COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

CBO's Long-Term Budget Outlook
June 5, 2012

Today, the Congressional Budget Office (CBO) released its annual Long-Term Budget Outlook. CBO's projections demonstrate, unequivocally, that the United States cannot continue on its current course without accumulating unsustainable and economically dangerous levels of debt.

Under the Alternative Fiscal Scenario, CBO projects debt to rise from 73 percent of GDP at the end of FY2012 (up from only 36 percent in FY2007), to 93 percent of GDP by 2022, and nearly 200 percent by 2037. By 2043, CBO projects debt levels so economically implausible that they do not even report them. By the Committee for a Responsible Federal Budget's (CRFB) own estimates, debt would exceed 350 percent of GDP in the early 2050s and approach 900 percent by 2085.

Debt does appear to be sustainable under CBO's current law scenario – falling to 61 percent by 2022, 53 percent by 2050, and being fully paid off by 2070. However, this scenario is highly unrealistic since it assumes policymakers will deviate substantially from past practices. In addition, the scenario would likely throw the economy into a double-dip recession due to the "fiscal cliff" at the end of 2012.

Looking at the more realistic Alternative Fiscal Scenario shows that the deficit reduction enacted so far is not nearly sufficient to bring the debt under control. A comprehensive debt reduction plan must replace the abrupt and untargeted savings under current law with a more gradual and smart path to declining debt levels.

Fig. 1: Fiscal Projections under CBO's Two Scenarios (Percent of GDP)

	2000	2012	2022	2037	2050
Extended Baseline Scenario					
Spending	18.2%	23.4%	22.4%	25.3%	25.9%
Revenue	20.6%	15.8%	21.2%	23.7%	26%
Deficit	2.4%	-7.6%	-1.2%	-1.6%	0.1%
Debt	**35%**	**73%**	**61%**	**53%**	**36%**
Alternative Fiscal Scenario					
Spending	18.2%	23.4%	24.3%	35.7%	43.8%*
Revenue	20.6%	15.7%	18.5%	18.5%	18.5%
Deficit	2.4%	-7.7%	-5.9%	-17.2%	-25.3%*
Debt	**35%**	**73%**	**93%**	**199%**	**334%***

Note: Negatives denote deficits.
*Extrapolated by CRFB.

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The Long-Term Debt Outlook

CBO's Long-Term Budget Outlook focuses on two very different scenarios in making its projections: an "Extended Baseline Scenario" and an "Alternative Fiscal Scenario."

Fig. 2: Assumptions under CBO's Extended Baseline and Alternative Fiscal Scenarios

	Extended Baseline Scenario	Alternative Fiscal Scenario
2001/2003/2010 Tax Cuts	Expire at the end of 2012	Continued indefinitely
Alternative Minimum Tax Patch	Expired at end of 2011	Inflation-indexed patches
"Tax Extenders"	Expired at end of 2011	Extended indefinitely
Sequester	Allowed to take effect in 2013	Cancelled
Sustainable Growth Rate	27% physician cut in 2013	Continued "doc fixes"
Long-Term Revenue	Grows substantially as under current law	Frozen in 2022 at 18.5% of GDP
Long-Term Health Care*	ACA cost controls assumed to be in effect through 2029; Subsidies grow at current law	ACA cost controls assumed to be in effect through 2022; Subsidies grow faster than current law
Long-Term Non-Health, Non-Retirement Spending	Frozen as a share of GDP in 2022	Increases to historical levels by 2027; Frozen as share of GDP thereafter

*ACA refers to Affordable Care Act.

The Extended Baseline Scenario is essentially a reflection of current law. This scenario assumes a "fiscal cliff" at year's end where all of the 2001/2003/2010 tax cuts expire, Medicare physician payments are cut by 27 percent, millions of additional taxpayers pay the Alternative Minimum Tax (AMT), the automatic cuts or "sequester" from the Budget Control Act is implemented, and various other tax cuts ("tax extenders") expire. This scenario also assumes the cost controls from the 2010 health care reform legislation (PPACA) are fully implemented through 2029, despite questions over the sustainability of some of these provisions. Finally, the scenario assumes rapidly growing revenue as a result of standard "bracket creep," more individuals being pushed into the un-indexed Alternative Minimum Tax, and the health insurance excise tax from PPACA hitting a growing number of insurance plans.[1]

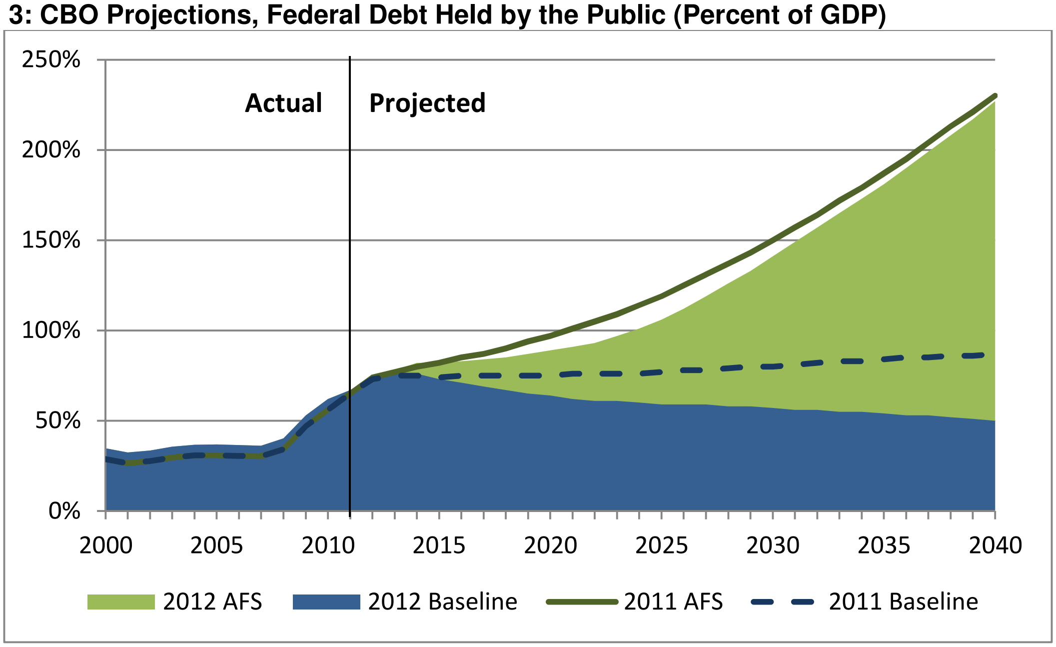
The Alternative Fiscal Scenario, on the other hand, essentially assumes Congress will continue to do what it is doing today. That scenario assumes a renewal of the 2001/2003/2010 tax cuts, AMT patches and Medicare doc fixes continue to be enacted, deactivation of the sequester, and extensions of other tax cuts. Beyond ten years, CBO assumes in its Alternative Fiscal Scenario that revenue stays constant as percentage of GDP, that discretionary and some other spending grows to historical levels, and that the cost controls from PPACA are only effective in pushing down costs through 2022.

[1] Bracket creep refers to individuals gradually being pushed into higher tax brackets as their annual earnings grow faster than the price-indexed elements of the tax code.

Under the Extended Baseline Scenario, debt would be on a clear downward path. Deficits would fall immediately from 7.6 percent of GDP in 2012 to 3.8 percent by 2013, would remain between one and two percent of GDP from 2015 through 2040, and would be wiped away completely by 2050. As a result, debt would fall from 73 percent of GDP this year to 61 percent in 2022, 53 percent in 2037, and would be fully paid off by 2070. While this scenario would lead to substantial deficit reduction, it would likely do so at the cost of a double-dip recession and would rely on unwise and poorly targeted policy changes such as across-the-board spending cuts. More importantly, the scenario is unrealistic and inconsistent with previous congressional action.

Under the more realistic Alternative Fiscal Scenario, the short-term economy would be in better shape, but the medium- and long-term fiscal situation would be completely out of control. Under that scenario, debt would reach 93 percent of GDP by 2022, 199 percent by 2037, and 247 percent by 2042. Extrapolating those projections forward, debt would be on a path to grow to 334 percent by 2050, 619 percent by 2070, and nearly 900 percent by 2085. Of course, it is clear that no economy could sustain debt levels at such heights. At some point, the Alternative Fiscal Scenario projections would prompt a fiscal crisis.

Fig. 3: CBO Projections, Federal Debt Held by the Public (Percent of GDP)



Deficits, Spending, and Revenues

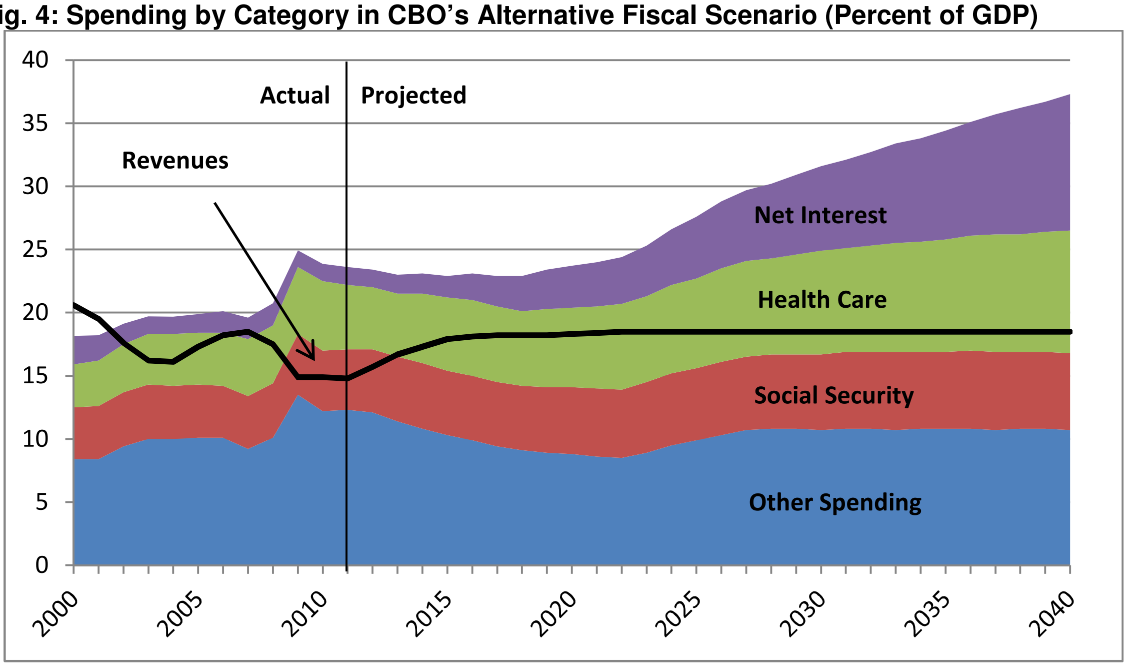
Driving the growing levels of federal debt is the widening projected imbalance between spending and revenues. Under the Alternative Fiscal Scenario, CBO projects deficits to decline modestly to below 5 percent of GDP toward the latter half of this decade, and then proceed on a rapid upward path.

CBO projects deficits reaching 5.9 percent in 2022 and 17.2 percent in 2037; extrapolating their numbers would lead to deficits exceeding 25 percent of GDP by 2050 and 50 percent before 2080.

This growing imbalance is due mainly to spending growth in federal health care programs, Social Security, interest on the debt, and to the assumption that revenues will remain frozen at their 2022 levels (18.5 percent of GDP) for the duration of the 75-year outlook.

By the mid-2030s, under current benefit formulas, Social Security spending would rise from 5.4 percent of GDP in 2022 to 6.2 percent, with annual cash-flow deficits of roughly one-quarter that amount. At the same time, mandatory health care spending (net of premiums) would climb from 4.9 percent of GDP in 2012 to 9.3 percent in 2037 (assuming the Medicare cost controls from the PPACA were discontinued or unsuccessful in controlling costs beyond 2022). Finally, interest costs are projected to skyrocket from 1.4 percent of GDP in 2012 to 9.5 percent in 2037.

Fig. 4: Spending by Category in CBO's Alternative Fiscal Scenario (Percent of GDP)



CBO also projects substantial growth in entitlement spending as a share of the economy in their Extended Baseline Scenario, albeit somewhat less than in the Alternative Fiscal Scenario. Social Security is still projected to increase to 6.2 percent of GDP in 2037, but health care spending is projected to grow from 4.9 percent of GDP in 2012 to 8.6 percent in 2037 – less than the 9.3 percent in the Alternative Fiscal Scenario based on the assumption that physicians will accept a 27 percent payment cut and PPACA's cost control measures will be effective until the year 2030.[2]

Contrary to under the Alternative Fiscal Scenario, the Extended Baseline Scenario assumes continued revenue growth sufficient to finance the cost of growing entitlement spending. The source of this revenue growth is a combination of the expiration of the 2001/2003/2010 tax cuts, discontinuation of AMT patches, real bracket creep from the ordinary tax code, nominal bracket creep from the unindexed AMT, and ever-growing levels of revenue from the inflation-indexed surtax on high-cost insurance plans. As a result of these factors, revenue will surpass its historical record of 20.6 percent of GDP by 2018, reach 23.7 by 2037, and grow to 29.8 percent by 2087.

Obviously, the country's fiscal outlook is much better under the Extended Baseline Scenario, but it would require lawmakers and voters to allow federal revenues to reach unprecedented levels – in addition to allowing various across-the-board spending cuts to take place.

Long-Term Economic Outlook

As we have explained in the past, the "fiscal cliff" scheduled to occur at the end of 2012 under current law would substantially dampen short-term growth and likely put the economy into a double dip recession.[3] However, the medium- and long-term consequences of continuing current policy are even more dire.

Under the Alternative Fiscal Scenario, CBO finds that gross domestic product (GDP) would be nearly 2 percent lower than current law in 2027 and 6.6 percent lower by 2037. Gross national product (GNP) – which also includes the income U.S. residents earn from foreign investments (and excludes what non-residents earn from U.S. investments) – would be about 4.4 percent lower than current law in 2027 and 13.4 percent lower by 2037.[4]

Beyond 2037, debt levels become too high for CBO to reliably estimate the economic consequences. CBO projects that rising debt levels would have increasingly negative

[2] CBO's 2010 Long-Term Outlook (and "Data Underlying" Figure 2.4) offers its most recent projection for PPACA's effects on net federal mandatory health care spending, including subsidies increases and Medicare cost controls in the act. In this report, CBO projected net spending reductions due to PPACA from 2028 onward, if cost controls were fully effective (a threshold date that would fall about eight years later if cost controls were only half-effective).

[3] Committee for a Responsible Federal Budget. "CBO Joins the Cliff Estimating Game." May 22, 2012. http://crfb.org/blogs/cbo-joins-cliff-estimating-game. Congressional Budget Office." Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013." May 22, 2012. http://www.cbo.gov/publication/43262.

[4] Note this numbers represent "central tendencies" as CBO gives ranges of estimates based on several models.

impacts on the economy – restricting the ability of policymakers to respond to crises, raising interest payments to creditors, and increasing the risk of a sudden fiscal crisis.

Conclusion

The country's long-term fiscal health is in danger. Public debt is projected to surpass the size of the economy in only 12 years under CBO's Alternative Fiscal Scenario, and to be twice the size of the economy by 2037. A fiscal crisis of some form would surely occur before debt levels reached such heights.

The Extended Baseline Scenario does show a declining debt path. Yet its assumptions are not only unrealistic, but would likely lead to a recession if allowed to occur. Moreover, the composition of policies in the "fiscal cliff" generally is undesirable because it cuts spending across-the-board rather than in a targeted way and generates revenue from higher rates rather than through pro-growth tax reform.

Policymakers should strive to enact a debt and deficit path which looks like the Extended Baseline Scenario over the long-run, yet achieves these savings in a gradual, thoughtful, and credible way. Such a plan could inspire confidence for the business sector and credit markets while also leaving a better economy for future generations.