

Executive Summary Background

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Entitlement-Driven Long-Term Budget Substantially Worse Than Previously Projected

Brian M. Riedl

Federal budget projections consistently warn that America faces a future of unaffordable entitlement spending, deep federal debt, and economic stagnation unless lawmakers modernize runaway entitlement programs. This paper shows that the long-term budget picture may even be substantially worse than previously projected.

Specifically, a realistic budget projection shows that combined nominal Medicare, Social Security, and Medicaid spending will double over the next decade. Adding in the costs of the war on terrorism, Hurricane Katrina, and other congressional spending priorities pushes total 2015 federal spending well past \$4 trillion, and the budget deficit to \$873 billion—a level that could lead to harmful tax increases.

Dismal Budget Picture. The 2006–2050 budget picture is even more dismal. Because of the cost of fully funding Social Security, Medicare, and Medicaid, leading long-term budget projections have calculated that federal spending will increase from the current 20 percent of gross domestic product (GDP) to a peacetime high of nearly 33 percent of GDP by 2050.

Yet even that may be a severe underestimate. These projections assume slower entitlement growth than estimated by the Social Security and Medicare trustees as well as substantial reductions in defense and other spending. Most critically, they assume that the resulting unprecedented increase in the national debt will not affect interest rates.

More realistic assumptions show that Social Security, Medicare, and Medicaid costs will leap from 8.4 percent of GDP to 18.9 percent of GDP by 2050. Unless lawmakers reform these programs, they will have to fund their costs by:

1. **Raising taxes** every year until federal taxes are *57 percent* (\$11,000 per household, adjusted into today's economy) above the current levels;
2. **Eventually eliminating every other federal program**, including spending on defense, education, anti-poverty programs, and veterans benefits, by 2045; or
3. **Running massive budget deficits** (the status quo option). This is the most expensive option because it would cause the federal debt to increase from the current level of 40 percent of GDP to 500 percent of GDP. Beginning in 2025, just a small interest rate response would push federal spending to 44 percent of GDP by 2040 and 73 percent by 2050—levels *twice as high* as previous projections.

Those who consider these scenarios overly pessimistic should examine the Western European

This paper, in its entirety, can be found at:
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economies that are already sinking under the weight of their enormous social insurance systems. With birth rates that are not even sufficient to replace their current population, many “old Europe” nations have been forced to impose steep tax increases on their remaining workers to fund these bloated benefit systems.

Overall, government spending in the 15 nations comprising the pre-2004 European Union (EU-15) averages 48 percent of GDP, and tax revenues average 41 percent of GDP. These high tax rates and expenditures, combined with tight economic regulations, have hammered their economies. Compared to the United States, per capita income is 30 percent lower in the EU-15, economic growth rates are 34 percent lower, unemployment is substantially higher, and living standards match only America’s poorest states.

As their populations continue to age, the economies of countries such as Germany and France risk

collapsing under the weight of their unrealistically generous retirement and welfare systems. These European crises provide a glimpse into America’s future if government spending continues to increase steeply.

Conclusion. The data presented in this paper are not predictions of what will occur. They merely represent three painful possible outcomes if lawmakers choose to continue on their current course with Social Security, Medicare, and Medicaid. The data show that unreformed entitlements not only could cause significant economic pain, but also could eventually place the entire American economic and financial system in crisis. Modernizing entitlements and averting this calamity is the most important economic challenge of this era.

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The 2006–2050 budget picture is even more dismal. Because of the cost of fully funding Social Security, Medicare, and Medicaid, leading long-term budget projections have calculated that federal spending will increase from the current 20 percent of gross domestic product (GDP) to a peacetime high of nearly 33 percent of GDP by 2050.¹

Yet even that may be a severe underestimate. These projections assume slower entitlement growth than estimated by the Social Security and Medicare trustees as well as substantial reductions in defense and other spending. Most critically, they assume that the resulting unprecedented increase in the national debt will not affect interest rates. More realistic assumptions show that Social Security, Medicare, and Medicaid costs will leap from 8.4 percent of

Talking Points

- By 2015, rapidly escalating entitlement costs will push projected federal spending past \$4 trillion and the budget deficit to \$873 billion.
- Current 50-year budget projections may have severely underestimated projected spending by assuming massive spending cuts and generally frozen interest rates.
- Without reform, Social Security, Medicare, and Medicaid costs are projected to expand from 8.4 percent of GDP today to 18.9 percent of GDP by 2050. Paying for these programs would require unprecedented annual tax increases, elimination of every other federal program, or massive deficit spending.
- If lawmakers do nothing, net interest costs will push projected federal spending to 44 percent of GDP by 2040 and an unsustainable 73 percent of GDP by 2050.
- The only way to avoid these painful outcomes is by reforming Social Security, Medicare, and Medicaid as soon as possible.

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GDP to 18.9 percent by 2050. Unless lawmakers reform these programs, they will have to fund their costs by:

1. **Raising taxes** every year until federal taxes are 57 percent (\$11,000 per household, adjusted into today's economy)² above the current levels;
2. **Eventually eliminating every other federal program**, including spending on defense, education, anti-poverty programs, and veterans benefits, by 2045; or
3. **Running massive budget deficits** (the status quo option). This is the most expensive option because it would cause the federal debt to increase from the current level of 40 percent of GDP to 500 percent of GDP. Beginning in 2025, just a small interest rate response would push federal spending to 44 percent of GDP by 2040 and 73 percent by 2050—levels *twice as high* as previous projections.

The data presented in this paper are not predictions of what will occur. They merely represent three painful possible outcomes if lawmakers choose to continue on the current course with Social Security, Medicare, and Medicaid. The data show that unreformed entitlements not only could cause significant economic pain, but also could eventually place the entire American economic and financial system in crisis. Modernizing entitlements and averting this calamity is the most important economic challenge of this era.

2006–2015 Projections

The Congressional Budget Office's most recent 10-year baseline budget projections, released in

August 2005, show a rapidly improving budget picture, with discretionary spending increases slowing down, tax revenues swelling, and the budget coming close to balance by 2015.³ However, these projections are based on a set of unrealistic assumptions that Congress requires the Congressional Budget Office to include, based on existing law. The CBO is required to assume, for example, that:

1. No additional supplemental funding will be appropriated for the war on terrorism;
2. Congress will limit discretionary spending increases, which have averaged 9 percent annually since 2000, to the inflation rate (approximately 3 percent) over the next decade; and
3. Congress will allow the 2001, 2003, and other tax cuts to expire and not update the income thresholds for the Alternative Minimum Tax (AMT). This would translate into a steep tax increase for nearly every taxpayer.

Because lawmakers require such unrealistic assumptions, the CBO's budget projections also include a table of alternative assumptions that allow readers to insert more realistic policies into the baseline.

Table 1 corrects for these flaws by (1) incorporating additional supplemental funding for the war on terrorism; (2) assuming that discretionary appropriations will expand as fast as the GDP after 2006; and (3) assuming that the tax cuts will be made permanent and the AMT will be fixed.⁴ Table 1 also incorporates a rough estimate of hurricane relief and reconstruction spending in the Gulf Coast.

Consequently, Table 1 shows a budget picture that is vastly different from the CBO baseline. Com-

1. Congressional Budget Office, *The Long-Term Budget Outlook*, December 2003, at www.cbo.gov/showdoc.cfm?index=4916&sequence=0 (November 3, 2005), and associated spreadsheet at www.cbo.gov/Spreadsheet/4916_Data.xls (November 3, 2005). The scenario reported here is the intermediate spending and low-tax scenario. World War II was the only time that federal spending exceeded this level.
2. Throughout this paper, future budget data are adjusted into the 2005 economy. Generally, future spending and revenue projections are calculated as a percent of future GDP. To provide a current perspective, this paper then translates those projected future percentiles into today's GDP level to come up with a "current equivalent." This is the best method for holding prices, income, and population constant over time. For a more detailed explanation, see Appendix 2.
3. Congressional Budget office, *The Budget and Economic Outlook: An Update*, August 2005, p. 8, Table 1.4, at www.cbo.gov/ftpdocs/66xx/doc6609/08-15-OutlookUpdate.pdf (November 3, 2005).
4. For the methodology, see Appendix 2.

bined nominal Medicare, Social Security, and Medicaid spending doubles by 2015. Adding in the costs of the war on terrorism, Hurricane Katrina, and other congressional spending priorities pushes total 2015 spending well past \$4 trillion and the budget deficit to \$873 billion. Although these budget deficits would still not be large enough to raise interest rates or reduce economic growth significantly, they would increase the likelihood of major tax rate increases that would impose severe burdens on taxpayers and the overall economy. Because all spending must eventually be paid for with taxes, the only way to guarantee long-term tax relief is to control long-term spending.

These budget projections show how difficult it will be to exercise such spending control. Federal spending has already surged 33 percent since 2001 to a peacetime record of nearly \$22,000 per household.⁵ According to the CBO projections, retirement of the baby boomers combined with the unaffordable Medicare prescription drug benefit will increase Medicare spending by 9 percent annually. Medicaid spending will rise by nearly 8 percent annually, and Social Security will cost 6 percent more each year. Not even a strong economic boom could provide the tax revenue necessary to keep pace with such large, structural, persistent spending hikes.

Even these estimates could prove overly optimistic. Table 2, which breaks down the mandatory spending baseline, assumes that several entitlements will remain nearly frozen through 2015. History suggests that Members of Congress will continue to expand these programs by 4 percent to 6 percent

annually and create additional entitlement programs on top of them. The Office of Management and Budget (OMB) estimates that these CBO numbers strongly underestimate the cost of the Medicare drug benefit.⁶ Recession, additional terrorist attacks, and an extended American presence in Iraq would each harm the economy, reduce tax revenues, and/or precipitate additional spending increases.

In other words, even though projections always include a large margin for error, all signs point to rapid spending increases and a deteriorating federal budget picture.

2006–2050: Long-Term Projections

Like the 10-year projections, the long-term budget picture may be vastly worse than previously thought. The most commonly cited long-term budget projections were released by the CBO in December 2003.⁷ Its most middle-of-the-road scenario projected that Social Security, Medicare, and Medicaid costs would drive total federal spending from the current 20 percent of GDP to 33 percent by 2050—by far the highest peacetime spending level in American history.

While these projections are alarming by themselves, the CBO may have substantially *underestimated* the coming spending increases. This paper's 2006–2050 static budget projections begin with the 10-year numbers stated in the previous section.⁸ After 2015, they differ from the CBO's December 2003 projections in four ways:

1. Retaining the CBO's tax and Medicaid formulas but updating them for budget changes over the past 18 months.⁹

5. The historical spending-per-household figures are adjusted for inflation. For a summary of recent federal budget trends, see Brian M. Riedl, "Federal Spending: By the Numbers," Heritage Foundation *WebMemo* No. 881, October 11, 2005, at www.heritage.org/Research/Budget/wm881.cfm.
6. The Congressional Budget Office compared its Medicare drug benefit cost estimate with the Office of Management and Budget's estimate in Douglas Holtz-Eakin, director, Congressional Budget Office, letter to Representative Jim Nussle, February 2, 2004, at www.cbo.gov/ftpdocs/49xx/doc4995/OMBDrugLtr.pdf (November 3, 2005).
7. Congressional Budget Office, *The Long-Term Budget Outlook*. The scenario reported here is the intermediate spending and low-tax scenario.
8. For the methodology, see Appendix 2.
9. Because some portions of the tax code are not easily adjusted for inflation, large inflation can slightly increase tax revenues as a percent of GDP. Thus, if debt monetization creates large inflation, the assumption of tax revenues at 17.8 percent of GDP will turn out to be a slight underestimate.

Table 1

Federal Budget Projections, 2005-2015

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total Revenues												
CBO Baseline	\$1,879	\$2,154	\$2,265	\$2,348	\$2,455	\$2,581	\$2,711	\$2,835	\$3,000	\$3,147	\$3,303	\$3,467
Tax Extenders	1,879	2,154	2,281	2,396	2,525	2,676	2,817	3,076	3,313	3,480	3,661	3,848
AMT Reform			-4	-14	-29	-45	-46	-191	-286	-300	-318	-334
			-12	-34	-41	-50	-60	-50	-27	-33	-40	-47
Total Outlays	2,292	2,470	2,660	2,824	2,973	3,115	3,250	3,447	3,625	3,855	4,087	4,340
Discretionary Outlays	894	963	1,041	1,095	1,121	1,146	1,155	1,202	1,257	1,313	1,370	1,429
Defense	394	463	438	461	485	510	535	560	585	612	639	666
Nondense	440	468	483	509	535	563	590	618	646	674	704	735
War Supplementals	60	30	70	75	65	45	30	25	26	27	27	28
Katrina Spending		2	50	50	35	28						
Mandatory Outlays	1,238	1,327	1,408	1,481	1,560	1,641	1,732	1,846	1,931	2,067	2,198	2,345
Social Security	492	519	546	574	602	634	670	709	753	801	852	907
Medicare	297	332	385	437	462	491	527	574	606	665	722	785
Medicaid	176	184	192	203	221	239	260	282	305	330	357	387
Other Spending	381	417	416	422	439	453	463	481	464	483	495	506
Offsetting Receipts	-108	-125	-143	-160	-167	-167	-177	-189	-200	-215	-230	-242
Tax Extenders									15	15	15	15
Katrina Spending			15	10	10							
Budget Reconciliation			-3	-5	-7	-9	-11	-11	-12	-12	-13	-13
Net Interest Outlays	160	180	211	248	292	328	363	399	437	475	519	566
CBO Baseline	160	180	208	237	271	295	316	332	341	346	351	355
Policy Effects			3	11	21	33	47	67	96	129	168	211
Surplus/Deficit	-413	-317	-395	-476	-518	-534	-539	-612	-625	-708	-784	-873

Note: All amounts are in \$billions.

Source: Heritage Foundation calculations based largely on Congressional Budget Office data. See Appendix 2 for methodology.

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Table 2

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Mandatory Spending Baseline, 2005-2015

Program Spending	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Average Growth
Social Security	\$519	\$546	\$574	\$602	\$634	\$670	\$709	\$753	\$801	\$852	\$907	5.6%
Medicare	332	385	437	462	491	527	574	606	665	722	785	9.0%
Medicaid	184	192	203	221	239	260	282	305	330	357	387	7.8%
Civil Service Retirement/Disability Fund	55	57	59	62	64	67	69	71	74	76	78	3.6%
EITC and Child Credit Outlays—Extended	49	50	51	51	52	52	52	51	51	51	51	0.2%
Military Retirement	39	41	43	45	46	48	49	50	52	53	54	3.2%
Supplemental Security Income	39	37	35	41	42	44	50	43	49	50	52	3.0%
Veterans Benefits	36	35	34	37	37	38	41	37	40	41	42	0.8%
Food Stamps	33	33	33	33	33	34	35	36	37	38	39	1.7%
Unemployment Compensation	33	34	37	40	42	44	46	48	51	53	55	5.5%
Commodity Credit Corporation	18	18	16	14	14	13	13	12	12	12	12	-3.7%
TANF	18	18	18	18	17	17	17	17	17	17	17	-0.5%
Student Loan Program	14	6	7	8	8	8	8	9	9	9	9	4.2%
Child Nutrition Programs	13	13	14	15	15	16	17	17	18	19	19	0.8%
Federal Employee Health Benefits	6	7	7	8	9	9	10	11	12	13	14	4.3%
Foster Care and Adoption Assistance	6	7	7	8	8	8	9	9	9	10	10	8.1%
TRICARE Military Retiree Health	6	7	7	8	8	9	10	10	11	12	13	8.0%
Universal Service Fund	6	7	7	7	7	8	8	8	8	8	8	2.9%
Railroad Retirement Program (gross)	5	6	6	6	6	6	7	7	7	7	8	3.5%
State Children's Health Insurance Program	5	5	5	5	5	5	5	5	5	5	5	0.4%
Child Support Enforcement and Family Support	4	4	5	5	5	5	5	5	6	6	6	4.6%
Other Veterans Benefits	3	3	3	3	3	3	4	4	4	4	4	2.6%
Crop Insurance and Other Farm Credit Activities	3	4	4	4	4	4	4	4	4	5	5	5.8%
Child Care Entitlement to States	3	3	3	3	3	3	3	3	3	3	3	0.0%
Rehabilitation Services	3	3	3	3	3	3	3	3	3	3	3	2.8%
Social Services Block Grant	2	2	2	2	2	2	2	2	2	2	2	-0.4%
Other Mandatory Spending	19	18	17	15	21	17	15	17	15	14	12	-2.7%
Subtotal	1,452	1,539	1,636	1,724	1,817	1,920	2,046	2,143	2,294	2,441	2,600	6.0%
Offsetting Receipts												
Medicare	-38	-56	-63	-67	-71	-78	-85	-93	-102	-113	-125	-12.5%
Social Security	-11	-12	-12	-13	-14	-15	-16	-17	-18	-19	-21	-6.7%
Military Retirement	-16	-16	-15	-16	-16	-17	-17	-18	-18	-18	-18	-1.2%
Civil Service and Other Retirement	-19	-19	-22	-22	-23	-24	-25	-26	-27	-28	-28	-4.3%
TRICARE for Life	-10	-11	-12	-12	-13	-14	-15	-16	-17	-18	-19	-6.6%
Electromagnetic Spectrum Auctions	0	0	-8	-8	0	0	0	0	0	0	0	0.0%
Energy/Natural Resource Receipts	-13	-13	-12	-12	-12	-12	-13	-13	-14	-14	-14	-0.7%
Other	-18	-16	-16	-17	-18	-17	-18	-17	-19	-20	-17	1.4%
Subtotal	-125	-143	-160	-167	-167	-177	-189	-200	-215	-230	-242	-6.9%
Reductions in 2006 Budget Reconciliation		-3	-5	-7	-9	-11	-11	-12	-12	-13	-13	
Katrina-Related Mandatory Spending (estimate)		15	10	10	0	0	0	0	0	0	0	
Total Baseline Estimate	1,327	1,408	1,481	1,560	1,641	1,732	1,846	1,931	2,067	2,198	2,345	5.8%

Note: All amounts are in \$billions.

Source: Congressional Budget Office and Office of Management and Budget.

2. Replacing the CBO's Social Security and Medicare projections with the projections of the Social Security and Medicare trustees.
3. Holding defense and all other program spending (excluding Social Security, Medicare and Medicaid) constant as a percent of GDP after 2015 (the CBO assumed that defense spending would be halved and other spending reduced by 12 percent).
4. Dropping the CBO's assumption that interest rates will remain generally frozen through 2050. While modest levels of debt, such as those experienced today, do not significantly raise interest rates, the huge projected debt levels almost surely would do so because of an uncertain economic future. As explained in detail below, this paper conservatively assumes that after 2025 (when public debt begins to exceed 100 percent of GDP) each 1 percentage point increase in America's debt-to-GDP ratio would increase the average interest rate paid on the federal debt by one basis point (1/100 of 1 percent).

Under these assumptions, federal spending is projected to reach 44 percent of GDP by 2040 and 73 percent of GDP by 2050—more than *double* the CBO projections. (See Chart 1.) Net interest costs account for nearly all of the difference. (See Table 3.) Even a minuscule interest rate response to this large debt pushes total spending exponentially higher.

The spending projections detailed in Appendix 1 reveal that Social Security, Medicare and Medicaid, and net interest payments dominate projected federal spending trends through 2050.

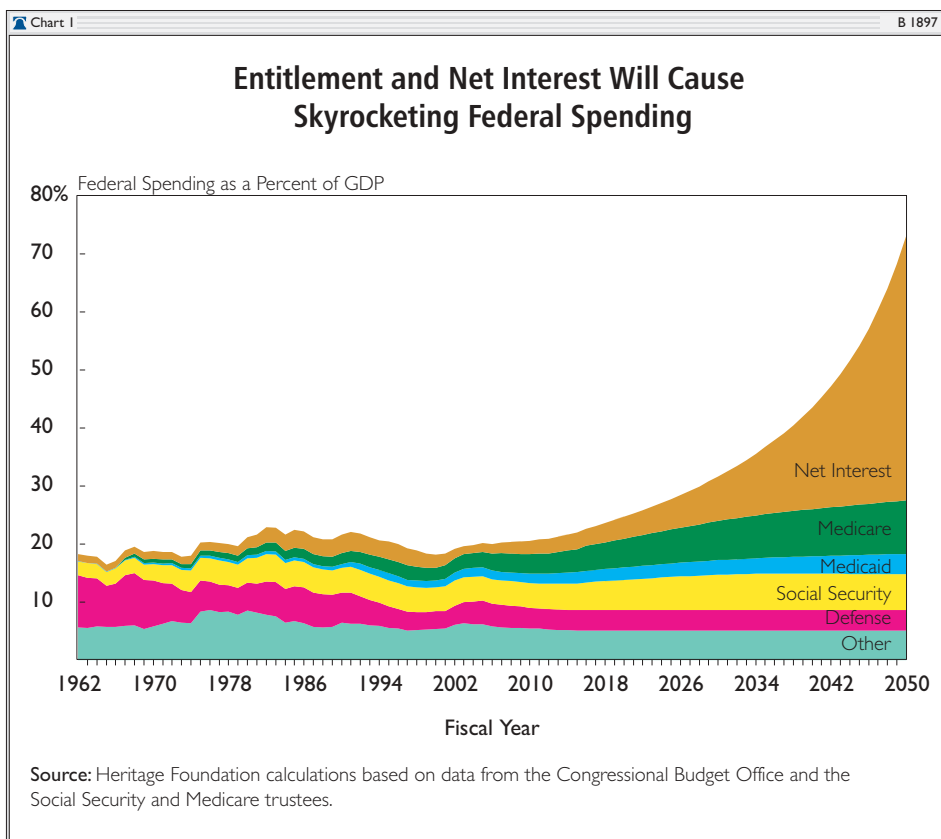


Table 3 B 1897

Net Interest Spending Pushes Heritage's Spending Projections Above CBO's

Year	Program Spending		Net Interest		Total Spending	
	CBO	Heritage	CBO	Heritage	CBO	Heritage
2005	18.7%	18.7%	1.5%	1.5%	20.1%	20.1%
2015	17.6%	19.1%	2.4%	2.9%	20.0%	22.0%
2020	18.5%	21.0%	2.5%	3.7%	21.1%	24.7%
2030	20.8%	24.0%	3.7%	7.7%	24.5%	31.7%
2040	22.2%	26.0%	6.1%	17.5%	28.3%	43.6%
2050	23.4%	27.6%	9.4%	45.6%	32.8%	73.1%

Note: All amounts are expressed as a percent of GDP.

Source: Heritage Foundation calculations and Congressional Budget Office, "Long-Term Budget Outlook," December 2003, immediate spending and low tax scenario.

Social Security. Social Security costs are projected to rise gradually from 4.2 percent of GDP to 6.3 percent in 2034 and then level off.¹⁰ In today's

economy, these GDP numbers would translate into a permanent increase from the current \$519 billion spending level to approximately \$770 billion—an increase of \$2,200 per household annually.

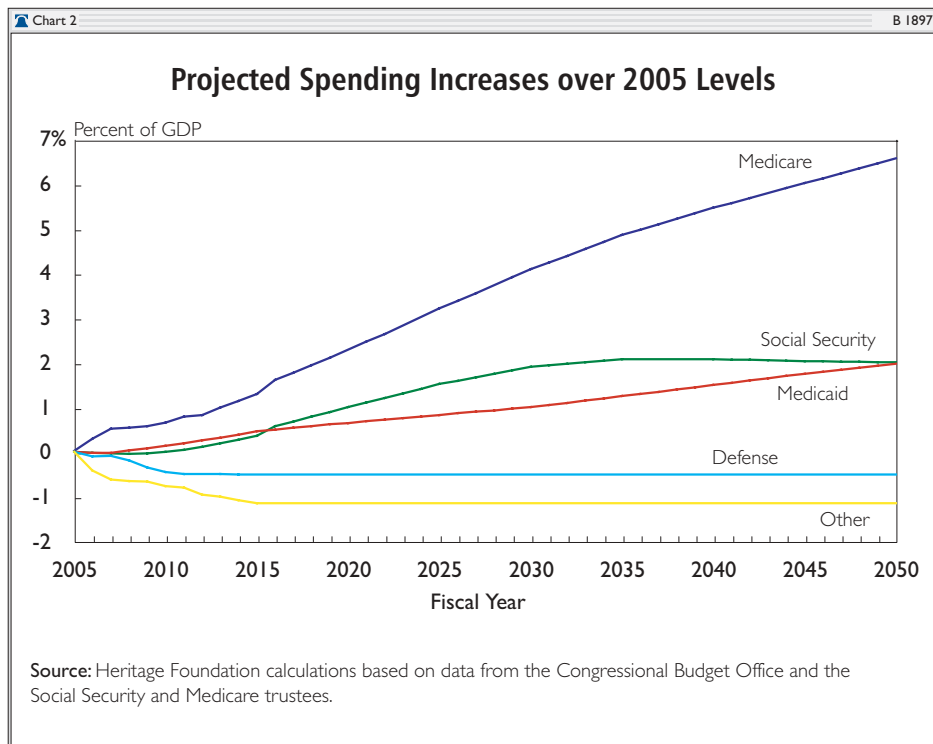
Demographics are driving this cost increase. Social Security benefits for current retirees are funded by current taxpayers. This is sustainable only if there are enough workers paying taxes to support all current retirees collecting benefits. As the 77 million baby boomers retire (and as life spans continue to lengthen), the same-size workforce will need to support many more retirees. When Social Security was created in 1935, 42 workers supported each retiree. In 2005, the ratio is 3:1, and by 2030, it will be 2:1. At that point, a married couple will be supporting themselves, their children, and *their very own retiree*.

Some erroneously suggest that future taxpayers will be spared these costs because the Social Security “trust fund” will pay all promised benefits until 2041. It is true that years of payroll tax revenues exceeding program costs will have created a cumulative \$5.7 trillion Social Security surplus (on paper) by the time the system starts running in the red in 2017. However, the surplus has already been spent. More specifically, each year’s Social Security surplus has been lent to the U.S. Treasury for Congress to spend along with all other tax revenue. In 2017, when Social Security starts calling for its money back, the Treasury will be able to repay the debt only by collecting that amount in new taxes. In other words, the taxpayers, not some vague government entity, will have to repay the

\$5.7 trillion to the trust fund to keep the system running until 2041.¹¹

In that sense, the Social Security trust fund does not save taxpayers a dime. It is merely an accounting device: a running tally of the amount of the Social Security surplus that Congress has spent and that future taxpayers will have to repay to fund all benefits until 2041. Each year’s Social Security benefits will continue to be funded by current taxpayers. There is no mountain of money waiting to be tapped.

Medicare and Medicaid. Medicare’s financial crisis is immensely more serious than Social Security’s. Both programs face the same demographic crunch, but while Social Security simply transfers a predetermined amount of income from workers to retirees, Medicare must cope with the rapidly rising cost of delivering high-quality, technologically advanced health care to an aging population. If health care costs continue to rise by 8 percent



10. These projections are very similar to projections by the CBO and the Social Security trustees.

11. See Brian M. Riedl, “Why Social Security’s Problems Begin in 2018,” Heritage Foundation Commentary, February 17, 2005, at www.heritage.org/Press/Commentary/ed021705b.cfm.

annually, Medicare will have to increase spending steeply just to provide the same level of care to the same number of seniors. The addition of health care cost inflation to these demographic challenges will make Medicare's financial hole many times greater than that of Social Security.

The Medicare trustees project that Medicare spending will increase from 2.7 percent to 9.3 percent of GDP by 2050—triple the size of Social Security's increase. (See Chart 2.) Converting these GDP percents into their equivalents in today's economy, Medicare's annual budget would increase from \$332 billion to \$1,135 billion—an annual cost increase of \$7,000 per household.

Even this estimate may be low. The Medicare trustees estimate that per capita Medicare spending will grow approximately 1 percentage point faster than GDP. This represents a slowdown from the 3.0 percent excess growth rate since 1970 and the 1.7 percent excess growth of Medicare spending since 1990. (The CBO assumed even slower growth than the trustees assumed.)¹² If per capita Medicare spending continues to grow at historical rates, even the trustees' expensive projections will prove overly optimistic.

It is noteworthy that the new Medicare drug benefit will account for one-quarter of all projected Medicare spending after 2020.¹³

Seniors needing nursing home and long-term care treatment (which are not covered by Medicare) often end up on Medicaid. Such care is very expensive (thousands of dollars per month per patient) and is projected to drive up Medicaid spending from 1.5 percent of GDP to 3.5 percent by 2050. In today's economy, these GDP percents translate into an increase from \$184 billion to \$426 billion (an increase of about \$2,200 per household), not counting the 43 percent of Medicaid costs that

states must pay. This 2.0 percent of GDP increase matches Social Security's projected cost increase. In 2006, Medicare and Medicaid combined will cost the federal government more than Social Security for the first time ever. By 2050, they will cost taxpayers twice as much as Social Security.

Net Interest. The Social Security, Medicare, and Medicaid spending increases are projected to drive federal program (i.e., non-interest) spending from 18 percent of GDP to nearly 28 percent by 2050. Historically, tax revenues have remained relatively close to 18 percent of GDP. If lawmakers do not reform runaway entitlements, keeping up with this runaway spending will require raising taxes annually, with total taxes eventually reaching 57 percent of GDP, or nearly \$11,000 per household (in today's economy).¹⁴ Such tax increases, in addition to being politically unlikely, would severely damage long-term economic growth, not to mention making it nearly impossible for most families to make ends meet.

Without higher taxes or less spending, this runaway spending would likely create budget deficits of an unprecedented size. Over time, such debt would induce exponential increases in net interest costs. (See text box, "Debt, Interest Rates, and Vicious Circles.") Current debt levels of 40 percent of GDP are too small to increase interest rates significantly; as projected debt levels surpass 100 percent, 200 percent, and then 300 percent of GDP, however, it becomes increasingly likely that a global capital shortage or inflation would raise interest rates, especially since Western Europe is not likely to be in a position to supply much capital or buy American debt because of its own entitlement crises.

This paper assumes that after 2025 (when the public debt surpasses 100 percent of GDP), each 1 percentage point increase in America's debt-to-GDP

12. See Congressional Budget Office, *The Long-Term Budget Outlook*, and Technical Review Panel on the Medicare Trustees Reports, *Review of Assumptions and Methods of the Medicare Trustees' Financial Projections*, December 2000, pp. 27–42, at www.cms.hhs.gov/publications/technicalpanelreport/chapter3.asp (November 3, 2005).

13. Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, March 23, 2005, p. 28, at www.cms.hhs.gov/publications/trusteesreport/tr2005.pdf (November 3, 2005). The trustees estimated that this expense pushes Medicare spending up by one-third, which translates into one-fourth (33/133) of the total Medicare cost.

14. In 2005, taxes averaged \$19,147 per household. Adding \$10,918 in new taxes would be a 57 percent increase.

ratio would increase the total interest rate paid on government bonds by one basis point (1/100 of 1 percentage point). This interest rate response to huge federal debt is actually *smaller* than the response projected by several leading economists.

Yet even this conservative assumption means that net interest will overwhelm the federal budget, rising gradually at first, from 1.5 percent of GDP in 2005 to 3.7 percent in 2020 and 7.7 percent in 2030. By then, however, the vicious circle of debt and interest rate increases is projected to push net interest costs to 17.5 percent of GDP by 2040 and 45.6 percent by 2050. To put that amount in context, in today's economy net interest spending of 45.6 percent of GDP would translate into over \$5.5 trillion, or \$50,000 per household annually.

Realistically, interest costs would never reach that level. The static scenario is sustainable only until about 2040, after which the escalating national debt and federal budget would likely trigger an economic crisis. Under status quo policies, projecting the federal budget or U.S. economy after 2040 may be like trying to project the specific devastation from a natural disaster.

Chart 3 puts these interest costs in perspective. Even without any interest rate response, total 2005–2050 net interest spending would total \$43.9 trillion. A marginal interest rate response of one basis point would raise that cost to \$64.1 trillion. A marginal interest rate response of two basis points would translate into a \$118.3 trillion net interest cost in today's economy.

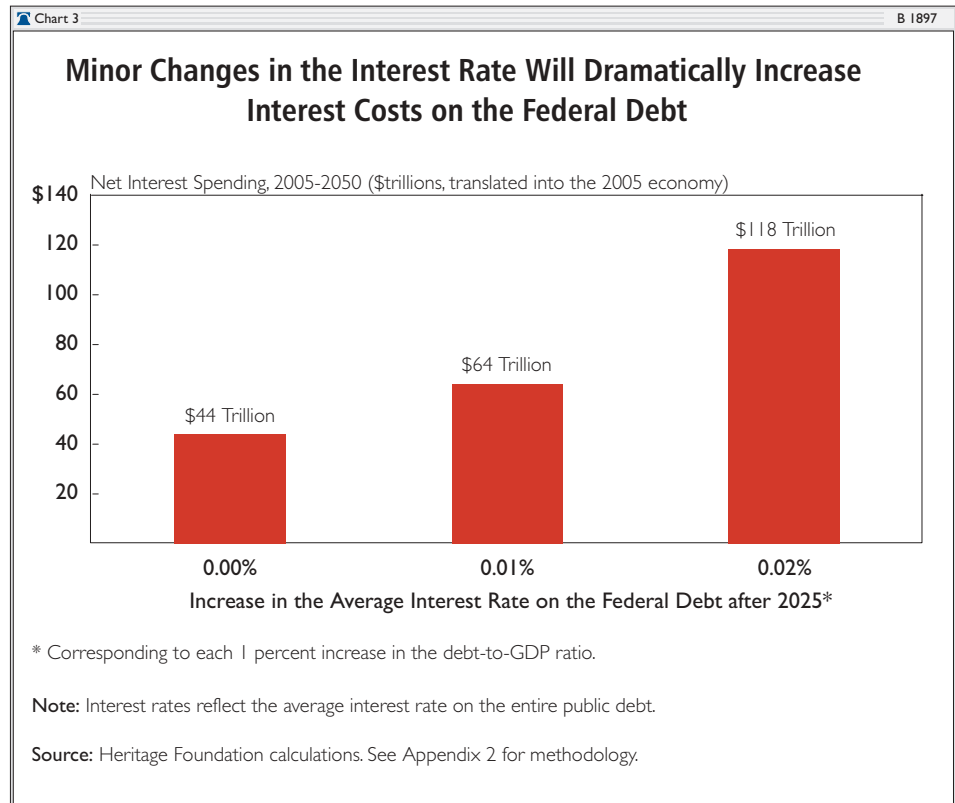
Limited Options for Lawmakers

It is easy to brush off these projections by asserting that lawmakers would obviously fix the system

before such an economic crisis could occur. Yet this is exactly the point: These programs will not repair themselves. Fundamental entitlement reforms are the only way to avert this economic and budgetary crisis. In effect, lawmakers who deny that Social Security and Medicare are in crisis and reject all options to modernize these programs are voting to keep the United States on this unsustainable path. Every year lawmakers delay these reforms pushes the ultimate cost up even further. Indeed, reform is the only acceptable solution.

Option 1: Reforming Social Security and Medicare. Successful Medicare reform would create an entirely new system based on the principles of personal choice, market competition, and light regulation. The key change would be in the financing of the system.

Instead of a defined benefit entitlement, which Medicare is today, the new Medicare program would be a defined contribution system. Based on an equitable formula that reflects market realities, the government would contribute a defined



Debt, Interest Rates, and Vicious Circles

Debt and Interest Rates. All else being equal, high levels of federal debt can increase interest rates. This can happen in two ways:

- **Borrowing from the private sector.** Governments that borrow heavily create a shortage of money available to be lent to others and therefore raise the price of money (the interest rate). However, in today's large global capital markets, government borrowing is just one of many variables affecting interest rates. For example, interest rates are also a function of expected inflation, private demand for credit, investor confidence, and the availability of foreign capital to offset the amount that Washington borrowed. Current low interest rates show that it would take substantially more federal borrowing before the federal debt would create a capital shortage large enough to overwhelm all other factors and noticeably raise interest rates. Eventually, however, the unprecedented debt levels projected in this paper would likely create such a shortage.
- **Monetizing (printing new money).** While printing new money could reduce debt, it would also create destabilizing levels of inflation, which would force up interest rates as creditors demanded compensation for their lost purchasing power.

These increased interest rates will occur only when debt levels far exceed America's current 40 percent debt-to-GDP ratio. This paper rules out any interest rate effect until the debt-to-GDP ratio surpasses 100 percent. Even then, the interest rate effect would begin slowly.

Vicious Circles. Federal Reserve Chairman Alan Greenspan recently testified before Congress that:

Large deficits could result in rising interest rates and ever-growing interest payments on the accumulating stock of debt, which in turn would further augment deficits in future years. That process could result in deficits as a percentage of gross domestic product rising without limit. Unless such a development were headed off, these deficits could cause the economy to stagnate or worse at some point over the next couple of decades.¹

Chairman Greenspan is referring to the vicious circle that occurs when very large federal debt begins to raise interest rates. This would likely happen as follows: Expanding federal debt means that Washington is borrowing more money from the capital markets. Such borrowing will increase the demand for credit and noticeably push up interest rates if the debt is large enough. To pay these rising interest costs, the federal government must borrow additional money, but this in turn raises the interest rate more, costing Washington more and necessitating even more borrowing. Unless the borrowing stops, the process will continue until rising debt and interest rates force capital markets to refuse to lend money to the government out of fear that the government may default on its enormous debt.

At that point, the government risks defaulting on its debt unless economically devastating tax increases can replenish that revenue. Capital markets suffer from high interest rates and investment shortages. Pressure increases for Washington to monetize debt by simply printing more money, which would only create inflation and even higher interest rates. This combination of unaffordable government spending levels, hyperinflation, and steep increases in the interest rate can create serious economic crises.

1. Alan Greenspan, "Federal Reserve Board's Semiannual Monetary Policy Report to the Congress," testimony before the Committee on Financial Services, U.S. House of Representatives, July 20, 2005, footnote 1, at www.federalreserve.gov/boarddocs/hh/2005/july/testimony.htm (October 27, 2005).

How Much Would Net Interest Costs Increase?

Most of the difference between this paper and other long-term spending projections resides in the assumptions of how much interest Washington will pay on its expanding national debt.

Over the past 40 years, annual net interest costs have averaged 6.1 percent of the total public debt. More recently, the cost of servicing the debt has dropped from 7.1 percent in 1991 to 3.7 percent in 2004.¹ This paper's 2006–2015 projections, which rely in part on CBO data, calculate that the annual interest cost will level off at 5.4 percent of public debt from 2012 through 2015, as interest rates may increase slightly and then level off over the next decade.

Post-2015 interest rates are less predictable. Most long-term spending projections assume a constant interest rate through 2050. While the current debt level of 40 percent of GDP is not large enough to create the capital shortage necessary to raise interest rates significantly, most economists would agree that the huge debt levels projected for the next 50 years would force Washington eventually to borrow a substantial portion of the world's available savings, thereby leaving less savings for others to borrow and creating a capital shortage that raises the price of capital (the interest rate).

Because an economy the size of America's has never faced debt like this, projecting precisely how much the interest rate will increase is difficult. The key question is how much interest rates will increase with each percentage point increase in America's debt-to-GDP ratio. Harvard's Robert Barro calculates five basis points; the Federal

Reserve's Thomas Laubach calculates four to five basis points (using projected rather than current debt-to-GDP ratios); and the American Enterprise Institute's Eric Engen and former Council of Economic Advisers Chairman R. Glenn Hubbard estimate approximately three basis points.²

Using those estimates, this paper assumes that after 2025 (when the debt-to-GDP ratio is projected to surpass 100 percent), the average cost of servicing the debt will increase by only one basis point for each percentage point increase in the debt-to-GDP ratio. This is assumed for two reasons. First, in the global economy, the impact of U.S. federal debt on interest rates has been shown to be smaller than suggested, especially for government bonds, which strengthens the case for a conservative estimate. Second, and most important, the experts' estimates measure how debt affects *current* interest rates, yet the interest cost of the federal debt at any given moment is a weighted average of current and past (lower) interest rates, since much of the federal debt is in bonds sold two years to 10 years earlier.

Combining those factors, the conservative assumption of a one basis point increase in the total cost of serving the debt seems plausible. (Under this assumption, annual net interest spending between 2025 and 2050 would rise from 5.4 percent to 9.2 percent of total public debt.) However, this is merely an estimate. The actual interest rate response could be more or less. Either way, even a change of one basis point in the interest rate would affect net interest costs by tens of trillions of dollars.

1. Heritage Foundation calculation using Council of Economic Advisers, *Economic Report of the President* (Washington, D.C.: U.S. Government Printing Office, 2005), p. 303, Table B-78, and p. 305, Table B-80, at www.gpoaccess.gov/eop/2005/2005_erp.pdf (November 3, 2005).
2. Robert Barro, "Have No Fear: Bush's Tax Plan Won't Jack Up Interest Rates," *Business Week*, May 5, 2003, at www.businessweek.com/magazine/content/03_18/b3831029_mz007.htm (November 3, 2005); Thomas Laubach, "New Evidence on the Interest Rate Effects of Budget Deficits and Debt," Board of Governors of the Federal Reserve System, May 2003, at www.federalreserve.gov/pubs/feds/2003/200312/200312pap.pdf (November 3, 2005); and Eric Engen and R. Glenn Hubbard, "Federal Government Debt and Interest Rates," American Enterprise Institute Working Paper No. 105, June 2, 2004, at www.aei.org/publications/pubID.20885/pub_detail.asp (November 3, 2005).

amount to Medicare beneficiaries' coverage, just as the Federal Employees Health Benefits Program (FEHBP) does for federal workers and retirees. Seniors in such a system could bring their pre-retirement health care plan with them into retirement or choose new coverage options, including new fee-for-service, managed care, or consumer-driven plans such as health savings accounts.

The government contribution would be capped at a dollar amount, just as the contribution in the FEHBP is capped, and seniors wanting more expensive plans could choose to pay extra amounts above the government contribution. Seniors choosing plans below the government contribution could keep 100 percent of the savings from choosing less expensive health plans. There would be no detailed benefit mandates or price controls. Unlike the current system, seniors would not be restricted by statute from spending their own money on medical services or physicians of their own choice.

This Medicare reform model is broadly similar to what a majority of the National Bipartisan Commission on the Future of Medicare recommended in 1999.¹⁵ Thanks to competition, consumer choice, and minimal red tape, the FEHBP has proven to be a highly popular and successful government program. It relies on the free-market principles of consumer choice and competition and has a record of superior performance in controlling health care costs.¹⁶

Social Security reform must involve some reduction in the growth rate of benefits for younger workers, possibly through a combination of progressive indexing of benefits and a higher retirement age. However, these benefit changes would not leave

future seniors with lower benefits than current seniors. Allowing workers to invest a portion of their payroll taxes in personal Social Security retirement accounts, with their names on them, that involve conservative stock index funds and bond funds could more than compensate for any changes in their Social Security benefits. Under such a reform, workers could create their own nest eggs, which they would own and could even pass down to loved ones.

It is true that the transition to private accounts could cost more than the current system in the short run. However, by paying slightly more now, taxpayers would avoid a \$3.7 trillion tab over the next 75 years (in much the same way that, when refinancing a mortgage, paying points up front will significantly reduce the long-term interest costs).¹⁷

Option 2: Unprecedented Tax Increases. Chart 4 shows how much Congress would have to increase taxes to finance the projected spending and still balance the budget. Following an immediate tax increase of \$3,323 per household to balance the budget, keeping pace with spending would require total tax increases of \$4,516 by 2020, \$7,472 in 2030, \$9,436 in 2040, and \$10,918 in 2050 (all adjusted into today's economy). This tax revenue could be collected by raising the top marginal income tax rate from 35 percent to 80 percent and the typical family's marginal tax rate from 25 percent to 57 percent. (If the tax increases harmed economic growth, even larger tax increases would be required to raise the necessary revenue).¹⁸ Overall, this represents a federal tax burden of 28 percent of GDP, not counting the average state and local tax burden of 10.5 percent of GDP.

15. The commission was led by former Senator John Breaux (D-LA) and Congressman Bill Thomas (R-CA). For more information, see National Bipartisan Commission on the Future of Medicare, Web site, at thomas.loc.gov/medicare (November 3, 2005).

16. See Robert E. Moffit, Ph.D., "Lessons of Success: What Congress Can Learn from the Federal Employees Program," Heritage Foundation *WebMemo* No. 565, September 14, 2004, at www.heritage.org/Research/HealthCare/wm565.cfm.

17. This transition cost could be financed by enacting a federal taxpayers' bill of rights limiting the growth of federal spending to inflation plus population growth. Such a common-sense spending limitation would save \$4 trillion over the next decade—enough to finance Social Security reform, make all tax cuts permanent, and possibly even balance the budget. See Brian M. Riedl, "Restrain Runaway Spending with a Federal Taxpayers' Bill of Rights," Heritage Foundation *Backgrounder* No. 1793, August 27, 2004, at www.heritage.org/Research/Budget/bg1793.cfm.

18. Tax revenues would have to increase by 9.8 percent of GDP. Under static scoring, this would mean that individual income taxes would rise from 7.6 percent of GDP to 17.4 percent of GDP, an increase of 129 percent. Thus, each marginal tax rate is multiplied by 2.29.

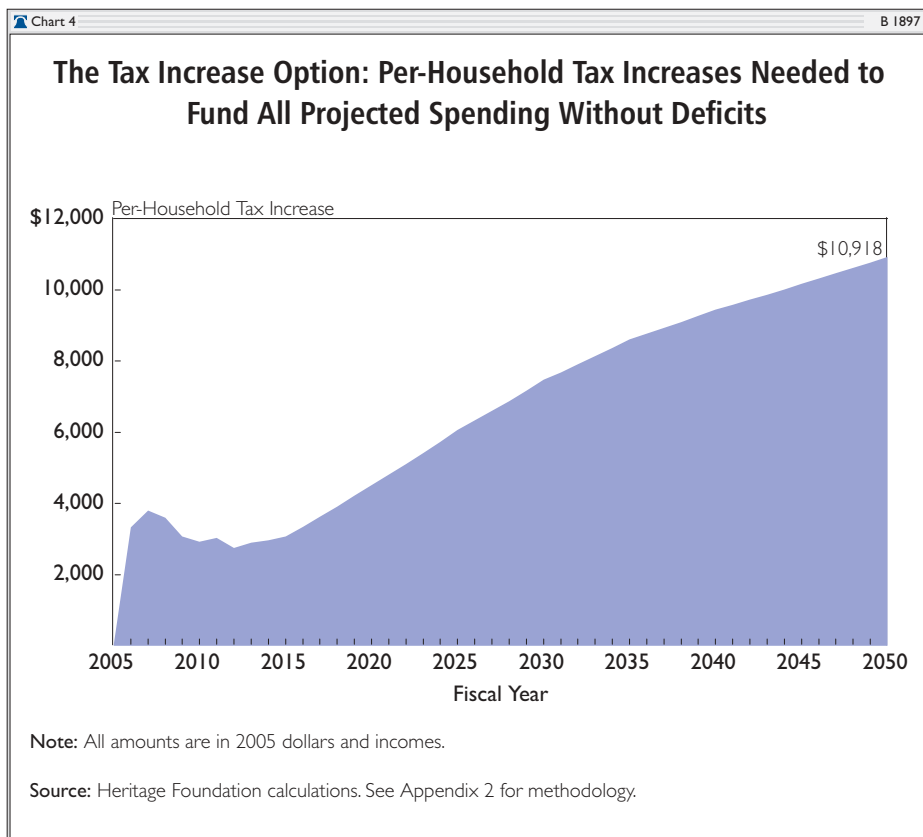
This tax increase is actually lower than otherwise needed because annual balanced budgets would prevent the accumulation of mountainous budget deficits, which would drive up net interest costs. Still, tax increases of nearly \$11,000 per household would overwhelm family budgets and stagnate the economy. Critics of the 2001 and 2003 tax cuts should note that repealing those cuts would not come close to making up this shortfall.

Option 3: Eliminating All Other Spending.

Chart 5 provides a spending cut scenario to fund Social Security, Medicare, and Medicaid while retaining a balanced budget. Eliminating spending on homeland security, justice, veterans benefits, highways, unemployment benefits, the environment, social services, community development, energy, international aid, science research, and farm subsidies would immediately balance the budget. From there, making room for the “big three entitlements” would require eliminating education spending by 2018, health research by 2020, federal employee retirement benefits by 2021, other anti-poverty spending by 2026, and defense spending by 2045. By that point, Social Security, Medicare, and Medicaid would consume the entire federal budget except for relatively small interest payments on pre-2006 debt.

While this scenario is unlikely, it illustrates what lawmakers would need to do to finance unreformed Social Security, Medicare, and Medicaid programs without tax increases or budget deficits.

Option 4: Spiraling Debt and Economic Crisis. If lawmakers do not reform entitlements and reject paying for them through unprecedented tax increases or program eliminations, the only other option is deficit spending on an unprecedented scale.



The combination of revenues at 18 percent of GDP and government program (non-interest) spending at 28 percent of GDP would create budget deficits large enough to increase the national debt from the current 40 percent of GDP to 100 percent, 200 percent, and then 300 percent of GDP. This would set off a vicious circle of rapidly increasing debt translating into higher net interest spending (exacerbated by higher interest rates), which would increase debt even further—possibly to 500 percent of GDP. Such exponential increases in government borrowing would devastate financial markets and eventually could trigger a financial and economic crisis.

Weighing the Four Options. Raising taxes and using debt to pay for Social Security, Medicare, and Medicaid are not viable options because of their potential to harm the economy. Furthermore, government spending itself can harm the economy. Simply stated, higher government spending undermines economic growth by transferring additional resources from the productive sector of the econ-

omy to the government, which uses them less efficiently.

Government spending crowds out productive private-sector activity by taking away resources and reallocating them based on political considerations rather than economic decisions. In addition, government spending discourages work, savings, and other productive choices. For example, relying on government retirement programs discourages saving for retirement. Finally, government spending inhibits innovation because programs such as Medicare and Medicaid are more centralized and bureaucratic than the private sector, which is constantly seeking new opportunities and improvements to maximize the bottom line.¹⁹

Issues at Stake

Before choosing a course of action, American citizens and lawmakers must address two fundamental issues surrounding the entitlement debate: (1) budgetary priorities and fairness and (2) economic and budgetary unsustainability.

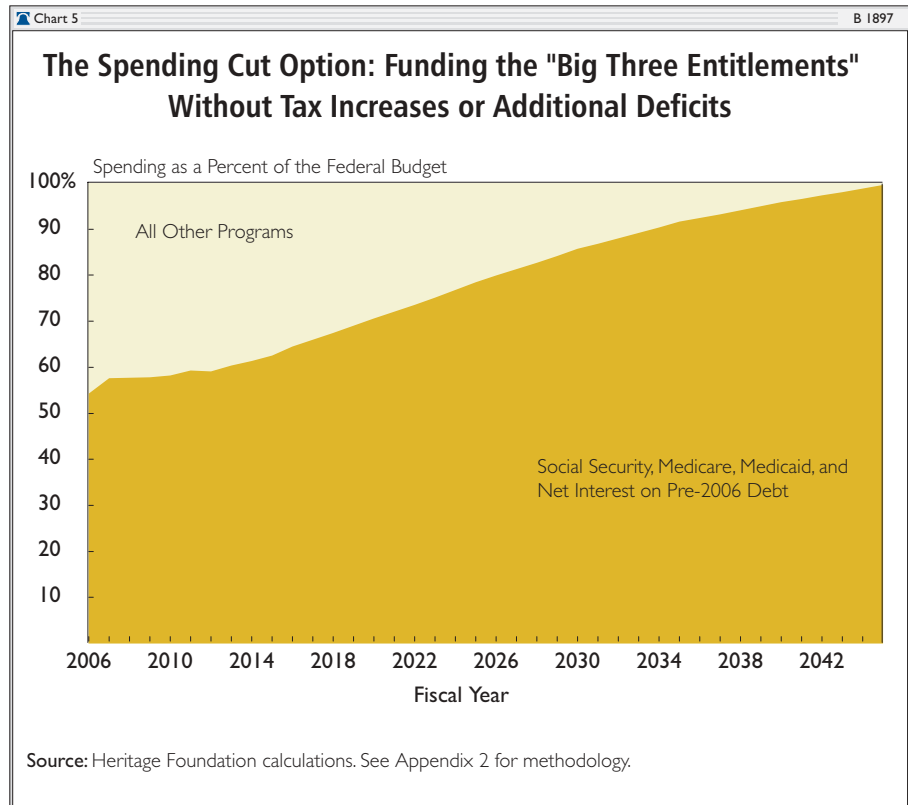
Budgetary Priorities and Fairness. When asked to describe the purpose of federal taxes and spending, respondents from across the political spectrum would typically include providing for the common defense, assisting poor families, and providing public goods. Yet the rapid growth of Social Security and Medicare threatens these and all other portions of the federal budget.

As Social Security and Medicare continue to expand, there will be no room in the federal budget for defense, homeland security, education, welfare, housing, social services, health research, veterans

benefits, criminal justice, highway construction, or environmental protection. Each program will face massive spending cuts or complete elimination as America moves from a welfare state to what *National Review* editor Rich Lowry has called the “geriatric state.”²⁰

In other words, the federal budget will become one giant mechanism to transfer income from working families to senior citizens. One generation will be taxed into poverty to support another generation. As summed up by Ron Brownstein of the *Los Angeles Times*:

To call this behavior a breakdown of fiscal responsibility misses its true nature. This is a stunning abandonment of generational responsibility. Washington is behaving like a father who steals his kid’s credit card and



19. See Daniel J. Mitchell, Ph.D., “The Impact of Government Spending on Economic Growth” Heritage Foundation *Backgrounder* No. 1831, March 15, 2005, at www.heritage.org/Research/Budget/bg1831.cfm.

20. Rich Lowry, “Operation Please Granny,” October 27, 2003, at www.townhall.com/columnists/richlowry/rl20031027.shtml (November 3, 2005).

goes on a bender. Individually, America's parents make sacrifices every day to provide opportunities for their children; but collectively, the nation is now pursuing precisely the opposite course—indulging itself even at the price of reducing opportunity for its children.²¹

It is difficult to justify raising taxes by \$11,000 per household for working families, who already face the expenses of raising children and making mortgage payments, to transfer money to senior citizens who are often wealthier, lack current child-raising costs, and often have entirely paid off their homes.²² Senior citizens are certainly entitled to receive the amount that they paid into the Social Security and Medicare systems, and low-income seniors may require additional assistance.

However, the current system functions as an unsustainable pyramid scheme, through which many current seniors will receive benefits several times greater than the amount that they paid into the system and many current taxpayers will receive much less than they pay into the system. That is fundamentally unfair.

Economic and Budgetary Unsustainability.

The current system is economically unsustainable. Spending for Social Security, Medicare, and Medicaid is projected to increase from 8.4 percent of GDP in 2005 to 18.9 percent of GDP in 2050. Lawmakers would have to raise taxes by an amount eventually nearing \$11,000 per household (adjusted into today's economy) in order to pay for all projected spending. Over time, such tax increases would devastate the U.S. economy and substantially harm working families. Assuming that those tax increases do not occur, the net interest cost of current federal debt, combined with trillions of dollars of new debt, would push spending to unsustainable levels.

Those who consider these scenarios overly pessimistic should examine the Western European

Table 4		B 1897
U.S. Government Spending Projected to Reach European Levels		
Nation	Spending (%GDP)	
United States (2050)	83.6	
Sweden	58.3	
Denmark	55.8	
United States (2040)	54.1	
France	53.5	
Austria	51.3	
Belgium	50.5	
Finland	50.1	
Germany	48.5	
Italy	48.0	
Netherlands	47.5	
Greece	46.8	
Portugal	45.9	
Luxembourg	44.0	
United States (2030)	42.2	
United Kingdom	40.7	
Spain	39.9	
United States (2020)	35.2	
Ireland	33.3	
United States (2005)	30.5	

Note: European figures are for 2002 and include all levels of government. U.S. figures include 10.5 percent of GDP spent by state/local governments.

Source: Heritage Foundations calculations and Organisation for Economic Cooperation and Development, "OECD in Figures," July 2004, pp. 36-37.

economies that are already sinking under the weight of their enormous social insurance systems. With birth rates that are not even sufficient to replace their current population, many "old Europe" nations have been forced to impose steep tax increases on their remaining workers to fund these bloated benefit systems.

21. Ron Brownstein, "Snowballing Debt Awaits Tomorrow's Taxpayers," *Los Angeles Times*, December 1, 2003.

22. For more information on the wealth of senior citizens, see Chris Edwards and Tad DeHaven, "War Between the Generations: Federal Spending on the Elderly Set to Explode," Cato Institute *Policy Analysis* No. 488, September 16, 2003, at www.cato.org/pubs/pas/pa488.pdf (November 3, 2005).

Overall, government spending in the 15 nations comprising the pre-2004 European Union (EU-15) averages 48 percent of GDP, and tax revenues average 41 percent of GDP. (See Table 4.) These high tax rates and expenditures, combined with tight economic regulations, have hammered their economies. Compared to the United States, per capita income is 30 percent lower in the EU-15, economic growth rates are 34 percent lower, unemployment is substantially higher, and living standards match only America's poorest states.²³

As their populations continue to age, the economies of countries such as Germany and France risk collapsing under the weight of their unrealistically generous retirement and welfare systems. These European crises provide a glimpse into America's future if government spending continues to increase steeply.

Conclusion

The data presented in this paper are not predictions of what will occur. They merely represent three painful, possible outcomes if policymakers continue on their current course with Social Security, Medicare, and Medicaid. Unless lawmakers reform these programs, the nation will be forced to choose among devastating tax increases, the elimination of nearly every other federal program, and budget deficits large enough to jeopardize the entire U.S. economy. The longer lawmakers wait, the more expensive and painful these reforms will become.

—Brian M. Riedl is Grover M. Hermann Fellow in Federal Budgetary Affairs in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

23. Mitchell, "The Impact of Government Spending on Economic Growth."

APPENDIX 1 DATA

Fiscal Year	Mandatory				Discretionary		Programs Subtotal	Net Interest	Total Spending	Revenue	Surplus/ Deficit	Public Debt
	Social Security	Medicare	Medicaid	Other	Defense	Other						
2000	4.1	2.2	1.2	2.2	3.0	3.3	16.0	2.3	18.2	20.6	2.4	34.7
2001	4.2	2.3	1.3	2.1	3.0	3.4	16.4	2.0	18.4	19.7	1.3	32.9
2002	4.3	2.4	1.4	2.4	3.3	3.7	17.5	1.6	19.2	17.7	-1.5	33.9
2003	4.3	2.5	1.5	2.5	3.7	3.8	18.2	1.4	19.6	16.2	-3.4	36.1
2004	4.3	2.6	1.5	2.4	3.9	3.8	18.5	1.4	19.8	16.3	-3.6	37.2
2005	4.2	2.7	1.5	2.4	4.0	3.8	18.7	1.5	20.1	17.6	-2.6	37.7
2006	4.2	3.0	1.5	2.2	3.9	4.1	18.9	1.6	20.5	17.5	-3.0	38.2
2007	4.2	3.2	1.5	2.0	3.9	4.1	18.9	1.8	20.7	17.2	-3.5	39.3
2008	4.2	3.2	1.5	1.9	3.8	4.0	18.7	2.0	20.7	17.1	-3.6	40.6
2009	4.2	3.3	1.6	1.8	3.7	3.9	18.4	2.2	20.6	17.1	-3.5	42.0
2010	4.2	3.3	1.6	1.7	3.6	3.7	18.2	2.3	20.5	17.1	-3.4	43.5
2011	4.3	3.5	1.7	1.7	3.5	3.7	18.4	2.4	20.8	17.1	-3.7	45.2
2012	4.3	3.5	1.8	1.5	3.5	3.7	18.4	2.5	20.9	17.3	-3.6	46.9
2013	4.4	3.7	1.8	1.5	3.5	3.7	18.7	2.6	21.3	17.4	-3.9	48.8
2014	4.5	3.8	1.9	1.4	3.5	3.7	18.9	2.7	21.6	17.5	-4.1	50.9
2015	4.6	4.0	2.0	1.3	3.5	3.7	19.1	2.9	22.0	17.6	-4.4	53.2
2016	4.8	4.3	2.0	1.3	3.5	3.7	19.7	3.0	22.7	17.8	-4.8	55.8
2017	4.9	4.4	2.0	1.3	3.5	3.7	20.0	3.1	23.1	17.8	-5.3	58.8
2018	5.0	4.6	2.1	1.3	3.5	3.7	20.3	3.3	23.6	17.8	-5.8	62.2
2019	5.1	4.8	2.1	1.3	3.5	3.7	20.6	3.5	24.1	17.8	-6.3	65.9
2020	5.2	5.0	2.2	1.3	3.5	3.7	21.0	3.7	24.7	17.8	-6.9	70.1
2021	5.3	5.1	2.2	1.3	3.5	3.7	21.3	4.0	25.2	17.8	-7.4	74.6
2022	5.4	5.3	2.2	1.3	3.5	3.7	21.6	4.2	25.8	17.8	-8.0	79.5
2023	5.5	5.5	2.3	1.3	3.5	3.7	21.9	4.5	26.4	17.8	-8.6	84.8
2024	5.6	5.7	2.3	1.3	3.5	3.7	22.2	4.8	27.1	17.8	-9.2	90.6
2025	5.8	5.9	2.3	1.3	3.5	3.7	22.6	5.2	27.7	17.8	-9.9	96.7
2026	5.8	6.1	2.4	1.3	3.5	3.7	22.8	5.6	28.4	17.8	-10.6	103.3
2027	5.9	6.2	2.4	1.3	3.5	3.7	23.1	6.0	29.2	17.8	-11.3	110.4
2028	6.0	6.4	2.4	1.3	3.5	3.7	23.4	6.5	29.9	17.8	-12.1	118.0
2029	6.1	6.6	2.5	1.3	3.5	3.7	23.7	7.1	30.8	17.8	-13.0	126.1
2030	6.1	6.8	2.5	1.3	3.5	3.7	24.0	7.7	31.7	17.8	-13.9	134.7
2031	6.2	6.9	2.6	1.3	3.5	3.7	24.2	8.3	32.5	17.8	-14.7	143.9
2032	6.2	7.1	2.6	1.3	3.5	3.7	24.5	9.0	33.5	17.8	-15.7	153.6
2033	6.2	7.2	2.7	1.3	3.5	3.7	24.7	9.8	34.5	17.8	-16.7	163.9
2034	6.3	7.4	2.7	1.3	3.5	3.7	24.9	10.6	35.6	17.8	-17.7	174.9
2035	6.3	7.5	2.8	1.3	3.5	3.7	25.2	11.5	36.7	17.8	-18.9	186.6
2036	6.3	7.6	2.8	1.3	3.5	3.7	25.4	12.5	37.9	17.8	-20.0	198.9
2037	6.3	7.8	2.9	1.3	3.5	3.7	25.5	13.6	39.1	17.8	-21.3	212.0
2038	6.3	7.9	2.9	1.3	3.5	3.7	25.7	14.8	40.5	17.8	-22.7	225.9
2039	6.3	8.0	3.0	1.3	3.5	3.7	25.9	16.1	42.0	17.8	-24.1	240.8
2040	6.3	8.1	3.0	1.3	3.5	3.7	26.0	17.5	43.6	17.8	-25.7	256.6
2041	6.3	8.2	3.1	1.3	3.5	3.7	26.2	19.1	45.3	17.8	-27.5	273.4
2042	6.3	8.4	3.1	1.3	3.5	3.7	26.3	20.8	47.2	17.8	-29.4	291.5
2043	6.3	8.5	3.2	1.3	3.5	3.7	26.5	22.8	49.3	17.8	-31.4	311.0
2044	6.3	8.6	3.2	1.3	3.5	3.7	26.6	25.0	51.6	17.8	-33.8	331.9
2045	6.3	8.7	3.3	1.3	3.5	3.7	26.8	27.4	54.2	17.8	-36.3	354.6
2046	6.3	8.8	3.3	1.3	3.5	3.7	26.9	30.1	57.1	17.8	-39.2	379.2
2047	6.3	8.9	3.3	1.3	3.5	3.7	27.1	33.2	60.3	17.8	-42.5	406.1
2048	6.2	9.0	3.4	1.3	3.5	3.7	27.3	36.8	64.0	17.8	-46.2	435.5
2049	6.2	9.1	3.4	1.3	3.5	3.7	27.4	40.9	68.3	17.8	-50.4	468.0
2050	6.2	9.3	3.5	1.3	3.5	3.7	27.6	45.6	73.1	17.8	-55.3	504.0

Source: Heritage Foundation calculations. See Appendix 2 for methodology.

Table 6 B 1897

Projected Federal Spending and Revenues

Fiscal Year	GDP	Mandatory				Discretionary		Programs Subtotal	Net Interest	Total Spending	Revenue	Surplus/ Deficit
		Social Security	Medicare	Medicaid	Other	Defense	Other					
2000	\$9,817	\$406	\$216	\$118	\$211	\$295	\$320	\$1,566	\$223	\$1,789	\$2,025	\$236
2001	10,128	429	238	129	211	306	343	1,657	206	1,863	1,991	128
2002	10,487	452	254	148	252	349	385	1,840	171	2,011	1,853	-158
2003	11,004	471	274	161	276	405	421	2,007	153	2,160	1,782	-378
2004	11,554	492	297	176	273	454	441	2,133	160	2,292	1,879	-413
2005	12,271	519	332	184	292	493	470	2,290	180	2,470	2,154	-317
2006	12,967	546	385	192	285	508	533	2,449	211	2,660	2,265	-395
2007	13,655	574	437	203	267	536	559	2,576	248	2,824	2,348	-476
2008	14,372	602	462	221	276	550	570	2,681	292	2,973	2,455	-518
2009	15,106	634	491	239	277	555	591	2,787	328	3,115	2,581	-534
2010	15,836	670	527	260	275	565	590	2,887	363	3,250	2,711	-539
2011	16,578	709	574	282	281	585	618	3,048	399	3,447	2,835	-612
2012	17,331	753	606	305	267	611	646	3,188	437	3,625	3,000	-625
2013	18,105	801	665	330	271	639	674	3,380	475	3,855	3,147	-708
2014	18,903	852	722	357	267	666	704	3,568	519	4,087	3,303	-784
2015	19,729	907	785	387	266	694	735	3,774	566	4,340	3,467	-873
2016	20,577	990	882	412	277	724	766	4,052	613	4,665	3,669	-996
2017	21,462	1,055	955	438	289	755	799	4,291	674	4,965	3,826	-1,139
2018	22,385	1,124	1,033	466	302	788	834	4,546	743	5,289	3,991	-1,298
2019	23,348	1,198	1,118	495	315	822	870	4,817	821	5,638	4,162	-1,476
2020	24,352	1,276	1,210	524	328	857	907	5,102	911	6,013	4,341	-1,672
2021	25,399	1,356	1,306	556	342	894	946	5,400	1,011	6,412	4,528	-1,884
2022	26,491	1,441	1,409	588	357	932	987	5,714	1,125	6,839	4,723	-2,116
2023	27,630	1,531	1,521	624	373	972	1,029	6,050	1,251	7,301	4,926	-2,375
2024	28,818	1,627	1,641	660	389	1,014	1,073	6,403	1,393	7,797	5,138	-2,659
2025	30,057	1,728	1,770	700	405	1,058	1,120	6,782	1,552	8,334	5,359	-2,975
2026	31,350	1,826	1,899	743	423	1,103	1,168	7,162	1,750	8,912	5,589	-3,323
2027	32,698	1,930	2,036	785	441	1,151	1,218	7,561	1,974	9,534	5,829	-3,705
2028	34,104	2,040	2,184	829	460	1,200	1,270	7,983	2,228	10,210	6,080	-4,130
2029	35,570	2,156	2,342	879	480	1,252	1,325	8,433	2,516	10,949	6,341	-4,607
2030	37,100	2,278	2,512	931	500	1,306	1,382	8,909	2,844	11,753	6,614	-5,139
2031	38,695	2,389	2,676	987	522	1,362	1,441	9,377	3,218	12,595	6,899	-5,696
2032	40,359	2,505	2,851	1,049	544	1,421	1,503	9,874	3,640	13,513	7,195	-6,318
2033	42,094	2,627	3,038	1,115	568	1,482	1,568	10,398	4,118	14,515	7,505	-7,011
2034	43,904	2,755	3,236	1,185	592	1,545	1,635	10,950	4,661	15,610	7,827	-7,783
2035	45,792	2,889	3,448	1,259	617	1,612	1,706	11,532	5,278	16,810	8,164	-8,646
2036	47,761	3,014	3,653	1,337	644	1,681	1,779	12,108	5,981	18,089	8,515	-9,574
2037	49,815	3,143	3,870	1,420	672	1,753	1,856	12,713	6,778	19,491	8,881	-10,610
2038	51,957	3,278	4,100	1,507	701	1,829	1,935	13,349	7,685	21,034	9,263	-11,771
2039	54,191	3,419	4,343	1,599	731	1,907	2,019	14,018	8,720	22,737	9,661	-13,076
2040	56,521	3,566	4,601	1,696	762	1,989	2,105	14,720	9,903	24,623	10,077	-14,546
2041	58,952	3,714	4,862	1,798	795	2,075	2,196	15,439	11,260	26,700	10,510	-16,190
2042	61,487	3,867	5,138	1,906	829	2,164	2,290	16,195	12,819	29,013	10,962	-18,051
2043	64,131	4,027	5,429	2,020	865	2,257	2,389	16,987	14,614	31,601	11,433	-20,168
2044	66,888	4,194	5,737	2,140	902	2,354	2,491	17,819	16,692	34,511	11,925	-22,586
2045	69,764	4,367	6,063	2,267	941	2,456	2,599	18,692	19,104	37,796	12,438	-25,359
2046	72,764	4,552	6,403	2,401	981	2,561	2,710	19,609	21,920	41,528	12,973	-28,556
2047	75,893	4,745	6,762	2,535	1,023	2,671	2,827	20,563	25,222	45,785	13,530	-32,254
2048	79,157	4,946	7,141	2,683	1,067	2,786	2,948	21,572	29,115	50,687	14,112	-36,575
2049	82,560	5,155	7,542	2,832	1,113	2,906	3,075	22,623	33,736	56,359	14,719	-41,640
2050	86,110	5,373	7,965	2,988	1,161	3,031	3,207	23,726	39,258	62,984	15,352	-47,632

Note: All amounts are in nominal \$billions.
Source: Heritage Foundation calculations. See Appendix 2 for methodology.

Table 7 B 1897

Projected Federal Spending and Revenues, Translated into the 2005 Economy

Fiscal Year	GDP	Mandatory				Discretionary		Programs Subtotal	Net Interest	Total Spending	Revenue	Surplus/ Deficit
		Social Security	Medicare	Medicaid	Other	Defense	Other					
2000	\$1,227.1	\$507	\$270	\$147	\$264	\$369	\$400	\$1,957	\$279	\$2,236	\$2,531	\$295
2001	1,227.1	520	288	157	256	371	416	2,008	250	2,258	2,413	155
2002	1,227.1	529	297	173	295	408	451	2,153	200	2,353	2,168	-185
2003	1,227.1	525	306	179	308	452	469	2,238	171	2,409	1,988	-421
2004	1,227.1	523	315	187	290	482	468	2,265	170	2,434	1,996	-439
2005	1,227.1	519	332	184	292	493	470	2,290	180	2,470	2,154	-317
2006	1,227.1	517	364	182	270	481	504	2,318	200	2,517	2,143	-374
2007	1,227.1	516	393	182	240	482	502	2,315	223	2,538	2,110	-428
2008	1,227.1	514	394	189	235	470	487	2,289	249	2,539	2,096	-443
2009	1,227.1	515	399	194	225	451	480	2,264	266	2,530	2,097	-433
2010	1,227.1	519	408	201	213	438	457	2,237	281	2,518	2,101	-417
2011	1,227.1	525	425	209	208	433	457	2,256	295	2,552	2,098	-453
2012	1,227.1	533	429	216	189	433	457	2,257	309	2,567	2,124	-443
2013	1,227.1	543	451	224	184	433	457	2,291	322	2,613	2,133	-480
2014	1,227.1	553	469	232	173	432	457	2,316	337	2,653	2,144	-509
2015	1,227.1	564	488	241	165	432	457	2,348	352	2,700	2,156	-543
2016	1,227.1	590	526	245	165	432	457	2,416	366	2,782	2,188	-594
2017	1,227.1	603	546	250	165	432	457	2,454	385	2,839	2,188	-651
2018	1,227.1	616	566	255	165	432	457	2,492	407	2,899	2,188	-712
2019	1,227.1	629	588	260	165	432	457	2,532	432	2,963	2,188	-776
2020	1,227.1	643	610	264	165	432	457	2,571	459	3,030	2,188	-842
2021	1,227.1	655	631	269	165	432	457	2,609	489	3,098	2,188	-910
2022	1,227.1	667	653	272	165	432	457	2,647	521	3,168	2,188	-980
2023	1,227.1	680	675	277	165	432	457	2,687	556	3,243	2,188	-1,055
2024	1,227.1	693	699	281	165	432	457	2,727	593	3,320	2,188	-1,132
2025	1,227.1	706	723	286	165	432	457	2,769	634	3,402	2,188	-1,215
2026	1,227.1	715	743	291	165	432	457	2,803	685	3,488	2,188	-1,301
2027	1,227.1	724	764	295	165	432	457	2,837	741	3,578	2,188	-1,390
2028	1,227.1	734	786	298	165	432	457	2,872	802	3,674	2,188	-1,486
2029	1,227.1	744	808	303	165	432	457	2,909	868	3,777	2,188	-1,589
2030	1,227.1	753	831	308	165	432	457	2,947	941	3,887	2,188	-1,700
2031	1,227.1	758	849	313	165	432	457	2,974	1,021	3,994	2,188	-1,806
2032	1,227.1	762	867	319	165	432	457	3,002	1,107	4,109	2,188	-1,921
2033	1,227.1	766	886	325	165	432	457	3,031	1,200	4,231	2,188	-2,044
2034	1,227.1	770	905	331	165	432	457	3,060	1,303	4,363	2,188	-2,175
2035	1,227.1	774	924	337	165	432	457	3,090	1,414	4,504	2,188	-2,317
2036	1,227.1	774	939	344	165	432	457	3,111	1,537	4,647	2,188	-2,460
2037	1,227.1	774	953	350	165	432	457	3,132	1,670	4,801	2,188	-2,614
2038	1,227.1	774	968	356	165	432	457	3,153	1,815	4,968	2,188	-2,780
2039	1,227.1	774	983	362	165	432	457	3,174	1,974	5,149	2,188	-2,961
2040	1,227.1	774	999	368	165	432	457	3,196	2,150	5,346	2,188	-3,158
2041	1,227.1	773	1,012	374	165	432	457	3,214	2,344	5,558	2,188	-3,370
2042	1,227.1	772	1,025	380	165	432	457	3,232	2,558	5,790	2,188	-3,603
2043	1,227.1	771	1,039	387	165	432	457	3,250	2,796	6,047	2,188	-3,859
2044	1,227.1	769	1,052	393	165	432	457	3,269	3,062	6,331	2,188	-4,143
2045	1,227.1	768	1,066	399	165	432	457	3,288	3,360	6,648	2,188	-4,460
2046	1,227.1	768	1,080	405	165	432	457	3,307	3,697	7,003	2,188	-4,816
2047	1,227.1	767	1,093	410	165	432	457	3,325	4,078	7,403	2,188	-5,215
2048	1,227.1	767	1,107	416	165	432	457	3,344	4,513	7,858	2,188	-5,670
2049	1,227.1	766	1,121	421	165	432	457	3,363	5,014	8,377	2,188	-6,189
2050	1,227.1	766	1,135	426	165	432	457	3,381	5,594	8,975	2,188	-6,788

Note: All amounts are in nominal \$billions.
Source: Heritage Foundation calculations. See Appendix 2 for methodology.

Table 8 B 1897

Projected Federal Spending and Revenues Per Household, Translated into the 2005 Economy

Fiscal Year	GDP	Mandatory				Discretionary		Programs Subtotal	Net Interest	Total Spending	Revenue	Surplus/ Deficit
		Social Security	Medicare	Medicaid	Other	Defense	Other					
2000	\$109,076	\$4,511	\$2,400	\$1,310	\$2,346	\$3,278	\$3,554	\$17,399	\$2,478	\$19,876	\$22,502	\$2,626
2001	109,076	4,625	2,562	1,394	2,272	3,297	3,697	17,846	2,221	20,067	21,445	1,377
2002	109,076	4,702	2,639	1,534	2,625	3,629	4,009	19,138	1,779	20,916	19,275	-1,641
2003	109,076	4,664	2,718	1,593	2,737	4,014	4,168	19,893	1,518	21,411	17,667	-3,744
2004	109,076	4,645	2,804	1,662	2,577	4,287	4,162	20,137	1,510	21,639	17,739	-3,900
2005	109,076	4,613	2,951	1,636	2,596	4,382	4,178	20,356	1,600	21,956	19,147	-2,809
2006	109,076	4,593	3,239	1,615	2,397	4,273	4,483	20,600	1,775	22,375	19,053	-3,323
2007	109,076	4,585	3,491	1,622	2,133	4,283	4,462	20,576	1,981	22,557	18,756	-3,801
2008	109,076	4,569	3,506	1,677	2,091	4,178	4,329	20,350	2,216	22,566	18,632	-3,934
2009	109,076	4,578	3,545	1,726	1,998	4,009	4,265	20,121	2,368	22,490	18,637	-3,853
2010	109,076	4,615	3,630	1,791	1,894	3,891	4,063	19,884	2,500	22,384	18,673	-3,711
2011	109,076	4,665	3,777	1,855	1,848	3,849	4,063	20,057	2,625	22,682	18,653	-4,029
2012	109,076	4,739	3,814	1,920	1,681	3,848	4,063	20,065	2,750	22,815	18,881	-3,934
2013	109,076	4,826	4,006	1,988	1,632	3,847	4,063	20,362	2,862	23,224	18,959	-4,264
2014	109,076	4,916	4,166	2,060	1,541	3,840	4,063	20,586	2,995	23,581	19,059	-4,522
2015	109,076	5,015	4,340	2,140	1,471	3,839	4,063	20,867	3,129	23,996	19,168	-4,828
2016	109,076	5,248	4,675	2,182	1,471	3,839	4,063	21,477	3,250	24,727	19,446	-5,281
2017	109,076	5,361	4,851	2,225	1,471	3,839	4,063	21,810	3,423	25,233	19,446	-5,787
2018	109,076	5,477	5,034	2,269	1,471	3,839	4,063	22,152	3,619	25,771	19,446	-6,325
2019	109,076	5,595	5,224	2,312	1,471	3,839	4,063	22,504	3,837	26,341	19,446	-6,895
2020	109,076	5,716	5,421	2,345	1,471	3,839	4,063	22,854	4,079	26,933	19,446	-7,487
2021	109,076	5,823	5,608	2,389	1,471	3,839	4,063	23,193	4,343	27,536	19,446	-8,090
2022	109,076	5,932	5,802	2,421	1,471	3,839	4,063	23,528	4,630	28,158	19,446	-8,712
2023	109,076	6,043	6,003	2,465	1,471	3,839	4,063	23,884	4,940	28,823	19,446	-9,377
2024	109,076	6,156	6,210	2,498	1,471	3,839	4,063	24,237	5,274	29,511	19,446	-10,065
2025	109,076	6,272	6,425	2,541	1,471	3,839	4,063	24,611	5,633	30,244	19,446	-10,798
2026	109,076	6,355	6,606	2,585	1,471	3,839	4,063	24,918	6,088	31,006	19,446	-11,560
2027	109,076	6,439	6,793	2,618	1,471	3,839	4,063	25,222	6,584	31,806	19,446	-12,360
2028	109,076	6,524	6,984	2,651	1,471	3,839	4,063	25,531	7,125	32,656	19,446	-13,210
2029	109,076	6,610	7,182	2,694	1,471	3,839	4,063	25,858	7,716	33,574	19,446	-14,128
2030	109,076	6,697	7,384	2,738	1,471	3,839	4,063	26,192	8,363	34,555	19,446	-15,109
2031	109,076	6,734	7,543	2,781	1,471	3,839	4,063	26,431	9,072	35,503	19,446	-16,057
2032	109,076	6,771	7,705	2,836	1,471	3,839	4,063	26,685	9,837	36,522	19,446	-17,076
2033	109,076	6,808	7,871	2,891	1,471	3,839	4,063	26,942	10,670	37,612	19,446	-18,166
2034	109,076	6,845	8,040	2,945	1,471	3,839	4,063	27,203	11,579	38,782	19,446	-19,336
2035	109,076	6,883	8,213	3,000	1,471	3,839	4,063	27,468	12,572	40,040	19,446	-20,594
2036	109,076	6,883	8,342	3,054	1,471	3,839	4,063	27,652	13,659	41,311	19,446	-21,865
2037	109,076	6,883	8,473	3,109	1,471	3,839	4,063	27,837	14,841	42,678	19,446	-23,232
2038	109,076	6,883	8,606	3,163	1,471	3,839	4,063	28,025	16,133	44,158	19,446	-24,712
2039	109,076	6,883	8,741	3,218	1,471	3,839	4,063	28,215	17,551	45,765	19,446	-26,319
2040	109,076	6,883	8,879	3,272	1,471	3,839	4,063	28,406	19,111	47,518	19,446	-28,072
2041	109,076	6,872	8,996	3,327	1,471	3,839	4,063	28,567	20,835	49,401	19,446	-29,955
2042	109,076	6,861	9,114	3,381	1,471	3,839	4,063	28,729	22,740	51,469	19,446	-32,022
2043	109,076	6,850	9,234	3,436	1,471	3,839	4,063	28,892	24,856	53,749	19,446	-34,303
2044	109,076	6,839	9,356	3,490	1,471	3,839	4,063	29,058	27,219	56,277	19,446	-36,831
2045	109,076	6,828	9,479	3,545	1,471	3,839	4,063	29,224	29,869	59,094	19,446	-39,648
2046	109,076	6,824	9,598	3,599	1,471	3,839	4,063	29,394	32,858	62,252	19,446	-42,806
2047	109,076	6,819	9,718	3,643	1,471	3,839	4,063	29,554	36,249	65,803	19,446	-46,357
2048	109,076	6,815	9,841	3,698	1,471	3,839	4,063	29,726	40,119	69,845	19,446	-50,399
2049	109,076	6,811	9,964	3,741	1,471	3,839	4,063	29,889	44,570	74,459	19,446	-55,013
2050	109,076	6,806	10,089	3,785	1,471	3,839	4,063	30,053	49,728	79,781	19,446	-60,335

Source: Heritage Foundation calculations. See Appendix 2 for methodology.

Table 9

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Snapshot: 2005 vs. 2020 Federal Budgets

Spending Category	2005			2020		2020 Budget Translated into the 2005 Economy	
	Nominal Outlays (\$billions)	%GDP	Per Household	Nominal Outlays (\$billions)	%GDP	Outlays (\$billions)	Per Household
Social Security	\$524	4.3%	\$4,655	\$1,276	5.2%	\$643	\$5,716
Medicare	\$337	2.7%	\$2,997	\$1,210	5.0%	\$610	\$5,421
Net Interest	\$180	1.5%	\$1,600	\$911	3.7%	\$459	\$4,079
Defense	\$495	4.0%	\$4,403	\$857	3.5%	\$432	\$3,839
Medicaid	\$184	1.5%	\$1,636	\$524	2.2%	\$264	\$2,345
Income Security Programs	\$212	1.7%	\$1,886	\$344	1.4%	\$173	\$1,539
Federal Employee Retirement/Disability	\$94	0.8%	\$838	\$165	0.7%	\$83	\$740
Health Research and Regulation	\$69	0.6%	\$616	\$138	0.6%	\$69	\$616
Education	\$70	0.6%	\$625	\$126	0.5%	\$63	\$564
Veterans Benefits	\$68	0.6%	\$607	\$113	0.5%	\$57	\$508
Highways and Mass Transit	\$44	0.4%	\$392	\$85	0.4%	\$43	\$382
Justice Administration	\$41	0.3%	\$363	\$79	0.3%	\$40	\$353
Unemployment Compensation	\$38	0.3%	\$338	\$74	0.3%	\$37	\$331
International Affairs	\$33	0.3%	\$293	\$73	0.3%	\$37	\$326
Natural Resources and Environment	\$31	0.3%	\$277	\$60	0.2%	\$30	\$270
Other Spending	\$173	0.2%	1,541	\$277	1.1%	\$140	\$1,242
Undistributed Offsetting Receipts	-\$125	-1.0%	-\$1,111	-\$299	-1.2%	-\$151	-\$1,338
Total Spending	\$2,470	20.1%	\$21,956	\$6,013	24.7%	\$3,030	\$26,933
Total Revenues	\$2,154	17.6%	\$19,147	\$4,341	17.8%	\$2,188	\$19,446
Budget Surplus/Deficit	-\$317	-2.6%	-2,809	-\$1,672	-6.9%	-\$842	-\$7,487

Source: Heritage Foundation calculations. See Appendix 2 for methodology.

2020 Budget Projection

Table 9 compares the 2005 federal budget with the projected 2020 budget. Overall, federal spending is expected to rise from the current 20.1 percent of GDP to 24.7 percent. Medicare accounts for half of this increase, rising from 2.7 percent to 5.0 percent of GDP. Net interest more than doubles from the current 1.5 percent of GDP to 3.7 percent.

The final two columns allow for an easy comparison between 2005 and 2020 by translating the 2020 figures into today's economy. For example, the model projects a 2020 budget deficit of 6.9 percent of GDP. The same percentage of the 2005 GDP would be more than \$842 billion (\$7,487 per household).

Similarly, total 2020 federal spending adjusted into today's economy would equal \$3.03 trillion (\$560 billion more than in 2005) and cost \$26,933 per household (\$4,977 more than in 2005).

Unless Congress reforms Social Security, Medicare, and Medicaid, it will be left with three options (all numbers translated into today's economy and population):

- Balance the budget by raising taxes by \$842 billion (\$7,487 per household);
- Balance the budget by cutting other programs in 2020 by \$842 billion, which the second-to-last column of Table 9 show would require eliminating every other federal program besides defense; or
- Go deeper into debt, condemning the nation to a future of even higher net interest costs and taxes.

		2005		2030		2030 Budget Translated into the 2005 Economy	
Spending Category	Nominal Outlays	Per	Nominal Outlays	%GDP	Outlays	Per	
	(\$billions)	%GDP Household	(\$billions)	%GDP	(\$billions)	Household	
Net Interest	\$180	1.5%	\$1,600	7.7%	\$941	\$8,363	
Medicare	\$337	2.7%	\$2,997	6.8%	\$831	\$7,384	
Social Security	\$524	4.3%	\$4,655	6.1%	\$753	\$6,697	
Defense	\$495	4.0%	\$4,403	3.5%	\$432	\$3,839	
Medicaid	\$184	1.5%	\$1,636	2.5%	\$308	\$2,738	
Income Security Programs	\$212	1.7%	\$1,886	1.4%	\$173	\$1,539	
Federal Employee Retirement/Disability	\$94	0.8%	\$838	0.7%	\$83	\$740	
Health Research and Regulation	\$69	0.6%	\$616	0.6%	\$69	\$616	
Education	\$70	0.6%	\$625	0.5%	\$63	\$564	
Veterans Benefits	\$68	0.6%	\$607	0.5%	\$57	\$508	
Highways and Mass Transit	\$44	0.4%	\$392	0.4%	\$43	\$382	
Justice Administration	\$41	0.3%	\$363	0.3%	\$40	\$353	
Unemployment Compensation	\$38	0.3%	\$338	0.3%	\$37	\$331	
International Affairs	\$33	0.3%	\$293	0.3%	\$37	\$326	
Natural Resources and Environment	\$31	0.3%	\$277	0.2%	\$30	\$270	
Other Spending	\$173	0.2%	1,541	1.1%	\$140	\$1,242	
Undistributed Offsetting Receipts	-\$125	-1.0%	-\$1,111	-1.2%	-\$151	-\$1,338	
Total Spending	\$2,470	20.1%	\$21,956	31.7%	\$3,887	\$34,555	
Total Revenues	\$2,154	17.6%	\$19,147	17.8%	\$2,188	\$19,446	
Budget Surplus/Deficit	-\$317	-2.6%	-2,809	-13.9%	-\$1,700	-\$15,109	

Source: Heritage Foundation calculations. See Appendix 2 for methodology.

2030 Budget Projection

By 2030, Medicare will overtake Social Security as the most expensive federal program. Medicare's projected 4 percent of GDP expansion (from 2.7 percent to 6.8 percent) between 2005 and 2030 is twice the size of Social Security's 2 percent of GDP expansion (from 4.3 percent to 6.1 percent). Medicare will grow much faster than Social Security because, while both programs face the same demographic challenges related to the aging population, Medicare faces the additional challenge of rapidly rising health care costs.

Yet no government program will cost as much as net interest on the federal debt in 2030. In fact, at 7.7 percent of GDP (the equivalent of \$941 billion in 2005), net interest costs will be five times larger than the 2005 level of 1.5 percent of GDP (\$180 billion). The cause of this large increase is no secret: By 2030, federal spending will consume 31.7 percent of GDP, dwarfing the tax revenues of 17.8 percent. This translates into a budget deficit of 13.9 percent of GDP (\$1.7 trillion in today's economy). Federal spending will reach \$34,555 per household (translated into today's economy).

Once again, unless Congress reforms Social Security, Medicare, and Medicaid, it will be left with three options:

- Balance the budget by raising taxes by \$1,700 billion (\$15,109 per household);
- Balance the budget by eliminating every other program in 2030 (saving approximately \$1.1 trillion) and raising taxes by approximately \$650 billion (\$5,778 per household); or
- Go deeper into debt, condemning the nation to a future of even higher net interest costs and taxes.

Table 11

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Snapshot: 2005 vs. 2040 Federal Budgets

Spending Category	2005			2040		2040 Budget Translated into the 2005 Economy	
	Nominal Outlays (\$billions)	Per %GDP	Per Household	Nominal Outlays (\$billions)	%GDP	Outlays (\$billions)	Per Household
Net Interest	\$180	1.5%	\$1,600	\$9,903	17.5%	\$2,150	\$19,111
Medicare	\$337	2.7%	\$2,997	\$4,601	8.1%	\$999	\$8,879
Social Security	\$524	4.3%	\$4,655	\$3,566	6.3%	\$774	\$6,883
Defense	\$495	4.0%	\$4,403	\$1,989	3.5%	\$432	\$3,839
Medicaid	\$184	1.5%	\$1,636	\$1,696	3.0%	\$368	\$3,272
Income Security Programs	\$212	1.7%	\$1,886	\$798	1.4%	\$173	\$1,539
Federal Employee Retirement/Disability	\$94	0.8%	\$838	\$383	0.7%	\$83	\$740
Health Research and Regulation	\$69	0.6%	\$616	\$319	0.6%	\$69	\$616
Education	\$70	0.6%	\$625	\$292	0.5%	\$63	\$564
Veterans Benefits	\$68	0.6%	\$607	\$263	0.5%	\$57	\$508
Highways and Mass Transit	\$44	0.4%	\$392	\$198	0.4%	\$43	\$382
Justice Administration	\$41	0.3%	\$363	\$183	0.3%	\$40	\$353
Unemployment Compensation	\$38	0.3%	\$338	\$171	0.3%	\$37	\$331
International Affairs	\$33	0.3%	\$293	\$169	0.3%	\$37	\$326
Natural Resources and Environment	\$31	0.3%	\$277	\$140	0.2%	\$30	\$270
Other Spending	\$173	0.2%	1,541	\$644	1.1%	\$140	\$1,242
Undistributed Offsetting Receipts	-\$125	-1.0%	-\$1,111	-\$693	-1.2%	-\$151	-\$1,338
Total Spending	\$2,470	20.1%	\$21,956	\$24,623	43.6%	\$5,346	\$47,518
Total Revenues	\$2,154	17.6%	\$19,147	\$10,077	17.8%	\$2,188	\$19,446
Budget Surplus/Deficit	-\$317	-2.6%	-2,809	-\$14,546	-25.7%	-\$3,158	-\$28,072

Source: Heritage Foundation calculations. See Appendix 2 for methodology.

2040 Budget Projection

Social Security's costs generally level off at 6.3 percent of GDP after 2030, yet Medicare costs continue to increase. By 2040, Medicare is projected to cost 8.1 percent of GDP (nearly \$1 trillion in today's economy), which is triple the 2005 cost of 2.7 percent of GDP. By 2040, Medicaid will have doubled from its 2005 cost of 1.5 percent of GDP because the program will also pick up many of the long-term care costs for seniors that Medicare does not cover.

Overall, federal spending is projected to reach 43.6 percent of GDP by 2040 (\$5.35 trillion, or \$47,518 per household in today's economy). The enormous projected budget deficit of 26 percent of GDP means that net interest will again become the federal budget's most expensive item. This is a predictable result of decades of heavy borrowing to finance uncontrolled Social Security and Medicare costs.

Once again, unless Congress reforms Social Security, Medicare, and Medicaid, it will be left with three options:

- Balance the budget by raising taxes by \$3,158 billion (\$28,072 per household);
- Balance the budget by eliminating every other program in 2040 (saving approximately \$1.1 trillion) and raising taxes by approximately \$2.1 trillion (\$18,667 per household); or
- Go deeper into debt, condemning the nation to a future of even higher net interest costs and taxes.

Basically, this level of spending and debt represents a potential breaking point for the economy. Presumably, lawmakers will never let it come to this point.

Table 12

B 1897

Snapshot: 2005 vs. 2050 Federal Budgets

Spending Category	2005			2050		2050 Budget Translated into the 2005 Economy	
	Nominal Outlays (\$billions)	%GDP	Per Household	Nominal Outlays (\$billions)	%GDP	Outlays (\$billions)	Per Household
Net Interest	\$180	1.5%	\$1,600	\$39,258	45.6%	\$5,594	\$49,728
Medicare	\$337	2.7%	\$2,997	\$7,965	9.2%	\$1,135	\$10,089
Social Security	\$524	4.3%	\$4,655	\$5,373	6.2%	\$766	\$6,806
Defense	\$495	4.0%	\$4,403	\$3,031	3.5%	\$432	\$3,839
Medicaid	\$184	1.5%	\$1,636	\$2,988	3.5%	\$426	\$3,785
Income Security Programs	\$212	1.7%	\$1,886	\$1,215	1.4%	\$173	\$1,539
Federal Employee Retirement/Disability	\$94	0.8%	\$838	\$584	0.7%	\$83	\$740
Health Research and Regulation	\$69	0.6%	\$616	\$487	0.6%	\$69	\$616
Education	\$70	0.6%	\$625	\$446	0.5%	\$63	\$564
Veterans Benefits	\$68	0.6%	\$607	\$401	0.5%	\$57	\$508
Highways and Mass Transit	\$44	0.4%	\$392	\$301	0.4%	\$43	\$382
Justice Administration	\$41	0.3%	\$363	\$279	0.3%	\$40	\$353
Unemployment Compensation	\$38	0.3%	\$338	\$261	0.3%	\$37	\$331
International Affairs	\$33	0.3%	\$293	\$257	0.3%	\$37	\$326
Natural Resources and Environment	\$31	0.3%	\$277	\$213	0.2%	\$30	\$270
Other Spending	\$173	0.2%	1,541	\$981	1.1%	\$140	\$1,242
Undistributed Offsetting Receipts	-\$125	-1.0%	-\$1,111	-\$1,056	-1.2%	-\$151	-\$1,338
Total Spending	\$2,470	20.1%	\$21,956	\$62,984	73.1%	\$8,975	\$79,781
Total Revenues	\$2,154	17.6%	\$19,147	\$15,352	17.8%	\$2,188	\$19,446
Budget Surplus/Deficit	-\$317	-2.6%	-2,809	-\$47,632	-55.3%	-\$6,788	-\$60,335

Source: Heritage Foundation calculations. See Appendix 2 for methodology.

2050 Budget Projection

Between 2040 and 2050, the costs of nearly all entitlement programs (except Medicare) will generally have leveled off. However, years of budget deficits topping 10 percent of GDP will have created massive debt costs, triggering rising interest rates that will in turn push the debt higher in a vicious circle. As a result, 2050 federal spending is projected to reach 73 percent of GDP, with net interest amounting to over 45 percent of GDP.

This scenario is implausible. By the time federal spending passed 44 percent of GDP in 2040, the combination of rising interest rates and increased debt would have created a vicious circle leading to the exponential growth of federal spending. The U.S. economy would likely fall into a serious crisis well before this 2050 scenario could take place.

It is important to note that these are not predictions of what will occur. They are merely projections of what is likely to occur if policymakers continue on the current course. They show conclusively that current federal spending trends are absolutely unsustainable and that runaway entitlements could eventually jeopardize the entire United States economy unless lawmakers finally address these issues.

APPENDIX 2 METHODOLOGY

2006–2015 Calculations

Revenue estimates begin with the August 2005 CBO baseline²⁴ and are adjusted using CBO data²⁵ that reflect extensions of the expiring provisions of the 2001, 2003, and other tax cuts (excluding outlay portions) and the cost of reforming the Alternative Minimum Tax.

Discretionary spending for both defense and non-defense purposes in 2006 is listed at the levels contained in Table 1.4 of the August 2005 CBO baseline and then held constant as a share of GDP through 2015. War supplemental spending estimates come from Table 1.3 of the CBO's January 2005 budget projections. Katrina-related spending is based on preliminary Heritage Foundation estimates.

Mandatory spending estimates come from the August 2005 CBO baseline, adjusted for the outlay portions of extending the tax cuts listed above and for the mandatory spending reductions contained in the fiscal year 2006 budget resolution. Savings for specific years are estimated using the five-year savings of \$35 billion. Katrina-related spending is based on preliminary Heritage Foundation estimates.

Net interest spending estimates begin with the August 2005 CBO baseline and are adjusted by The Heritage Foundation after incorporating the net interest affect of each adjustment made to the baseline.

Mandatory program baselines were compiled using the data from the CBO Web site,²⁶ the CBO's

August baseline, and the Office of Management and Budget's Current Services Baseline (projected past 2010 by The Heritage Foundation).

2016–2050 Calculations

GDP growth after 2015 is projected at 4.3 percent annually in nominal dollars, which is similar to the rate projected by the Social Security trustees in the "Economic Assumptions and Methods" chapter of the 2005 OASDI Trustees Report.²⁷

Revenues are calculated in a manner similar to the CBO's low-tax scenario, used in the December 2003 *Long-Term Budget Outlook*, by setting tax revenues as a percentage of GDP (beyond the current 10-year window) at the average level of the previous 30 years. The 2003 report calculated that number at 18.4 percent of GDP after 2012, while the updated figure is 17.8 percent of GDP after 2015.

Social Security spending after 2015 is projected by using the intermediate scenario in the 2005 OASDI Trustees Report.²⁸

Medicare spending after 2015 is projected using the intermediate scenario in the 2005 Medicare Trustees Report.²⁹

Medicaid spending after 2015 is projected using the intermediate spending scenario in the CBO's December 2003 *Long-Term Budget Outlook*.³⁰ However, the CBO's current 2006–2015 baseline shows annual Medicaid spending levels at approximately 0.2 percent of GDP above the levels projected in December 2003. Accordingly, this paper adjusts

24. Congressional Budget Office, *The Budget and Economic Outlook*, p. 4, Table 1-2.

25. *Ibid.*, p. 16, Table 1-6.

26. Congressional Budget Office, Supplemental Data on Mandatory Spending, at www.cbo.gov/factsheets/FactSheets2005.shtml (November 9, 2005).

27. Social Security Administration, *The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, March 23, 2005, pp. 90–91, at www.socialsecurity.gov/OACT/TR/TR05/tr05.pdf (November 9, 2005).

28. *Ibid.*, pp. 169–173.

29. Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, p. 29, Table III.A2.

30. Congressional Budget Office, *The Long-Term Budget Outlook*.

annual Medicaid spending after 2015 up by 0.2 percent.

Defense and all other program spending is held constant as a percent of GDP after 2015. There is little legislative or historical evidence to suggest that this spending would see a strong diversion from current levels as a percent of GDP.

Net interest calculations are explained in the main text of this paper. Economic growth, inflation, and other economic impacts are less predictable than interest rates and therefore could not be incorporated into the paper. Those variables would likely worsen as a result of these fiscal pressures.

Other Calculations

Calculations after 2015 are first made as a percentage of GDP and then converted into nominal dollars, spending in terms of the 2005 economy, and costs per household.

Putting future spending in terms of the 2005 economy places future budget projections in context by showing how much those projections would cost Americans today. It can be done simply by taking long-term budget measures as a percentage of GDP (which automatically controls for GDP-influenced factors such as income, prices, and population) and then holding GDP constant at 2005 levels (effectively freezing those factors).

For example, Social Security is projected to cost \$1.28 trillion, or 5.24 percent of GDP in 2020. In the 2005 economy (with an estimated GDP of 12.27 trillion), 5.24 percent of GDP would translate into \$643 billion. Thus, Social Security's \$1.28

trillion nominal budget in 2020 would place the same burden on taxpayers and the economy as would a program costing \$643 billion in the 2005 economy. This represents the current equivalent of a \$124 billion increase over the \$519 billion spent in 2005.

Per-household calculations divide each program by the 112.5 million American households, as estimated by The Heritage Foundation using Census Bureau data. Because these percent-of-GDP measurements control for population over time, this 2005 household number can apply to future years when calculating the current equivalent tax or expenditure per household.

Tax increases needed to fund all spending and still balance the budget were calculated by setting tax revenues equal to spending beginning in 2006. Thus, publicly held debt and annual net interest payments remain roughly constant in nominal dollars and decline as a percentage of GDP. This keeps total spending each year much lower than would be the case if the debt and accompanying interest payments were increasing.

Federal program eliminations required to fund Social Security, Medicare, and Medicaid without tax increases or new debt were determined by setting federal spending equal to tax revenues beginning in 2006 (which limits net interest expenses) and then squeezing out the programs that would not fit each year as the big three entitlements expand. The order of eliminations was determined by working from the cheapest to the most expensive program categories.