Committee for a Responsible Federal Budget

CRFB Analysis of the FY2013 Mid-Session Review
July 27, 2012

Today, the Office of Management and Budget (OMB) released its annual Mid-Session Review, updating estimates for federal spending, revenue, and economic projections from the President's FY 2013 budget proposals first released in February. This review shows slightly lower deficit and debt levels than previously projected – largely due to updated economic and technical forecasts pushing down spending and interest payments. The President has proposed a combination of revenue increases and spending cuts large enough to put the debt on a slight downward path as a share of the economy by the end of the decade. However, debt would remain at nearly twice the historical average under the President's budget, and would likely grow over the long-term. More will need to be done to ensure debt is on a clear and certain downward path.

Our major findings include:

- The Mid-Session Review provides updated estimates to the President's proposed policies from February, including about $210 billion in jobs proposals, $325 billion of health care savings, $1.5 trillion from new revenues, and $235 billion of other savings, according to the Administration's own estimates. We discussed these proposals in detail in our previous analysis at http://crfb.org/document/analysis-presidents-fy-2013-budget.
- According to OMB, the President's budget would result in debt levels rising from 73.5 percent of GDP in 2012 up to a peak of 78.6 percent in 2014 and then gradually falling to 75.1 percent by 2022.
- Deficits under the President's budget are estimated to decline from 7.8 percent of GDP in 2012 to 3.2 percent by mid-decade and 2.6 percent per year from 2018 through 2022.
- Spending will average 22.3 percent of GDP from 2013-2022, compared to the historical average of about 21 percent. Revenue will average 19.1 percent of GDP, compared to the historical average of about 18 percent. By the end of the decade, spending is projected to reach 22.6 percent of GDP and revenue 20.0 percent.
- Overall, debt projections have slightly improved from those in the President's budget published in February. This is largely due to downward revisions to economic forecasts, pushing down revenues but pushing down spending and interest payments even more.

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OMB's newest estimates continue to make the case for enacting a larger comprehensive deficit reduction plan. The President takes the right approach by replacing the abrupt and unwise fiscal cliff with a gradual and thoughtful deficit reduction plan. However, the proposals in the President's budget do not go far enough to put the debt on a clear downward path over the next ten years and to control the long-term debt trajectory by reining in the growth of health care and retirement costs.

Deficits and Debts

Under the latest estimates, deficits in the President's budget would fall from 7.8 percent of GDP ($1.2 trillion) in 2012 to 2.9 percent of GDP ($576 billion) in 2017 before stabilizing at 2.6 percent for the remainder of the ten-year outlook. Over the decade, deficits would average 3.2 percent of GDP, compared to the 3.3 percent average projected in February.

Fig. 1: Budget Projections (Percent of GDP)

Fiscal Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
REVENUES												
2013 Budget (CBO)	15.4%	17.2%	18.7%	19.4%	19.6%	19.6%	19.6%	19.6%	19.7%	19.7%	19.8%	19.4%
2013 Budget (OMB)	15.8%	17.8%	18.7%	19.0%	19.1%	19.2%	19.4%	19.5%	19.7%	19.9%	20.1%	19.2%
Current Law (CBO)	15.8%	18.7%	19.8%	20.4%	20.5%	20.6%	20.7%	20.7%	20.9%	21.0%	21.2%	20.5%
Mid-Session Review	15.7%	17.0%	18.6%	18.9%	19.0%	19.2%	19.3%	19.5%	19.7%	19.9%	20.0%	19.1%
CRFB Realistic	15.8%	17.2%	18.0%	18.4%	18.5%	18.6%	18.6%	18.6%	18.6%	18.7%	18.8%	18.4%
OUTLAYS												
2013 Budget (CBO)	23.5%	23.4%	23.0%	22.4%	22.4%	22.1%	22.0%	22.3%	22.5%	22.6%	22.8%	22.5%
2013 Budget (OMB)	24.3%	23.3%	22.6%	22.3%	22.5%	22.2%	22.0%	22.3%	22.5%	22.7%	22.8%	22.5%
Current Law(CBO)	23.4%	22.5%	22.1%	21.8%	21.9%	21.7%	21.5%	21.8%	21.9%	22.0%	22.4%	22.0%
Mid-Session Review	23.5%	23.1%	22.5%	22.2%	22.3%	22.0%	21.9%	22.1%	22.3%	22.5%	22.6%	22.3%
CRFB Realistic	23.4%	22.9%	22.8%	22.4%	22.5%	22.3%	22.3%	22.7%	22.9%	23.1%	23.6%	22.8%
DEFICITS												
2013 Budget (CBO)	8.1%	6.1%	4.2%	3.1%	2.8%	2.5%	2.5%	2.8%	2.8%	2.9%	3.0%	3.2%
2013 Budget (OMB)	8.5%	5.5%	3.9%	3.4%	3.4%	3.0%	2.7%	2.8%	2.8%	2.8%	2.8%	3.3%
Current Law(CBO)	7.6%	3.8%	2.3%	1.5%	1.4%	1.0%	0.8%	1.0%	1.0%	1.0%	1.2%	1.4%
Mid-Session Review	7.8%	6.1%	3.9%	3.3%	3.2%	2.9%	2.6%	2.6%	2.6%	2.6%	2.6%	3.2%
CRFB Realistic	7.6%	5.7%	4.8%	4.0%	4.0%	3.8%	3.7%	4.1%	4.3%	4.4%	4.8%	4.3%
DEFICITS (BILLIONS)												
2013 Budget (CBO)	$1,253	$977	$702	$539	$529	$488	$510	$602	$638	$678	$728	$6,390
2013 Budget (OMB)	$1,327	$901	$668	$610	$649	$612	$575	$626	$658	$681	$704	$6,684
Baseline (CBO)	$1,171	$612	$385	$257	$259	$201	$175	$224	$234	$237	$303	$2,887
Mid-Session Review	$1,211	$991	$661	$595	$615	$576	$543	$578	$604	$627	$652	$6,444
CRFB Realistic	$1,183	$903	$788	$704	$746	$741	$772	$886	$968	$1,049	$1,187	$8,746

Note: For more information on CRFB's Baseline, see http://crfb.org/crfbs-realistic-baseline.

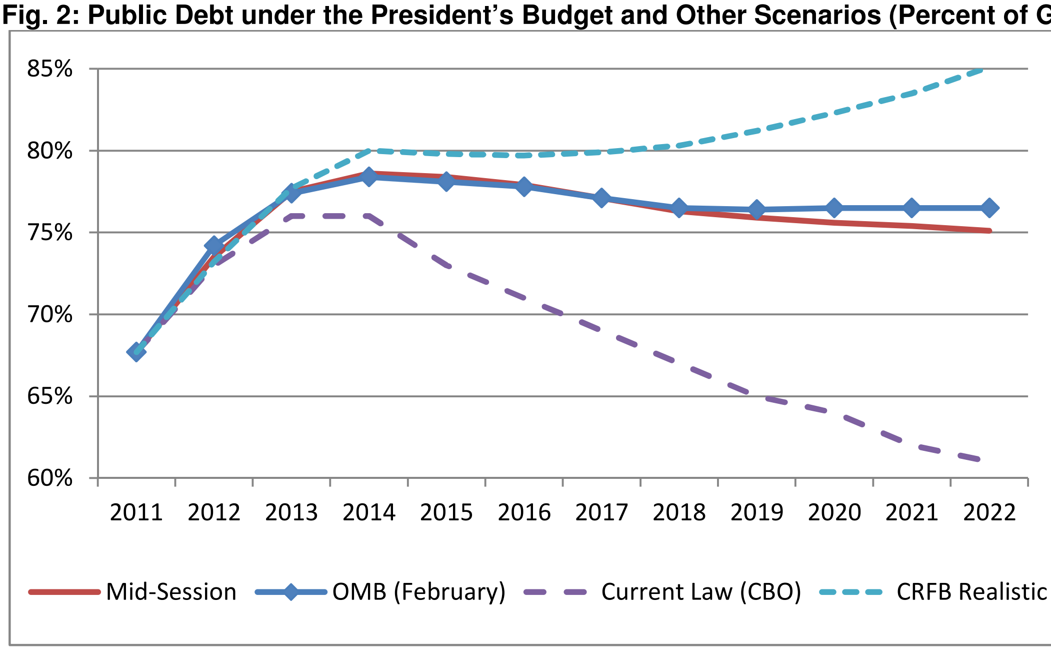
Driving these persistent deficits is a continued projected divergence between spending and revenues. Under the President's proposals, spending is projected to fall from 23.5 percent of GDP ($3.7 trillion) in 2012 to 21.9 percent ($4.6 trillion) in 2018, and then rise slowly thereafter – reaching 22.6 percent of GDP ($5.7 trillion) by 2022. This increase is largely the result of population aging as the retirement of the baby boom population puts pressure on Social Security and Medicare costs. It is also caused by rising interest costs as debt continues to accumulate and interest rates return to more normal levels.

Revenue, meanwhile, would rise continuously from 15.7 percent of GDP this year ($2.4 trillion) to 19 percent ($3.6 trillion) in 2016 and 20 percent of GDP ($5.1 trillion) by 2022. This rise is largely due to the economic recovery – which would push revenues toward historical levels of 18 percent of GDP or so – but also due to new revenues from the Affordable Care Act and proposed revenue increases from allowing the upper-income tax cuts to expire, limiting various tax expenditures for higher earners, and enacting other revenue provisions.

As a result of the continued deficits under the President's budget, debt will continue to grow in nominal terms indefinitely – from $11.4 trillion in 2012 to $19.1 trillion by 2022. As a share of the economy, debt is projected to grow from 73.5 percent in 2012 to a high of 78.6 percent in 2014 before gradually declining to 75.1 percent of GDP by 2022.

This debt numbers are somewhat better than previous projections from CBO and OMB – both which suggested the President's budget would stabilize the debt at about 76 percent of GDP through the ten-year window. It is also a substantial improvement over continuing current policy, which could result in debt levels of 85 percent of GDP or higher in 2022. On the other hand, these debt levels are far higher than current law – in which debt would decline to 61 percent of GDP, according to CBO.

Fig. 2: Public Debt under the President's Budget and Other Scenarios (Percent of GDP)



Moreover, these estimates may turn out to be overly optimistic when compared to what CBO would find, and still fall short of putting the debt on a clear and unequivocal downward path over the medium and long-term.

Changes from February

As mentioned above, OMB's latest projections have improved overall relative to their estimates from February. While revenues are projected to be about $500 billion lower from 2013 through 2022, spending is projected to be roughly $740 billion below the February levels. As a result, deficits are projected to be about $240 billion *smaller* over ten years, which means that even with $100 billion of less GDP in 2022, debt is projected to be 1.4 percent of GDP below in that year and deficits 0.2 percent of GDP below the February levels.

Changes in OMB's budgetary projections are due in part to changes in overall economic projections. Real GDP growth is now projected to grow about 0.4 percentage points slower in 2012 and 0.3 percentage points slower in 2013. As a result, revenue collection is projected to grow more slowly. On the other hand, OMB also projects interest rates to be lower – by 0.8 percent in 2012 and 2013 and 0.2 percent by 2022. Primarily as a result of these lower rates, net interest payments are projected to be roughly $420 billion less than OMB previously believed.

Fig. 3: Economic Projections

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP Growth											
Mid-Session Review	2.3%	2.7%	3.5%	4.1%	4.0%	3.8%	3.2%	2.7%	2.5%	2.5%	2.5%
OMB (February)	2.7%	3.0%	3.6%	4.1%	4.0%	3.9%	3.2%	2.7%	2.5%	2.5%	2.5%
CBO (January)	2.2%	1.0%	3.6%	4.9%	4.2%	3.3%	2.8%	2.6%	2.5%	2.4%	2.4%
Inflation											
Mid-Session Review	2.1%	1.9%	2.0%	2.0%	2.1%	2.2%	2.2%	2.2%	2.2%	2.2%	2.2%
OMB (February)	2.2%	1.9%	2.0%	2.0%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%
CBO (January)	1.7%	1.5%	1.5%	1.7%	2.0%	2.2%	2.3%	2.3%	2.3%	2.3%	2.3%
Unemployment Rate											
Mid-Session Review	8.0%	7.7%	7.3%	6.7%	6.2%	5.7%	5.4%	5.4%	5.4%	5.4%	5.4%
OMB (February)	8.9%	8.6%	8.1%	7.3%	6.5%	5.8%	5.5%	5.4%	5.4%	5.4%	5.4%
CBO (January)	8.8%	9.1%	8.7%	7.4%	6.3%	5.7%	5.5%	5.5%	5.4%	5.4%	5.3%
Interest Rate on 10-Year Treasury Bond											
Mid-Session Review	2.0%	2.7%	3.5%	4.1%	4.5%	4.9%	5.0%	5.1%	5.1%	5.1%	5.1%
OMB (February)	2.8%	3.5%	3.9%	4.4%	4.7%	5.0%	5.1%	5.1%	5.1%	5.3%	5.3%
CBO (January)	2.3%	2.5%	2.9%	3.5%	4.1%	4.6%	4.8%	5.0%	5.0%	5.0%	5.0%

In addition to economic changes, legislative and technical changes have some effect on the projections. On the legislative side, the passage of the payroll tax cut extension and the transportation bill, along with their savings on interest on the debt, have reduced 2013-2022 deficits by about $15 billion. On the technical side, OMB is now projecting slower health care cost growth as well as fewer-than-expected new Social Security beneficiaries. Due to a combination of these factors and somewhat lower projected cost-of-living-adjustments (COLAs), Social Security is projected to spend $110 billion less through 2022 than previously thought, while Medicare and Medicaid are projected to spend $220 billion less.

Fig. 4: Estimating Changes in the President's Budget Since February

Area	2013-2017 Savings/Costs (-)	2013-2022 Savings/Costs (-)
President's Budget Deficit	**-$3,440**	**-$6,689**
Legislative Changes	**$40**	**$15**
Economic and Technical Changes	**-$38**	**$225**
Revenue	-$363	-$518
Medicaid	$41	$123
Medicare	$52	$97
Social Security	$45	$110
Other Spending	$8	$16
Net Interest	$203	$422
Mid-Session Review Deficit	**-$3,439**	**-$6,449**

Conclusion

The Mid-Session Review provides yet another reminder of how serious our fiscal challenges are and how critical it is to move swiftly to enact a comprehensive plan to set our nation on a sustainable financial path. While the estimates now show the President's budget would put the debt on a slow downward path over the decade, these projections are in many ways contingent on health care cost growth continuing to temper and interest rates remaining low.

Importantly, without a credible plan to bring the debt under control, interest rates could start to rise to far higher levels than projected in this document. And though the President has the right idea by replacing the fiscal cliff with a more gradual and thoughtful deficit reduction plan, enacting such a plan into law will require political compromise in which both sides have to give something up.

When a bipartisan deficit reduction plan is agreed to, it should go much further than the President by bringing the debt down to a lower level and putting it on a clearer downward path over the medium term. That plan should also do more to slow the growth of entitlement spending over the long-term.

With a fiscal cliff looming at the end of the year, the next several months present an opportunity for policymakers to work together on a sensible plan to both avoid the fiscal cliff while also controlling rising debt. The strength of the American economy and standard of living will suffer if they do not.