United States Senate Budget Committee

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CBO's Outlook Drastically Understates Nation's Debt Path

The Congressional Budget Office baseline budget outlook dramatically understates—by nearly $6 trillion—the deficit and debt path that the nation is on. The agency's current law outlook shows deficits declining from $1.3 trillion last year to $1.1 trillion this year, and dropping further until fiscal year 2018, when it starts rising again. Using a realistic baseline, the nation will accumulate $9.8 trillion in public debt and $11.4 trillion in gross debt over the next ten years. The only reduction comes from the $2.1 trillion in cuts set forth in the Budget Control Act (BCA).

While on the surface of the report it appears that the budget outlook has become more benign, in fact it is not so. CBO's projections look brighter only because the agency is required to use unrealistic assumptions regarding current law. What's more, both the Congress and the president have in the past written laws in a way that manipulates the requirements under which CBO must operate. It sums up to a disservice to citizens who are owed the truth about the dire financial condition that the government faces.

In particular, the baseline outlook assumes the expiration of three policies that will not happen. First, it assumes that the tax cuts put in place in 2001 and 2003 will expire, raising taxes sharply at the end of this calendar year—a proposal not even President Obama supports. Second, the baseline assumes that the Alternative Minimum Tax (AMT) will begin to snare more and more taxpayers, even though the AMT has been patched annually to hold taxpayers harmless for more than a decade. Third, the baseline assumes that Medicare's payment rates for physicians will decrease by 27 percent on March 1, 2012, despite the fact that Congress has repeatedly prevented the payment reduction. While those assumptions are not tenable, they do improve CBO's baseline deficit outlook by $4.9 trillion over the projection period—overstating tax receipts by $4.6 trillion and understating Medicare spending by $326 billion.

The omissions regarding expiring policy also have an impact on the size of the national debt and the cost of servicing that debt. The higher interest costs add $846 billion to deficits and debt over the projection period, *which make the total deficit impact of the excluded policies $5.7 trillion*. Adding this amount to the baseline levels will increase gross federal debt to $27.4 trillion at the end of fiscal 2022. This would make the ratio of the nation's debt to its economic output approximately 111 percent in 2022, even higher than it is today.

A more realistic baseline outlook would show that deficits total some $9.9 trillion over the next 11 years—for an average deficit of some $900 billion each year for as far as the eye can see—and total debt well in excess of projected economic output. This is a dramatically different outlook than the CBO baseline projection would indicate—a dangerous course which must be confronted by the president in his upcoming budget submission.

Spending Rising Beyond Control

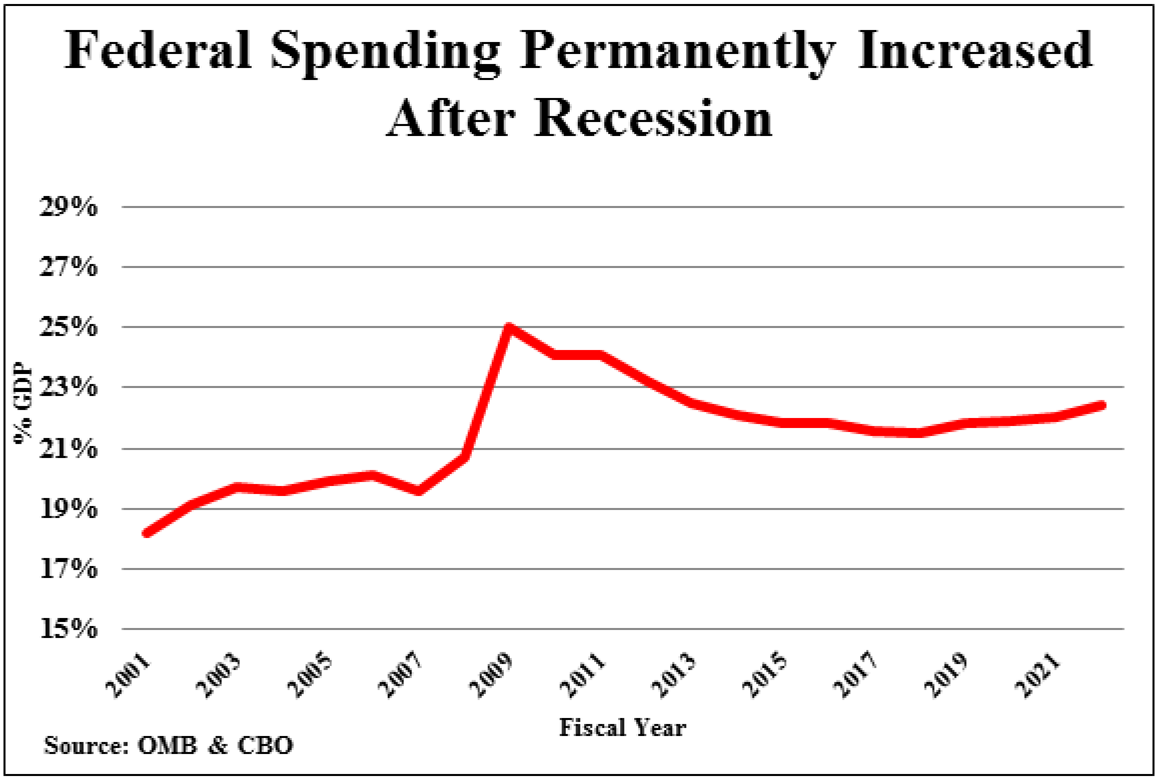
The shortcomings of the baseline primarily overstate the revenue side of the budget equation. An examination CBO's spending baseline shows that federal spending is on an unsustainable course. CBO projects federal spending will total $3.6 trillion in fiscal year 2012, and will increase to $5.5 trillion for 2022 in the baseline scenario, which assumes both that the statutory caps and sequester mechanism included in the Budget Control Act work as prescribed in the law to reduce the spending by some $2 trillion over 10 years. Even taking into account those reductions, spending is projected to increase by 53 percent between 2012 and 2022. Over the 11-year period covered by the report, federal spending under the current law baseline will total almost $48 trillion.

Mandatory spending, which covers programs such as Social Security, Medicaid, and food stamps, is expected to account for slightly more than $29 trillion—or 62 percent—of total federal spending in the baseline. Discretionary spending, which covers spending for defense and federal agency operations, will account for about $14 trillion (29 percent) in total spending, while net interest expense accounts for the remaining amounts (9 percent).

Growth in spending is being driven by both mandatory spending and the costs of servicing the national debt. Mandatory spending is large and growing at an average annual rate of 5.4 percent, more than twice the 2 percent average rate of inflation over the next decade. Net interest expense is currently low because interest rates are low, but that cost is expected to skyrocket at double-digit growth as the debt increases and interest rates return to more normal levels. Discretionary spending is expected to be below the growth in inflation, both because of the effects of the discretionary caps set in the Budget Control Act and the additional spending reductions required by its fallback sequester mechanism because of the failure of the Joint Select Committee on Deficit Reduction. (The fallback sequester falls principally on discretionary spending because it achieves savings equally from non-exempt defense and non-defense accounts, and almost all defense spending is considered to be discretionary spending.)

Within the mandatory spending category, particularly rapid growth is expected for federal health care programs. Spending on such programs, which account for 40 percent of net mandatory expenditures, are expected to grow at an average annual rate of 8 percent in the next decade. This results in large measure due to the costs of the health coverage expansions in the Patient Protection and Affordable Care Act (PPACA), which grow from $355 million today to $104 billion in 2022—an increase of almost three hundredfold.

The rapid growth in spending projected for the next 10 years will lead to a federal government that is permanently larger than it was before the 2008 financial crisis and subsequent recession. As shown in the chart, federal spending as a share of GDP is expected to decline slightly as the economy returns to trend growth, but will still be well above the average for most of the last decade.



Even more troubling, however, is the trend shown in the chart for the final years of the projection period. The slow and steady increase in federal spending as a share of the economy will not abate without serious reform of federal spending programs. Moreover, this chart might understate the projected size of the government because the risks to this outlook are to the downside. In particular, interest rates are still projected to be relatively low by historical standards. Should interest rates spike in the future (for example, from potential concerns about the federal government's ability to control its finances), federal spending as a share of the economy will likely be even higher than currently projected by the CBO.