A Call to Action for the Next Generation: Securing a Sustainable Fiscal Path

Start here with an introductory overview of fiscal policy. Understand its core objectives, the federal budget, deficit, and debt, and why it all matters for the next generation.

What is Fiscal Policy?

Fiscal policy guides the government's response to changing economic conditions and public policy priorities. It determines how the government manages its finances through a combination of both *taxation* and *spending*.

- *Expansionary fiscal policy* is used to help stimulate economic activity, either through increases in government spending, a reduction in taxes, or a combination of both. It is typically used during economic downturns to stimulate economic activity and often contributes to the deficit, when the government spends more money than it collects in revenues through taxation and fees.
- *Contractionary fiscal policy,* alternatively, is used to either cut spending or raise taxes, or both, to generate increased revenues in times when the economy is stable and growing. This can be done to help curb economic concerns such as inflation, and to build a government *surplus* to better help respond to future economic downturns.

Fiscal policy is separate from *monetary policy*, which is used to impact economic growth by managing interest rates and the supply of money circulating in the economy. Similar to fiscal policy, monetary policy can be used to help expand or contract the economy in response to fluctuations.

Objectives of Fiscal Policy

The federal government cannot just spend money freely to respond to changing economic conditions. It is, in fact, constrained by how much tax revenue it collects and how much *fiscal space*—its ability to reprioritize existing spending or borrowing—is available for new spending initiatives or tax cuts.

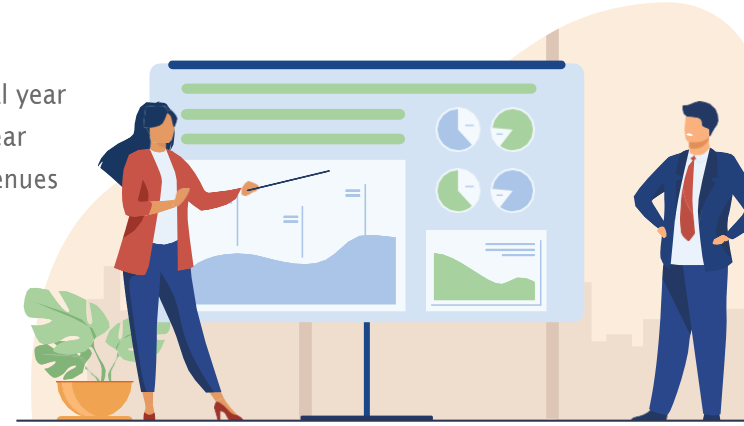
Balancing government spending and revenues is further constrained by political priorities, leading to complex policy maneuvers that require trade-offs in the short- and long-run to meet the country's ever-changing needs. It is within this dynamic economic, social, and political ecosystem that fiscal policy attempts to meet the following objectives:

- Economic growth
- Efficient allocation of resources
- Equitable distribution of income and wealth
- Employment generation
- Price stability

Understanding the Federal Budget, Deficit, and Debt

While the government has these fiscal tools at its disposal to respond to economic fluctuations, it is important to have a shared understanding of key economic terms as they relate. These include:

- The *federal budget*, an annual plan developed by lawmakers that reflects how the U.S. government should spend money to cover the costs of all federal priorities.
- The *federal deficit*, which is the difference between what the government generates in revenue (e.g., in taxes, fees, customs duties) and what it spends annually. The U.S. fiscal year runs October 1 through September 30 each year. In fiscal year 2023, the federal government collected $4.4 trillion in revenues and spent $6.1 trillion, resulting in an annual deficit for 2023 of $1.7 trillion.
- The *federal debt*, which is the accumulation of _all_ annual deficits since the nation's founding (offset by any years of surpluses), and currently exceeds $33 trillion.



One of the primary responsibilities of our elected officials is to determine how and how much the federal government will spend annually on the public programs and services it provides to the public. Each year, the President submits a budget proposal to Congress that outlines policy priorities for the nation and recommends how federal dollars should be allocated for the coming fiscal year. Congress must then pass legislation through the appropriations process that allocates these funds according to what it deems are the country's priorities. Sometimes lawmakers from both branches and parties agree on these priorities, but often they do not.

Revenues

Government revenues are collected from the public primarily through taxation. Revenues come from a variety of sources, including individual and corporate income taxes, payroll taxes, excise taxes, customs duties, estate and gift taxes, and other fees:

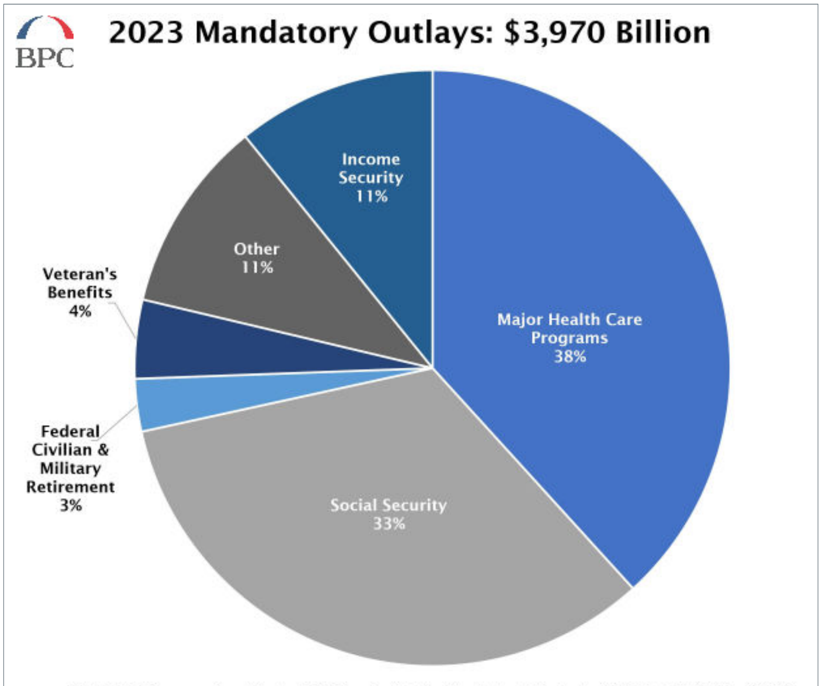
- **Income taxes:** Taxes levied on the wages and salaries earned by individuals, income from investments, and other income.
- **Corporate income taxes:** Taxes levied on business profits.
- **Payroll taxes:** Taxes paid by both employees and employers to fund public social insurance programs, levied on wages, salaries, and tips.
- **Excise taxes:** Taxes levied on the production or purchase of a particular good or service, such as gasoline, tobacco, alcohol, and air transportation, among others.
- **Customs duties:** Taxes levied on the import of goods into the U.S.
- **Estate and gift taxes:** Taxes levied on the transfer of wealth (e.g., estates and large gifts) of individuals.

Spending

The vast majority of federal dollars are dictated through *mandatory spending*, leaving approximately 30% to be determined as *discretionary spending* on a yearly basis by Congress. As a result, if the government spends more than it generates in revenues, the resulting deficit will have significant implications for the fiscal health of the nation.

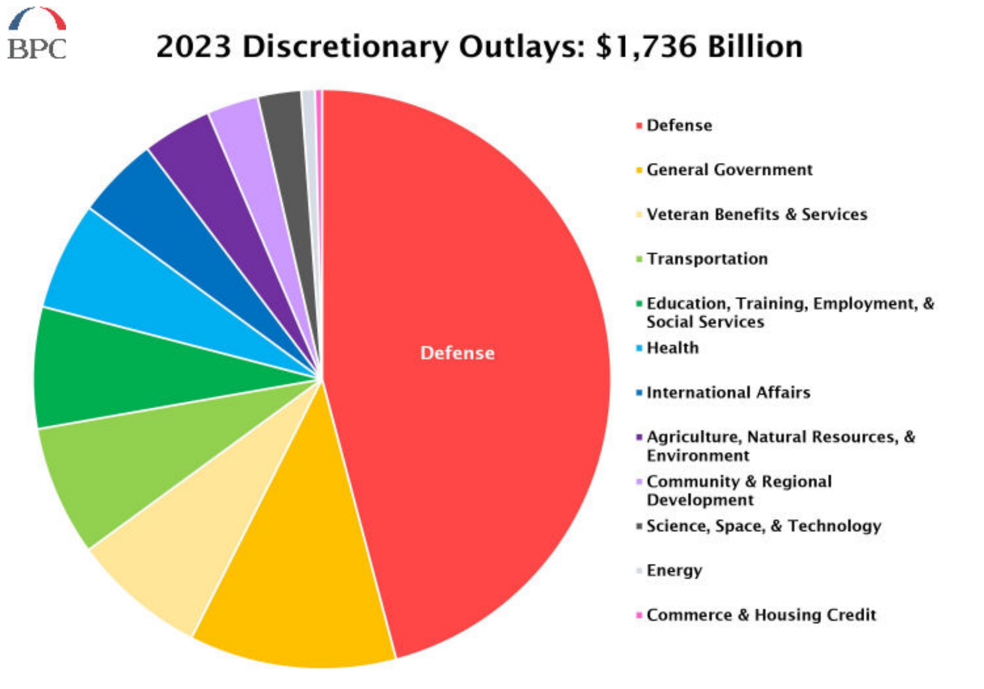
Government spending is divided into three categories:

- *Mandatory spending*: government spending for certain programs that is pre-determined by laws Congress passes and not subject to the annual appropriations process. This includes spending on critical health and income security programs that are administered by the government, such as Medicare, Medicaid, and Social Security, among others. Federal spending on higher education through the provision of student loans is also considered mandatory spending.



SOURCE: Congressional Budget Office, *Update to the Budget Outlook: 2023 to 2033*, May 2023.
NOTES: CBO Baseline Projections adjusted to exclude the effects of timing shifts. Numbers may not add due to rounding.

- *Discretionary spending*: government spending allocated annually by Congress through the annual appropriations process based on changing needs and priorities. This includes spending on national defense, education, natural resources, energy and the environment, and housing assistance, among a host of other public needs and services.



SOURCE: Office of Management and Budget, *Historical Tables, Budget of the United States Government: Fiscal Year 2023*, March 2023.
NOTES: General government includes central executive and legislative functions as well as the administrative costs of Medicare, Social Security, and income security programs.

- *Net interest*: When the government runs a deficit, it must borrow money from investors by issuing bonds to make up the difference between spending and revenues. Like all borrowers, the government pays interest for this ability to create fiscal space. Federal spending on net interest largely depends on current interest rates and the amount of debt outstanding. Rising interest rates lead to forgone future investments, misallocate existing resources, and hamper economic growth by increasing inflationary effects on goods and services. The more we borrow today, the more expensive it will be to continue borrowing in the future, igniting a ripple effect.

Why High Deficits & Debt Matter

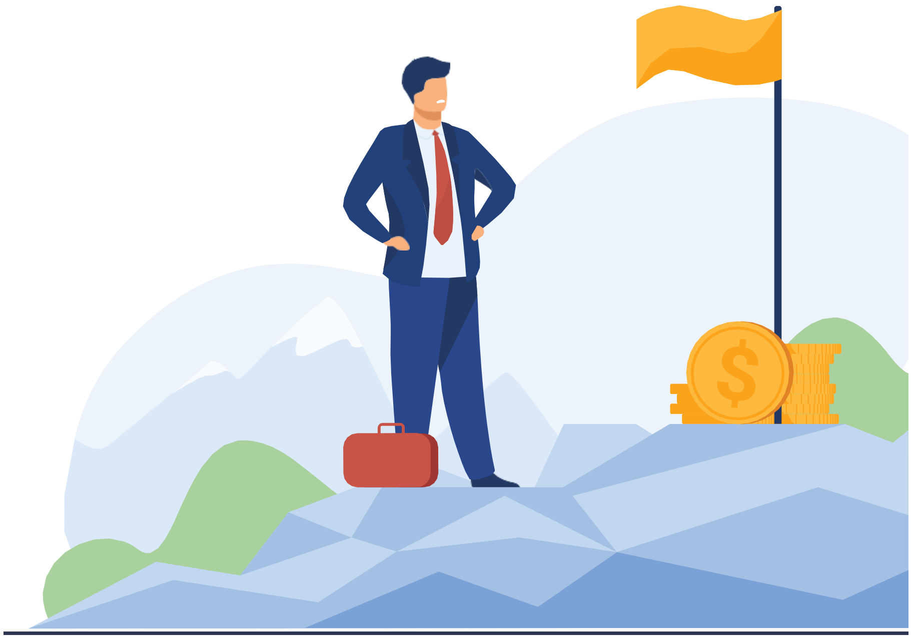
Even during recent periods of economic growth, the federal government has run large and growing budget deficits, near $1 trillion per year. Today, the federal debt will only continue climbing as mandatory spending and interest payments on the debt grow faster than revenues. At the current rate, the U.S. Congressional Budget Office (CBO) estimates that our debt could be nearly double the size of the U.S. economy within 30 years, with interest spending on track to become the largest federal program by 2045. The ongoing retirement of baby boomers will also continue to put more pressure on rising health care costs and social insurance programs.

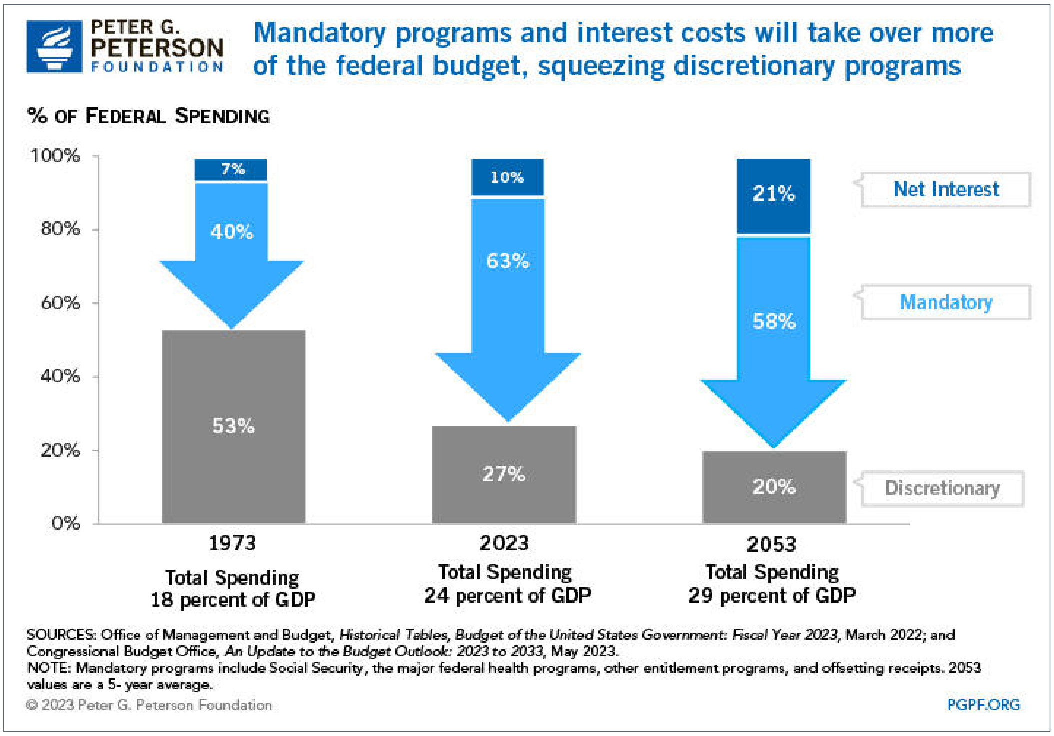
Higher interest payments owed on the national debt will also eventually force the government to make difficult fiscal trade-offs, impacting every American household and potentially jeopardizing the programs and services that millions of Americans—and especially vulnerable populations—depend on to sustain their livelihoods. Spending on other national priorities key for economic growth and opportunity, such as higher education, the environment, and healthcare, could decrease as they are relatively deprioritized against meeting our interest obligations. Such a scenario would pose great risks to the economy, as well as the nation's global reputation, for years to come. Our country's ability to lead on the global stage is determined, in part, by our fiscal security and economic competitiveness.

Ultimately, policymakers should strive to keep the country on a fiscally sustainable path. A *sustainable budget* is one that can continue on its current trajectory without harming the economy in the long run. To achieve this, policymakers must make tough trade-offs to address ballooning debt without stifling domestic growth and well-being.

A Call to Action for the Next Generation

All policy decisions broadly reflect our nation's values and priorities, particularly when it comes to allocating and raising federal dollars. With the federal debt relative to the size of the economy now higher than at any point since World War II at nearly 98% of GDP—and only projected to climb further as mandatory spending requirements continue to rise in the absence of new revenue generation or entitlement reform—it is paramount that policymakers across the political spectrum recognize their responsibility to secure a sustainable economic future for the next generation.





Determining precisely how to allocate funding for public programs and services—including those that support *the environment*, *higher education*, and *healthcare* — illustrates the complex decision-making process that policymakers face. Supporting these programs is costly, but also necessary to create economic opportunity and prosperity. Many of these programs are also widely popular among taxpayers. Therefore, policymakers must consider inherently difficult trade-offs between spending priorities and sources of new revenue to support those priorities.

While fiscal policy can be adjusted to respond to shifting economic conditions, the accompanying political decisions—whether and how to spend or tax—are complex and rarely produce a perfect nor easy solution. As such, policymakers consistently struggle to reduce the deficit, leaving the next generation increasingly responsible to course-correct our unsustainable fiscal outlook.