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Looking Beyond the Ten-Year Budget Window November 21, 2013

As CRFB recently [explained](#), our long-term debt problems are very far from solved.¹ Although debt levels are projected to stabilize over the next few years due to a combination of the economic recovery and enacted deficit reduction, debt will continue its upward trend later this decade and beyond as the Baby Boomers retire, interest rates normalize, and health care costs continue to grow.

Based on CRFB's projections, debt will decline as a share of GDP over the next few years – from a post-war record of 74 percent of GDP this fiscal year down to 69 percent of GDP by 2018. However, after 2018, debt levels will begin to rise, reaching 73 percent of GDP by 2023, exceeding the size of the economy by 2035, doubling it in the 2060s, and tripling it by the 2080s. Under a more pessimistic scenario, debt could reach 100 percent of GDP as soon as 2033 and 500 percent in the 2080s.²

Unfortunately, excessive focus on the short-term budget picture has led many policymakers to ignore the country's looming fiscal problems, and instead enact changes that have reduced ten-year budget deficits but done little to address the trajectory of long-term debt. Failure to look beyond this decade has led to policies like sequestration – which largely ignores the long-term drivers of the debt and produces *no new savings* after it ends in 2021 – and to policies which are nothing but timing shifts that actually *increase* the deficit in future years.

While ten-year estimates provide valuable insights and are the standard for scorekeepers like the Congressional Budget Office and Joint Committee on Taxation, policymakers would be remiss to not also focus on the long-term impact of policy changes.

To be sure, long-term fiscal analysis is inherently uncertain and notoriously imprecise. Moreover, ignoring the medium term all together would be a real mistake that could put the economy and budget at risk. However, a better understanding of long-term impact can help policymakers more effectively weigh potential choices and adequately address the challenges of an aging population and growing health costs in ways that are fair to future generations.

¹ Committee For a Responsible Federal Budget (CRFB), "Our Long-Term Debt Problems are Very Far From Solved." <http://crfb.org/document/report-our-long-term-debt-problems-are-very-far-solved>.

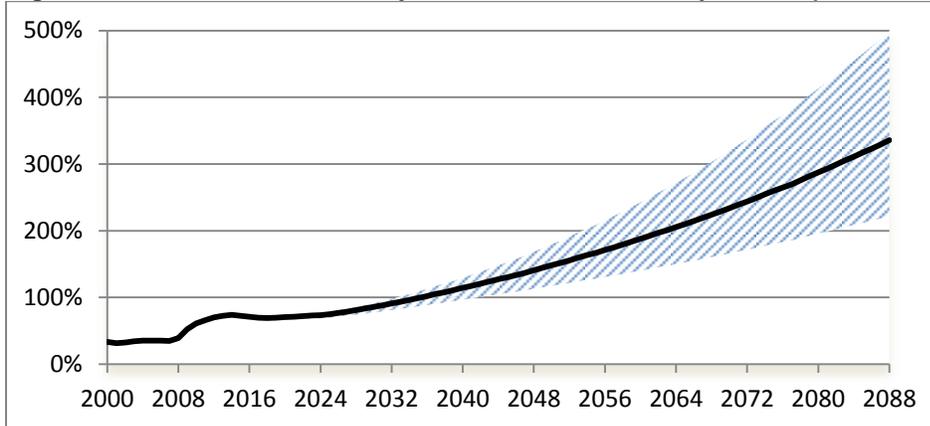
² Ibid



Identifying Long-Term Deficit Reduction

Recent claims that our debt problems have been brought under control are both flawed and short-sighted. The federal debt is at its highest level since the aftermath of World War II, and although it will decline as a share of the economy between 2014 and 2018, it will rise rapidly and unsustainably thereafter. A more detailed account of our long-term fiscal challenges is available in our [recent analysis](#), *Our Long-Term Debt Problems Are Very Far from Solved*.³

Fig. 1: CRFB Realistic Debt Projections with Uncertainty Bands (Percent of GDP)



As policymakers work to improve our fiscal picture, it is important to understand that not all deficit reduction is created equal. Two policies with identical amounts of ten-year savings can have very different long-term fiscal effects. By understanding these long-term impacts, policymakers can better avoid budget gimmicks, strengthen entitlement programs, improve the long-term fiscal picture, and compare options with a broader scope of information.

Some types of policies tend to save far more in the long run than in the first decade, including:

- Policies that address a fast-growing part of the budget or the tax code
- Policies that begin late in the ten-year window
- Policies that explicitly or implicitly change a growth rate or annual index update
- Policies that phase in over time
- Policies that reduce the value of a provision for new beneficiaries only
- Policies designed to inject competition or change behavior over time

Conversely, some types of policies tend to have shrinking savings over time, particularly:

- Policies that are only in effect temporarily
- Policies that cut provisions already scheduled to decline over time
- Policies that shift forward the timing of revenue collection or savings
- Policies that collect revenues or contributions now in exchange for new benefits later
- One-time asset sales or transition taxes

³ Ibid

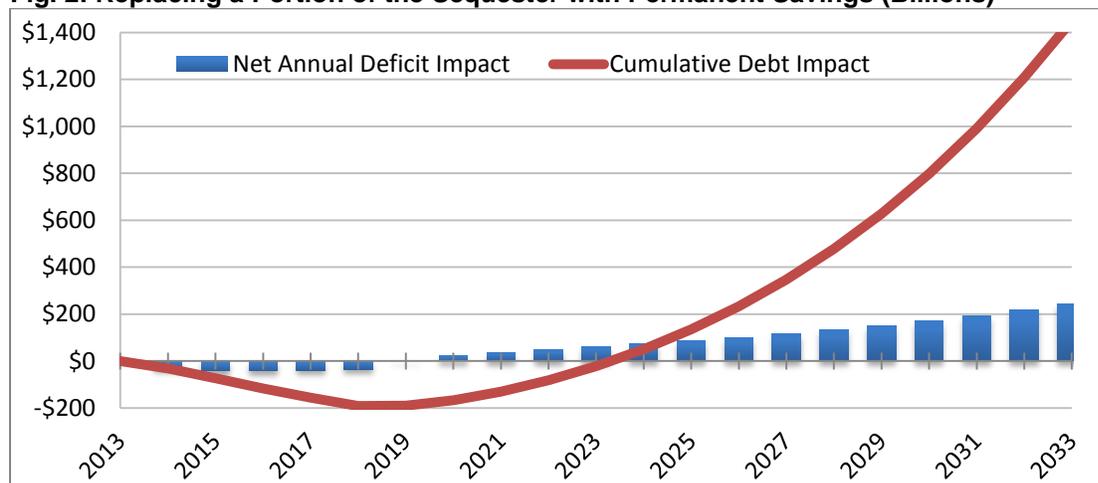


Replacing Short-Term Cuts with Long-Term Savings

Although sequestration has helped to reduce deficits over the next decade, it was intended to help bring both sides together on a bipartisan agreement to control the debt, rather than to actually go into effect. Its cuts are poorly targeted, hurt growth, do not tackle the drivers of our growing debt, do not grow over time, and end in 2021. For those reasons, policymakers should focus their attention on coming up with long-term savings instead. Below are a few illustrative examples (*estimates are very rough and exclude interest effects*):

- Replacing half the 2014 sequester with a modest package of farm subsidy cuts, higher PBGC premiums, and increased federal employee retirement contributions would be deficit-neutral in the first decade but reduce deficits by **\$50 to \$100 billion** in the second.
- Replacing half the 2014 sequester with expanded Medicare premium means-testing would be neutral through 2023 but reduce deficits by **\$300 to \$400 billion** through 2033.
- Replacing half the sequester for *five years* with the chained CPI would be neutral through 2023 but reduce deficits by about **\$1.2 trillion** in the second decade.
- Permanently replacing half the sequester with all the policies above and various Medicare payment reforms, and then “smoothing” discretionary spending to sequester levels by 2023, would be neutral over ten years but would reduce deficits in the second decade by over **\$1.8 trillion**.

Fig. 2: Replacing a Portion of the Sequester with Permanent Savings (Billions)



Note: Negative values reflect higher deficits/debt, and positive values reflect deficit/debt reduction. Estimates include interest costs and savings.

The above graph demonstrates the deficit and debt impact of replacing half of the sequester cuts for five years with the chained CPI, which would reduce the debt by over \$1.4 trillion by 2033 once interest costs and savings are incorporated.



How to Evaluate the Long-Term Impact of Policies

In order to understand the long-term impact of policy choices, lawmakers should request long-term impact analyses for major policy changes from scoring agencies or outside groups whenever possible. Within the context of a budget resolution, they should also set long-term targets where possible. However, there is more than one way to measure the long-term impact. Depending on the specifics of the policy, the goals of policymakers, and the analytical capabilities of the estimator, different methods may be warranted. Among the methods are:

Second Decade Analysis

A straightforward way to look beyond the first decade is a second-decade cost estimate. CBO occasionally estimates the direction of legislation in the second decade – whether it increases or decreases the deficit – but recently has estimated the magnitude of changes in a few instances, either through broad percent-of-GDP ranges or specific, but rough, dollar estimates. Although second decade analysis does not provide a complete picture of the long term, it offers substantial insight relative to looking at the first decade alone.

Future Point Estimate

Another way to look at the long term is to examine the budgetary effect of a policy in a particular future year. The magnitude could be expressed in dollar terms, as a percent of GDP, or as a percent of the program's cost or revenue stream. While this type of estimate does not provide a complete analysis of the long term and does not show how a policy's impact is changing over time, it does give an idea as to how a policy's impact in a future year compares to the first decade.

Long-Term Actuarial Impact

For some programs, estimators have the ability to project out 25, 50, or even 75 years. The latter time frame is particularly relevant for Social Security, since 75 years spans the lives of almost all current workers. When Social Security's actuaries score provisions, they estimate the effect on the program's 75-year actuarial imbalance, including the interest which accrues. The actuaries also show the full year-by-year impact of changes on spending and revenue (as a percent of payroll), especially focusing on the 75th year. Similar estimates can be made for the Medicare program, particularly Part A. This approach has the advantage of using a long time horizon and being useful for evaluating programs with dedicated revenue sources and trust funds; however, it may obscure effects in the relatively near term as well as the very long term.

Present Value/Fiscal Gap Analysis

A fiscal gap analysis uses present value calculations to show the amount of deficit reduction needed in a given year to stabilize the debt-to-GDP ratio over some time period. This type of analysis can be done over any number of years – though it is usually done over 25, 50, or 75 years – and can be presented as a share of GDP or in present-value dollars. One advantage to this approach is that by using present value estimates, which discount future money relative to current money, it rightfully recognizes that a dollar saved today is worth more than the same dollar saved 50 years from now. However, present value calculations are quite sensitive to which discount rates are used, which can lead to very different values.



Box 1: Examples of Legislation in 2013 That Incorporated Longer-Term Estimates

Immigration Reform

In scoring the Border Security, Economic Opportunity, and Immigration Modernization Act (S. 744), which passed the Senate in June, the Congressional Budget Office included important information on the *second decade impact*. Long-term analysis was especially necessary for this legislation since an influx of workers would result in immediate new revenue but also new entitlement spending that would increase slowly in coming decades.

The CBO score of the immigration bill provided second-decade totals, rounded to the nearest \$5 billion, as opposed to year-by-year estimates rounded to the nearest \$100 million for the first decade. According to their estimates, the legislation would increase revenue by \$456 billion in the first decade and \$1.5 trillion in the second decade, while increasing spending by \$321 billion in the first decade and \$875 billion in the second. The bill would reduce primary deficits by \$135 billion (0.1 percent of GDP) in the first decade and \$610 billion (0.2 percent of GDP) in the second decade.

Importantly, CBO was unable to determine whether the bill would reduce the deficit in the third decade – though a separate analysis from the Social Security Administration focusing exclusively on Social Security found that it would increase the cash-flow into that program through around 2050, reduce Social Security’s 75-year deficit by 0.21 percent of taxable payroll, and extend the life of the OASDI Trust Fund by two years.

President’s Chained CPI Proposal

In his FY 2014 budget proposal, President Obama proposed adopting the so-called chained CPI for measuring Social Security cost-of-living-adjustments (COLAs), other inflation-indexed mandatory programs, and the inflation-adjusted parameters of the tax code. In the case of Social Security, the President paired the switch with an increase in benefits for very old beneficiaries.

The Social Security Administration (SSA) estimated the *75-year actuarial impact* of the *Social Security* portion of chained CPI, along with the benefit increase. According to SSA, these changes would reduce Social Security costs by about \$120 billion through 2023. However, savings would grow and compound over time – saving about \$400 billion in the second decade and \$800 billion in the third decade.

On a 75-year actuarial basis, SSA found that the two policies would reduce the shortfall by 0.34 percent of payroll, which is the equivalent of 13 percent of the program’s 75-year shortfall or \$1.2 trillion on a present value basis. By itself, the chained CPI would close 20 percent of the 75-year gap.

Steady-State Analysis

For policy changes whose score is impacted by a shift in the timing of tax or spending actions, it may be useful to do a “steady-state” analysis. A steady-state analysis shows the budgetary effect of a policy, disregarding aspects that result in temporary effects or timing shifts. This type of analysis is particularly useful for policies with both permanent and temporary effects. In those cases, the steady-state analysis would measure the effect of the former while ignoring the latter. The measurement can be expressed in dollar terms or as a percent of GDP. An advantage to this approach is that it controls for the “noise” associated with timing shifts. On the other



hand, it ignores the fact that these shifts can create noticeable increases or decreases in borrowing levels upfront that – though temporary – can continue to have effects in later years in the form of higher or lower debt levels and, thus, interest payments.

Generational Accounting

Generational accounting is a method of accounting on a present value basis for the assets and liabilities faced by each generation. The approach was outlined in a 1991 paper by Alan Auerbach, Jagadeesh Gokhale, and Laurence Kotlikoff.⁴ Generational accounting measures the amount in present value that each generation consumes and pays to the government, including debt that is accumulated. The purpose of generational accounting is to make explicit the link between present consumption and the future debt burden. It is generally used for programs like Social Security and Medicare, but it can be applied across the federal budget. Generational accounting has the advantage of making explicit the balance of consumption benefits and debt burdens across generations, but it is difficult to interpret and may not adequately account for debt increases that can improve future generations’ living standards, such as investment in education.

Tenth-Year Effect

Often, true long-term analysis is not easily available or easily understood. However, even looking at the details of a ten-year score can offer insight as to what the long-term might look like. For example, a policy that reduces deficits over a total ten-year time frame, but increases them in the tenth year, is likely to increase them in future years. By focusing on the cost or savings of a policy in the tenth year and its trend from prior years, it is possible to gain a better understanding of the long-term impact. Looking at the tenth year has the advantage of using scores that are already widely available to get an idea of what the long-term effects may look like, but it does not account for effects that occur beyond the tenth year.

Conclusion

Budget discussions in recent years have more often focused on ten-year numbers rather than the country’s longer-term fiscal challenges. As a result, many of the savings lawmakers have enacted since 2010 have reduced short-term deficits without bending the long-term debt curve. Looking at other types of analysis that highlight longer-term impacts can help lawmakers refocus on controlling the debt trajectory in future decades.

The nation’s biggest fiscal challenges do not occur this decade, but over the long run, when population aging and rising health care costs threaten to cause the cost of entitlement programs to explode. Policymakers must put a renewed focus on the long-term, using this opportunity to replace short-term savings with policies that can achieve greater savings over the long run. When analyzing policy they should not ignore ten-year budget scores, but rather supplement them with a better understanding of the long-term impact.

⁴ Alan J. Auerbach, Jagadeesh Gokhale, and Laurence J. Kotlikoff. “Generational Accounts – A Meaningful Alternative to Deficit Accounting,” October 1991. NBER Working Paper. <http://www.nber.org/papers/w3589>.