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Analysis of CBO's Budget and Economic Projections February 5, 2013

Today, the Congressional Budget Office (CBO) released its updated budget and economic projections for the next ten years, incorporating the effects of the fiscal cliff package enacted early last month as well as the latest economic and technical adjustments.

For the first time since March 2011, CBO's current law projections show debt on an upward path as a share of the economy over the next decade. In the coming weeks and months, it is imperative that lawmakers take advantage of opportunities presented by the sequester and the congressional budget process to enact a comprehensive deficit reduction plan to reverse this trend.

Our main takeaways from the report are:

- Under current law, debt held by the public is expected to rise from 72.5 percent at the end of 2012 to almost 78 percent by 2014 before falling to 73 percent in 2018 and then rising continuously thereafter, reaching 77.0 percent by 2023. For comparison, debt was projected to be 58.5 percent of GDP in 2022 under CBO's August outlook.
- Under CBO's Alternative Fiscal Scenario (AFS) – which assumes policymakers waive the sequester, continue to enact “doc fixes,” and extend various expiring tax breaks – debt is projected to rise to nearly 87 percent of GDP by 2023 – roughly 10 percentage points higher than current law projections.
- Deficits under current law projections will average 3.3 percent of GDP over the next ten years and 4.4 percent of GDP under the AFS.
- With a large portion of the fiscal cliff resolved, CBO projects economic growth to average 1.4 percent in calendar year 2013, compared to a 0.3 percent decline projected last August. However, long-term growth will be about 0.1 percent slower as a result of the higher debt burden.
- CBO projects that an additional \$2.3 trillion of deficit reduction would not only put debt on a downward path toward 68 percent of GDP in 2023, but would also increase the size of the economy by almost 1 percent in that year.

Revenue, Spending, Deficits, and Debt

By making permanent a larger number of tax cuts, the American Taxpayer Relief Act (ATRA) substantially altered CBO's 10-year budget projections.

As a result of the expiration of the tax cuts for the highest earners, the expiration of the “payroll tax holiday,” the start of new taxes enacted under the Affordable Care Act, and the economic recovery, revenue is projected to grow substantially – from 15.8 percent of GDP in 2012 to 19.1 percent in 2015, and then will remain between 18.7 and 19.1 percent through 2023.

Fig. 1: Budget Projections Under CBO's February and August Baselines

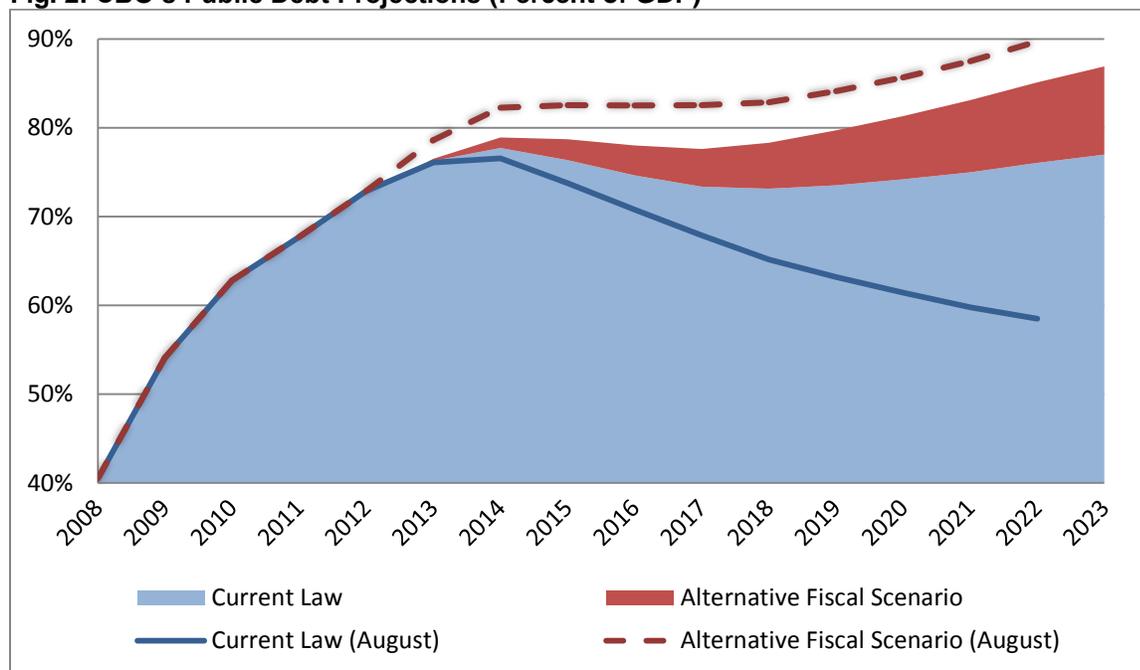
Fiscal Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Ten-Year*
REVENUES (Percent of GDP)													
CBO (February)	15.8%	16.9%	18.0%	19.1%	19.1%	18.9%	18.8%	18.7%	18.7%	18.9%	19.0%	19.1%	18.9%
CBO (August)	15.7%	18.4%	19.6%	20.3%	20.6%	20.7%	20.8%	20.9%	21.1%	21.2%	21.4%	N/A	20.6%
OUTLAYS (Percent of GDP)													
CBO (February)	22.8%	22.2%	21.7%	21.6%	21.6%	21.5%	21.7%	22.0%	22.2%	22.4%	22.9%	22.9%	22.1%
CBO (August)	22.9%	22.4%	21.9%	21.5%	21.6%	21.4%	21.2%	21.5%	21.7%	21.8%	22.3%	N/A	21.7%
DEFICITS (in Billions)													
CBO (February)	\$1,089	\$845	\$616	\$430	\$476	\$535	\$605	\$710	\$798	\$854	\$957	\$978	\$6,958
CBO (August)	\$1,128	\$641	\$387	\$213	\$186	\$123	\$79	\$130	\$142	\$144	\$213	N/A	\$2,258
DEBT (in Billions)													
CBO (February)	11,280	12,229	12,937	13,462	14,025	14,642	15,316	16,092	16,957	17,876	18,902	19,944	N/A
CBO (August)	11,318	12,064	12,545	12,861	13,144	13,371	13,536	13,746	13,964	14,181	14,464	N/A	N/A
DEFICITS (Percent of GDP)													
CBO (February)	7.0%	5.3%	3.7%	2.4%	2.5%	2.7%	2.9%	3.2%	3.5%	3.6%	3.8%	3.8%	3.3%
CBO (August)	7.3%	4.0%	2.4%	1.2%	1.0%	0.6%	0.4%	0.6%	0.6%	0.6%	0.9%	N/A	1.1%
DEBT (Percent of GDP)													
CBO (February)	72.5%	76.3%	77.7%	76.3%	74.6%	73.4%	73.1%	73.5%	74.2%	75.0%	76.0%	77.0%	N/A
CBO (August)	72.8%	76.1%	76.6%	73.8%	70.8%	67.9%	65.2%	63.2%	61.4%	59.8%	58.5%	N/A	N/A
ALTERNATIVE FISCAL SCENARIO (Percent of GDP)													
AFS DEFICITS (Feb.)	7.0%	5.5%	4.7%	3.7%	3.7%	3.8%	4.0%	4.5%	4.7%	4.8%	5.1%	5.0%	4.4%
AFS DEFICITS (Aug.)	7.3%	6.5%	5.6%	4.6%	4.5%	4.2%	4.2%	4.6%	4.8%	5.1%	5.5%	N/A	4.9%
AFS DEBT (Feb.)	72.5%	76.5%	78.9%	78.7%	78.0%	77.6%	78.3%	79.7%	81.3%	83.1%	85.1%	86.9%	N/A
AFS DEBT (Aug.)	72.8%	78.6%	82.3%	82.5%	82.5%	82.5%	82.9%	84.1%	85.7%	87.5%	89.7%	N/A	N/A

*Ten-year column reflects 2014-2023 for February baseline and 2013-2022 for August baseline.

Spending, meanwhile, is scheduled to fall from 22.8 percent of GDP in 2012 to 21.5 percent by 2017, largely as a result of the economic recovery and the so-called “sequestration,” before rising to 22.9 percent of GDP by 2023 due to a combination of new spending from the Affordable Care Act, the effects of population aging and health care cost growth, and growing interest payments.

As a result of the gulf between spending and revenue, deficits will persist throughout the decade. Under current law, deficits will fall from 7 percent of GDP (\$1.1 trillion) in 2012 to a low of 2.4 percent of GDP (\$430 billion) in 2015 before rising to 3.8 percent of GDP (\$978 billion) by 2023. Under the AFS, deficits will fall to only 3.7 percent of GDP (\$644 billion) in 2015 and reach 5.0 percent (\$1.3 trillion) by 2023.

Fig. 2: CBO's Public Debt Projections (Percent of GDP)



Source: Congressional Budget Office.

As a result, debt is no longer expected to be on a downward path under current law, as was the case in CBO's August current law projections. Instead, debt is projected to rise from 72.5 percent of GDP in 2012 to nearly 78 percent of GDP in 2014, fall to a low of 73 percent in 2018, and then resume on an upward path, reaching 77 percent by 2023. In dollar terms, debt would exceed \$19.9 trillion by 2023. This is a stark break from what was projected in August, when CBO projected debt to decline to 58.5 percent of GDP (\$14.5 trillion) by 2022 under current law.

While the sequester was delayed two months in the fiscal cliff agreement, it is projected to take effect on March 1 in CBO's current law baseline. If these across-the-board cuts were cancelled, deficits would be more than \$1.2 trillion higher over the next ten years, and debt would reach 81.7 percent of GDP by 2023. Under the Alternative Fiscal Scenario, which also assumes annual "doc fixes" and the continuation of many expiring tax provisions, debt will remain in the high 70s as a share of GDP through 2019 before rising to 87 percent of GDP by 2023.

CRFB will present our own realistic baseline later this week, which will show alternative projections that also account for a drawdown of the wars in Iraq and Afghanistan along with other changes.

Economic Projections

CBO's economic projections have changed dramatically in the short-term as a result of the fiscal cliff legislation, with changes in longer-term projections occurring as well. As a result of the American Taxpayer Relief Act (ATRA), lawmakers avoided more than half of the economic effects of the fiscal cliff and, thus, likely avoided an economic recession.

CBO now expects real GDP to grow by 1.4 percent in calendar year 2013, compared to a 0.3 percent decline in output under the August projections. Likewise, estimates of the unemployment rate are better in the near-term, with a 7.9 percent unemployment rate in 2013 compared to 8.8 percent in their August projections. Unemployment will remain high in the short and medium-term – staying above 7.5 percent through 2014, declining to 5.5 percent by 2018, and then settling around 5.3 percent by the end of the decade. Note that these economic projections still incorporate current law assumptions, which now include sequestration beginning in March and other policies expiring or activating as scheduled thereafter.

As the economy recovers, CBO projects inflation and interest rates will remain relatively low in the near-term. However, as the economy moves closer to full capacity, both measures will rise gradually. In the second half of the decade, growth of the consumer price index will level out at 2.3 percent per year and interest rates on 10-year Treasury bonds will rise from about 2 percent today to 5.2 percent later in the decade.

By the end of the decade, CBO projects real GDP growth of roughly 2.2 percent. This is slightly lower than prior projections of 2.3 percent, likely as a result of the higher debt burden. Under CBO's AFS, long-term growth will likely be even slower; based on CBO numbers provided elsewhere, GNP could be about 1 percent lower in 2023.

As CBO states, "If policymakers modified the tax and spending policies in current law, their actions could have significant implications for economic growth. For instance, less fiscal tightening this year would lead to stronger growth in 2013 but, if not accompanied by sufficient additional tightening in later years, would also restrain real output and income in the middle of the decade and beyond owing to higher federal debt."

In other words, while allowing the sequestration and other policies to take effect or expire as scheduled would represent a hit to *short-term growth*, avoiding these changes by continuing to rack up debt would slow *long-term growth*. This reality presents an opportunity to replace the mindless abrupt cuts in the sequester (and, later, scheduled cuts by the Medicare Sustainable Growth Rate formula) with a gradual, intelligent plan which actually brings the debt to a lower level by 2023, but does so in a more gradual and targeted way.

Fig. 3: CBO's Economic Projections

Calendar Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Ten - Year
Real GDP Growth													
CBO (February)	2.3%	1.4%	2.6%	4.1%	4.4%	3.8%	2.6%	2.4%	2.3%	2.2%	2.2%	2.2%	2.9%
CBO (August)	2.1%	-0.3%	3.1%	4.8%	4.5%	3.8%	3.1%	2.6%	2.4%	2.2%	2.3%	N/A	2.9%
OMB (July)	2.3%	2.7%	3.5%	4.1%	4.0%	3.8%	3.2%	2.7%	2.5%	2.5%	2.5%	N/A	3.2%
Blue Chip	1.9%	2.2%	2.8%	N/A									
Federal Reserve	1.8%	2.6%	3.4%	3.4%	N/A								
Inflation (CPI)													
CBO (February)	2.1%	1.6%	1.9%	2.1%	2.1%	2.2%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.2%
CBO (August)	1.8%	1.4%	1.8%	2.0%	2.2%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	N/A	2.1%
OMB (July)	2.1%	1.9%	2.0%	2.0%	2.1%	2.2%	2.2%	2.2%	2.2%	2.2%	2.2%	N/A	2.1%
Blue Chip	1.9%	1.9%	2.2%	N/A									
Federal Reserve*	1.7%	1.7%	1.8%	1.9%	N/A								
Unemployment Rate													
CBO (February)	8.1%	7.9%	7.8%	7.1%	6.3%	5.6%	5.5%	5.5%	5.4%	5.4%	5.3%	5.3%	5.9%
CBO (August)	8.2%	8.8%	8.7%	7.7%	6.7%	5.9%	5.5%	5.5%	5.4%	5.4%	5.3%	N/A	6.5%
OMB (July)	8.0%	7.7%	7.3%	6.7%	6.2%	5.7%	5.4%	5.4%	5.4%	5.4%	5.4%	N/A	6.1%
Blue Chip	7.8%	7.5%	7.0%	N/A									
Federal Reserve	7.9%	7.4%	6.8%	6.3%	N/A								
Interest Rates on 10-Year Treasury Notes													
CBO (February)	1.8%	2.1%	2.7%	3.5%	4.3%	5.0%	5.2%	5.2%	5.2%	5.2%	5.2%	5.2%	4.7%
CBO (August)	1.8%	1.8%	2.4%	3.0%	3.8%	4.5%	4.9%	5.0%	5.0%	5.0%	5.0%	N/A	4.0%
OMB (July)	2.0%	2.7%	3.5%	4.1%	4.5%	4.9%	5.0%	5.1%	5.1%	5.1%	5.1%	N/A	4.5%
Blue Chip	1.7%	2.2%	2.7%	N/A									

*Federal Reserve numbers reflect Personal Consumption Expenditures (PCE) index, which is on average 0.2 to 0.3 percentage points lower than the Consumer Price Index (CPI).

Changes in CBO's Baseline Since August

Since CBO's August baseline, current law deficits have increased by nearly \$4.6 trillion between 2013 and 2022, which is roughly the amount by which the American Taxpayer Relief Act increased the deficit. Other legislative changes roughly cancel out, with CBO extrapolating higher spending as a result of disaster relief for Hurricane Sandy but lower spending as a result of less spending on the wars in Iraq and Afghanistan (both are extrapolated by inflation in future years under baseline conventions).

While legislative changes dramatically increased deficit projections, economic changes also slightly increased them by \$141 billion over the next ten years. Specifically, improved economic growth in the short-term (due to avoiding most of the fiscal cliff) and higher debt levels over the next ten years will produce higher interest rates and, thus, interest payments than projected under previous current law baselines.

Technical adjustments since the August projections, however, have slightly reduced deficit projections. A further slowdown in projected health care cost growth has reduced deficit projections by nearly \$375 billion over the next ten years, with overall technical adjustments reducing deficits by about \$269 billion.

Fig. 4: CBO's Legislative, Economic, and Technical Changes from August Projections

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
CBO August Deficits	\$641	\$387	\$213	\$186	\$123	\$79	\$130	\$142	\$144	\$213	\$2,258
Legislative Changes											
Legislative Changes	\$330	\$344	\$309	\$358	\$419	\$483	\$519	\$579	\$645	\$710	\$4,696
<i>Changes under ATRA</i>	\$330	\$353	\$311	\$340	\$371	\$404	\$415	\$447	\$482	\$514	\$3,967
<i>Other changes*</i>	\$0	\$15	\$9	\$2	-\$6	-\$6	-\$8	-\$9	-\$11	-\$12	-\$25
<i>Debt service</i>	\$1	\$5	\$7	\$20	\$42	\$73	\$96	\$122	\$153	\$185	\$704
Economic Changes											
Economic Changes	-\$12	-\$31	-\$15	-\$4	-\$2	\$29	\$42	\$46	\$46	\$42	\$141
<i>Change in primary deficit</i>	-\$12	-\$38	-\$22	-\$11	-\$14	-\$1	\$11	\$14	\$14	\$13	-\$51
<i>Change in interest rates</i>	\$0	\$7	\$8	\$8	\$14	\$31	\$31	30	\$28	\$28	\$186
<i>Debt service</i>	\$0	\$0	\$0	-\$1	-\$1	-\$1	\$0	\$2	\$4	\$5	\$7
Technical Changes											
Technical Changes	-\$114	-\$84	-\$78	-\$64	-\$5	\$14	\$20	\$32	\$19	-\$8	-\$269
<i>Changes in health projections</i>	-\$7	-\$19	-\$19	-\$19	-\$26	-\$35	-\$45	-\$56	-\$66	-\$80	-\$373
<i>Other changes</i>	-\$102	-\$61	-\$46	-\$33	\$24	\$47	\$62	\$89	\$90	\$79	\$150
<i>Debt service</i>	-\$5	-\$4	-\$13	-\$12	-\$3	\$2	\$3	-\$1	-\$5	-\$7	-\$45
Total Changes											
Total Changes	\$204	\$229	\$217	\$290	\$412	\$526	\$580	\$656	\$710	\$744	\$4,568
CBO February Deficits											
CBO February Deficits	\$845	\$616	\$430	\$476	\$535	\$605	\$710	\$798	\$854	\$957	\$6,825

Note: Positives/negatives reflect increases/decreases in deficits, respectively. Numbers may not add due to rounding.

*Other changes include the Disaster Relief Appropriations Act, which provided \$50 billion in emergency funding for the damage done by Hurricane Sandy, and the 2013 Continuing Appropriations Resolution, which reduced funding for wars in Iraq and Afghanistan, among other changes.

Conclusion

With much of the policy ambiguity from the fiscal cliff resolved, CBO's projections are further evidence that lawmakers need to take action. CBO's latest budget projections show that the United States' fiscal path is clearly on an unsustainable track. This is true even if the sequestration were allowed to mindlessly and abruptly cut spending, but is especially true under the Alternative Fiscal Scenario, where debt would grow dramatically in this and future decades.

Ideally, lawmakers should replace the sequester with an intelligent and gradual deficit reduction plan that controls the debt over the long-term. Doing so would result in both short and long-term economic gains, and could avoid painful and disruptive austerity later. Lawmakers cannot continue to put off dealing with the nation's fiscal challenges. With several budget "speed bumps" approaching in the coming weeks and months, lawmakers will have ample opportunities to forge a bipartisan deficit reduction plan.