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Entitlements Darken Long-Term Outlook for Federal Budget

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For years, the Congressional Budget Office (CBO), Government Accountability Office, Social Security and Medicare Trustees, and think tanks from across the political spectrum have been warning Congress that the budget is on an unsustainable course, and for years Congress has ignored them. CBO recently issued a new warning in their updated "Long-Term Budget Outlook" that is *déjà vu* all over again.

Under either of two scenarios CBO examined, spending will explode, resulting in unprecedented levels of debt and deficits that would cause substantial harm to the economy. But this year, Congress does not need to read any further than the summary of the report to figure out what to do. As CBO states:

> Almost all of the projected growth in federal spending other than interest payments on the debt comes from growth in spending on the three largest entitlement programs—Medicare, Medicaid, and Social Security.[1]

Solving America's deficit problem is an impossible task unless entitlement programs are reformed. The current recession, which has put a finer point on the problem of trillion-dollar deficits, should elevate the need for reform to a level not even Congress can continue to ignore.

Outlook Does Not Look Good. CBO's analysis consists of two sets of projections whose chief difference is that one, the "Extended-Baseline Scenario," assumes no changes to current tax policy while the other, the "Alternative Fiscal Scenario," would extend the 2001 and 2003 tax cuts and patch the AMT. The former yields higher revenues, resulting in lower deficits and a rosier outlook than the latter. For simplicity and to illustrate that even the best-case scenario is a miserable option, this paper will quote numbers from the Extended-Baseline Scenario only.

The most frightening findings in this report are the deficit and debt projections. In this year and next year, the yearly budget shortfall, or deficit, will be the largest post-war deficits on record—exceeding 11 percent of the economy or gross domestic product (GDP)—and by 2080 it will reach 17.8 percent of GDP.

The national debt, which is the sum of all past deficits, will escalate even faster. Since 1962, debt has averaged 36 percent of GDP, but it will reach 60 percent, nearly double the average, by next year and will exceed 100 percent of the economy by 2042. Put another way, in about 30 years, for every $1 each American citizen and business earns or produces, the government will be an equivalent $1 in debt. By 2083, debt figures will surpass an astounding 306 percent of GDP.

This paper, in its entirety, can be found at:
www.heritage.org/Research/Budget/wm2510.cfm

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The report also finds high overall growth in the government as a share of the economy and of taxpayers' wallets that provides an additional area of concern. While total government spending has hovered around 20 percent of the economy since the 1960s, it has jumped by a quarter to 25 percent in 2009 alone and will exceed 32 percent by 2083. Taxes, which have averaged at 18.3 percent of GDP, will reach unprecedented levels of 26 percent by 2083. Never in American history have spending and tax levels been that high.

But Why Should This Year Be Any Different? Much of the shock of these statistics is old news. The specific numbers from report to report by CBO and even other agencies have changed slightly year to year as data is updated and assumptions are modified, but the message about the budget's unsustainable course has stayed the same. However, two factors should cause this year's "Long-Term Budget Outlook" to resonate more strongly and catalyze congressional action.

1. The current recession has proven how important it is to get and keep America's economy on track. America is in a period of high unemployment, negative economic growth, and trillion-dollar deficits. More trillion-dollar deficits will not get or keep America's economy on a sustainable path, nor will they be tolerated by the public, but that is precisely where the U.S. economy is headed.

   While debt levels at 300 percent of GDP would produce unimaginable economic pain, the situation would be even worse than CBO predicts. As debt levels increase, interest rates, too, must increase in order to encourage more citizens or foreign governments to buy up debt. However, CBO does not attempt to model interest rate increases. Had CBO accounted for this, long-term deficit and debt numbers would be far higher because rising interest rates would drive net interest costs up further, driving deficits and debt up even higher, driving interest rates up further, and so on in a vicious cycle. As CBO states on page eight of the report: "If debt actually increased as projected under either scenario, interest rates would be higher than otherwise and economic growth would be slower."[2]

2. The Obama Administration and Democratic congressional leadership are poised to make the budget situation far worse with proposals for new expensive federal programs, such as national health care. While many policy goals may seem important in isolation, they must still be paid for in the broader context of the entire budget. Americans cannot afford to let Congress quietly sweep this report under the rug; Congress must confront America's budget situation openly and honestly before passing policies that would make this bad situation worse.

Congress Has One Option: Entitlement Reform. As CBO explains, the cause of the bleak outlook is clear: "Debt soars (under either baseline) because of unrelenting growth in federal spending on health care programs and a rise in Social Security spending as a share of GDP, combined with a much smaller increase in tax revenues."[3] Indeed, over the projection period these retirement entitlements, which are already the largest pieces of the budget, will more than double in size.

Unlike other spending, which will actually decrease substantially over the projection period if stimulus spending is phased out, entitlement spending is part of mandatory spending and grows on autopilot. The automatic growth leads to exploding costs due to rising health care costs and the fact that the 77 million retiring baby boomers outnumber the workers who will support them by a 2-to-1 ratio. Cutting an earmark here or raising a soda tax there will be absolutely insufficient to overcome these pressures, which is why CBO correctly admits that entitlement reform is the only option.

Too Bad to Ignore. Now that Americans are all too familiar with the problems associated with eco-

1. Congressional Budget Office, "The Long-Term Budget Outlook," June 2009, p. xi, at *http://www.cbo.gov/ftpdocs/102xx/doc10297/06-25-LTBO.pdf* (June 26, 2009).
2. *Ibid.*, p. 8.
3. *Ibid.*, p. 16.

nomic slowdowns and trillion-dollar deficits, Congress ought to take the warnings issued in the CBO's "Long-Term Budget Outlook" seriously. Adding new entitlements, such as national health care, or ignoring the need to reform existing ones while claiming to care about fiscal responsibility will be disingenuous at best and economically debilitating at worst.

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