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CBO Budget Baseline Shows Historic Surge in Spending and Debt

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The Congressional Budget Office (CBO) recently released its annual 10-year budget baseline. However, Congress requires the CBO to include unrealistic assumptions in its baseline. Therefore, the CBO also provides a set of alternative budget assumptions that can be used to build a more realistic baseline. A realistic baseline shows that historic spending increases are projected to drive the budget deficit to $1,220 billion in 2009 and $1,477 billion by 2019—even before any additional economic "stimulus" bills are enacted.

Genuine spending reforms are the only way to bring the budget under control. Lawmakers should reject additional "stimulus" spending that will not prove any more effective than the previous failed "stimulus" bills. Instead, they should aid the economy by reducing marginal tax rates and extending current tax cuts.[1] Next, lawmakers should enact tough spending caps to help lawmakers set priorities and make trade-offs.[2] Then, Congress should disclose the massive unfunded obligations of Social Security, Medicare, and Medicaid; put those programs on long-term budgets; and create an entitlement reform commission.[3] Finally, lawmakers should enact the necessary entitlement and programmatic reforms that can keep government within those limits.[4]

Building a Baseline. Congress requires the CBO to include in its 10-year baseline the following unrealistic assumptions: The 2001 and 2003 tax cuts and all other temporary tax cuts will expire; the Alternative Minimum Tax (AMT) will not be annually adjusted for inflation; non-war discretionary spending will grow no faster than inflation through 2019.

The projections used in this paper adjust the CBO's baseline with the following assumptions:

- All expiring tax cuts will be extended, and the AMT will be annually adjusted for inflation;
- Spending on Iraq and Afghanistan will grow at CBO's "fast drawdown" scenario; and
- Other discretionary spending will expand by 5 percent per year beginning in FY 2009.

Under this more realistic budget baseline, the budget deficit reaches $1,220 trillion in 2009, drops to $718 billion by 2012, and rises back to $1,477 billion by 2019 (see Table 1).

If an $800 billion stimulus package is enacted, the deficit would raise by approximately $400 billion in 2009 and 2010, with net interest costs rising thereafter.

General Budget and Spending Trends[5]

- Context: Since World War II, federal spending has generally remained between 18 and 22 percent of the Gross Domestic Product (GDP). During the Bush Administration, spending increased from 18.4 to 20.9 percent of GDP.

This paper, in its entirety, can be found at:
www.heritage.org/Research/Budget/wm2193.cfm

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A More Realistic Budget Baseline

Fiscal Year	Budget Deficit ($ billions) No Stimulus Bill	Stimulus Bill*
2007	–$162	–$162
2008	–456	–456
2009	–1,220	–1,640
2010	–849	–1,289
2011	–790	–830
2012	–718	–758
2013	–808	–848
2014	–894	–934
2015	–979	–1,019
2016	–1,124	–1,164
2017	–1,204	–1,244
2018	–1,294	–1,334
2019	–1,477	–1,517

*Assumes enactment of $800 billion stimulus bill over two years.

Source: Heritage Foundation calculations using Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2009 to 2019," January 2009, at *http://www.cbo.gov/ftpdocs/99xx/doc9957/01-07-Outlook.pdf.*

Table 1 • WM 2193 heritage.org

- In 2008, spending increased by $249 billion, or 9.1 percent. Revenues declined by $45 billion, or 1.7 percent. This increased the budget deficit from $162 billion to $456 billion.
- In 2009, spending is projected to rise 20 percent, and revenues are projected to fall by 7.0 percent.
- The 20 percent spending increase projected for 2009 represents the largest government expansion since the 1952 height of the Korean War (adjusted for inflation).
- In 2009, Washington is expected to spend $184 billion on the Troubled Asset Relief Program (TARP) and $218 billion on the Fannie Mae and Freddie Mac bailout.[6] Excluding those temporary expenses, 2009 spending is set to rise by 6.3 percent excluding any additional "stimulus" legislation.
- In 2009, federal spending is projected to reach 25 percent of GDP—the highest level in American history outside of World War II. The next economic "stimulus" package would push this total even higher.
- Between 2009 and 2019, revenues are projected to remain relatively stable at 17.6 percent of GDP (slightly below the 18.3 historical average). Spending is projected to fluctuate between 22 and 25 percent of GDP—well above the 20.7 percent historical average.
- Medicare and Medicaid are each set to rise another 10 percent in 2009. Since 2005, Medicare has grown 40 percent faster than inflation. The Medicare drug entitlement alone will cost $56 billion per year by 2012 and $112 billion per year by 2018. Its annual expense will continue to increase thereafter.

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1. J. D. Foster, Ph.D., and William W. Beach, "Economic Recovery: How Best to End the Recession," Heritage Foundation *WebMemo* No. 2191, January 7, 2008, at *http://www.heritage.org/Research/Economy/wm2191.cfm.*
2. 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.*
3. Stuart M. Butler, Ph.D. et. al, "Taking Back our Fiscal Future" Heritage Foundation *White Paper*, March 31, 2008, at *http://www.heritage.org/Research/Budget/wp0408.cfm.* See also Alison Acosta Fraser, "The SAFE Commission Act (H.R. 3654) and the Long-Term Fiscal Challenge," testimony before the Committee on the Budget, United States House of Representatives, June 25, 2008, at *http://www.heritage.org/Research/Budget/tst062508b.cfm.*
4. For proposals, see Brian M. Riedl, "A Guide to Fixing Social Security, Medicare, and Medicaid," Heritage Foundation *Backgrounder* No. 2114, March 11, 2008, at *http://www.heritage.org/Research/Budget/bg2114.cfm.*
5. Past budget data comes from Office of Management and Budget, Budget of the United States Government: 2009 Historical Tables, at *www.whitehouse.gov/omb/budget/fy2009/hist.html* (January 7, 2009). Future projections were calculated by The Heritage Foundation using Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2009 to 2019," January 2009, at *http://www.cbo.gov/ftpdocs/99xx/doc9957/01-07-Outlook.pdf* (January 7, 2009).
6. CBO calculated the TARP cost by assuming a subsidy rate of just over 25 percent of the final $700 billion purchasing authority. This is a very rough estimate.

- Unemployment benefits are estimated to cost $77 billion in 2009, up from $34 billion in 2007.
- Defense spending is currently 4.0 percent GDP, up from 3.0 percent when President Bush took office. However, it remains well below the 40-year average of 5.1 percent of GDP, and lower than it had been at any time during the Cold War.
- From 2001 through 2008, federal spending surged 60 percent—6.9 percent per year, on average. Had spending increases been limited to 35 percent—4.4 percent annually—the 2008 budget would have been in balance.
- While the costs of the financial bailouts and economic stimulus bills are staggering, they are only a fraction of the coming costs from Social Security, Medicare, and Medicaid. Over the next decade, the CBO projects that Medicaid will expand by 7 percent annually, Medicare by 6 percent annually, and Social Security by 5 percent annually. These programs face a 75-year shortfall of $43 trillion—60 times greater than the gross cost of the financial bailout. They are the chief reason budget deficits are projected to grow even after the recession ends.

Deficits and Public Debt

- Background: Since World War II, the largest budget deficit recorded was 6.0 percent of GDP in 1983. The Bush Administration oversaw budget deficits averaging 2.0 percent of GDP.
- The projected 2009 budget deficit of 8.6 percent of GDP would shatter the postwar record. The next economic "stimulus" package could push the budget deficit above 10 percent of GDP.
- The budget deficit is projected to remain above 4.5 percent of GDP indefinitely. By comparison, the budget deficit has not reached that level since 1992.
- By 2019, the budget forecasts a $1.5 trillion annual budget deficit, a public debt of 78 percent of GDP, and annual net interest spending of $761 billion.
- Since World War II, the public debt has ranged from 23 percent of GDP to 49 percent of GDP. Large deficits are estimated to drive the debt ratio to 50 percent in 2009, and 78 percent of GDP by 2019—a peacetime record.
- The public national debt—$5.8 trillion as of 2008—is projected to double by 2015 and nearly triple by 2019.
- The public debt rose by $3.8 trillion during President Bush's eight years in office. It is projected to rise by $7.5 trillion over the next eight years.
- As the budget deficit increases over the next decade, so will net interest spending, from $196 billion (1.4 percent of GDP) in 2009 to $761 billion (3.4 percent of GDP) by 2019.
- Lawmakers have proposed $800 billion in "stimulus" spending based on their misguided belief that budget deficits stimulate economic growth. Yet the budget is already projected to run a record $2 trillion in budget deficits over the next two years even before any stimulus is enacted. If $2 trillion in deficit spending is not enough to aid the economy, then perhaps a new approach is needed. A more pro-growth stimulus would reduce marginal tax rates and thus create incentives to work, save, and invest—which are the true drivers of economic growth.[7]
- An $800 billion stimulus bill would add approximately $40 billion in annual net interest costs, which would grow by a compounding rate indefinitely.
- The coming tsunami of Social Security, Medicare, and Medicaid costs are projected to push the federal public debt to nearly 300 percent of GDP by 2050, and over 850 percent of GDP by 2082.[8]

7. See Brian M. Riedl, "Why Government Spending Does Not Stimulate Economic Growth," Heritage Foundation *Backgrounder* No. 2208, November 12, 2008, at *http://www.heritage.org/Research/Budget/bg2208.cfm*; Foster and Beach, "Economic Recovery."
8. Congressional Budget Office, "The Long-Term Budget Outlook," December 2007, Figure 1.2, at *www.cbo.gov/ftpdocs/88xx/doc8877/12-13-LTBO.pdf*, and supplemental data for Figure 1.2 at *www.cbo.gov/ftpdocs/88xx/doc8877/SupplementalData.xls*. This represents the alternative fiscal scenario.

Taxes and Tax Policy

- Context: Tax revenues have historically averaged 18.3 percent of GDP, and typically remained between 17 percent and 19 percent of GDP. As late as 2007, revenues were above the historical average.
- The recession pushed 2008 revenues down to 17.7 percent of GDP. Revenues are projected to bottom out at 16.5 percent of GDP in 2009 and then rebound to a stable 17.6 percent of GDP (assuming all tax extenders).
- Incorporating tax extenders, the CBO projects that 2009 revenues will fall by 7.0 percent, or $176 billion. Even this is optimistic. The shallow 2001 recession produced an 11 percent revenue drop over two years, and therefore the current much larger recession is likely to cause a much greater revenue drop.

The Tsunami Is Coming. The new budget baseline shows a historic expansion of government occurring right as the first baby boomers begin collecting Social Security and Medicare benefits. Current spending trends are absolutely unsustainable. If lawmakers continue to avoid necessary budget reforms, they are guaranteeing a future of record government debt and historic tax increases.

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