and higher public debt for longer. But most have placed smart cost controls on their systems, while also managing to pay for a larger share of the expense. The United States spends less on old-age benefits, but the projected growth in those benefits is much steeper, and no real plan is in place to pay for it all. Barring significant policy changes, the United States will end up in a worse debt situation in 2040 than the European welfare states that offer more generous old-age benefits.

FUTURE PROSPECTS

Recent bipartisan deals have offered at a least a pause in the political conflicts over fiscal policy, though there are no prospects for any larger deal. After four years of continuing resolutions and no annual budgets, Congress agreed to two-year budget deals in early 2014, and then again in late 2015 that loosened sequestration caps, but otherwise kept taxation and expenditures at roughly existing levels. In 2014, the Republican-led House voted to raise the debt limit without any conditions, the first so-called clean increase since 2009. They did so again in 2015.

The Obama administration and congressional Republicans have submitted long-term budget proposals that would moderate the debt trajectory, albeit to different degrees. Obama's plan would slow debt growth in the long term; the Republican plan would set debt on a downward long-term trajectory, eventually leading to a zero-debt balance.[37]

Both parties agree that Medicare costs should be controlled. The main cost savings in Obama's plan target Medicare. The Republican plan would squeeze even more cost savings out of health-care entitlements in the long term, mostly from means-testing Medicare and raising its eligibility age, along with cutting spending for Medicaid.

But plenty of disagreement between the two parties remains. The Obama and Republican plans differ on taxes and discretionary spending. Obama's plan relies mostly on higher revenues from tax hikes on the wealthy to lower the debt-to-GDP ratio. It would also considerably boost discretionary spending, busting the sequestration caps. The Republican plan relies only on spending cuts—and the cuts to discretionary programs would be deep, amounting to four times what the original sequestration bill was going to slash.[38] Social Security, meanwhile, takes no budget hit in either plan. Obama has even backtracked on Social Security reform since his previous budget, choosing in his recent budget plans not to propose a less-generous measure of inflation to calculate benefits.

Although both parties agree that the current debt situation is unsustainable, they are still far from agreeing on how to resolve it. Even if they can reach agreement on a reform plan, the biggest challenge may be to persuade the American public of its merits.

Endnotes

1. For a review of the literature, see "On Reinhart and Rogoff," Committee for a Responsible Federal Budget, May 3, 2013, http://crfb.org/blogs/reinhart-and-rogoff.
2. Andrea Pescatori et al., "Debt and Growth: Is There a Magic Threshold," IMF Working Paper no. 1434, February 2014, http://www.imf.org/external/pubs/ft/wp/2014/wp1434.pdf.
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