

# ISSUE BRIEF

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## CBO Budget Update: Historic Deficits Continue, Recession Threatens in 2013

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Three key messages emerge from the updated budget outlook released today by the Congressional Budget Office (CBO)<sup>1</sup>:

1. For the fourth year in a row, the federal government in 2012 will run a budget deficit exceeding \$1 trillion;
2. The nation's fiscal and economic challenges going forward remain both daunting and unaddressed, with continued record spending and deficits and high unemployment; and
3. Another recession threatens in 2013 if Congress fails to defuse Taxmageddon and the fiscal cliff.

**CBO Numbers Tell the Tale.** By the numbers, the CBO estimates are troubling enough:

- President Obama has administered yet another trillion-dollar-plus deficit, this one reaching \$1.1 trillion, or about 7.3 percent the size of the economy. The deficit is \$49 billion higher than CBO's January estimate, the result of an \$88 billion decline in tax revenue (compared with the January estimate) and \$38 billion less in projected spending.
- Debt held by the public this year will reach \$11.3 trillion by October, roughly three-fourths of the entire economy.
- Spending this year will reach \$3.6 trillion, almost 23 percent of the economy and well above the historical average of about 20.2 percent.
- Surprisingly, despite growing signs of a slowdown, CBO nevertheless projects that the economy will accelerate slightly in the second half of 2012, with real (inflation-adjusted) gross domestic product (GDP) reaching a still sluggish 2.25 percent and unemployment remaining around the current 8.3 percent.
- CBO projects that the economy will shrink by 0.5 percent next fiscal year under current policy, which includes the "fiscal tightening" of "Taxmageddon" and more than \$100 billion in automatic spending cuts called "sequestration." "If that tightening occurs," CBO says, "output will decline in the first half of next year and then rise only modestly in the second half." As CBO notes, these conditions "will probably be considered a recession."

Beyond the immediate, the outlook remains threatening. Assuming current policies, CBO projects that spending will continue its record-setting climb, reaching \$6 trillion—or 24.1 percent of GDP—by 2022. That spending—driven mainly by the three major entitlements: Medicare, Medicaid, and Social Security—will outpace tax revenue, resulting in deficits that never fall below \$800 billion throughout the decade.

Those figures arise out of an "alternative fiscal scenario" that CBO produces, reflecting mostly the continuation of current tax and spending policy rather than current law. CBO generates this alternative because Congress persists

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in adopting uncoordinated, ad hoc, spend-as-you-go budgeting.

CBO's conventional baseline, as required by statute, projects spending and revenue assuming "current law"—including changes in law scheduled to take place. Congress and the President, however, have rendered this yardstick completely irrelevant. They have abandoned any semblance of fiscal order, so Congress now passes, and the President signs, major spending and tax bills chaotically and lasting only for short durations, ensuring constant reruns of the same unresolved issues—only at higher costs. This practice renders projections based on current law highly misleading, hence the resort to an alternative.

For example, due to the Senate's failure for the third year running to enact a budget blueprint for fiscal year 2013, and the consequent failure to enact a single 2013 appropriations bill, congressional leaders have tentatively agreed to a six-month continuing resolution aimed at avoiding a post-election "lame duck" debacle over funding federal agencies.

The agreement will spend at the highest available rate: \$1.047 trillion (excluding disasters and overseas operations). That level, defined in the Budget Control Act (BCA)—spawn of last year's debt ceiling debate—is \$19 billion above the House budget resolution and \$4 billion above 2012 spending levels.<sup>2</sup>

**Taxmageddon and Fiscal Cliff Spell Recession.** Still unresolved, meanwhile, are the prospects for "Taxmageddon"—a \$500 billion tax hike in 2013 alone—scheduled to occur because the President and his allies insist on an increase in the top two tax rates to turn it off.<sup>3</sup> Also hanging fire is the BCA's automatic enforcement mechanism known as "sequestration," which will slash a devastating \$55 billion from national defense in 2013 alone.<sup>4</sup> Although the House has approved a set of alternative spending cuts for 2013, the Senate has thus far refused to consider it.

CBO notes: "Whether lawmakers allow scheduled policy changes to take effect or alter them will play a crucial role in determining the path of the federal budget over the next 10 years and the outlook for the economy." The effects of Taxmageddon are plainly shown and described in the CBO report. If Congress and the President avert Taxmageddon and the fiscal cliff, then CBO projects the economy will grow at a still anemic 1.7 percent in 2013 and the unemployment rate will remain at 8 percent.

If, on the other hand, Congress fails to act, then the economy will contract by 0.5 percent in 2013, and the unemployment rate will shoot up to 9.1 percent. Herein is the price of Washington's failure to deal with Taxmageddon and the fiscal

cliff: almost a full percentage point increase in the unemployment rate, which translates to about 1.6 million more Americans out of work.

**President and Congress Need to Get to Work.** The CBO analysis affirms the great need for Congress and President Obama to stop playing chicken with the economy. The President's past economic policies have plainly failed, as the economy drags and unemployment remains high. Yet he and Congress can at least avoid making matters worse by defusing Taxmageddon and thereby side-stepping the recession that CBO projects. This should be their first task upon returning from the August recess.

Beyond the immediate, CBO's report provides another warning about the nation's looming fiscal calamity. To change course, Congress first needs to cast off its cavalier disregard for budgeting and begin taking seriously this fundamental responsibility of governing. Then, with a renewed sense of urgency and responsibility, Congress and the President should get about the core business of restraining entitlement spending, which is, after all, the main driver of the budget crisis before the nation.

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1. Congressional Budget Office, *An Update to the Economic and Budget Outlook: Fiscal Years 2012 to 2022*, August 22, 2012, [http://www.cbo.gov/sites/default/files/cbofiles/attachments/08-22-2012-Update\\_to\\_Outlook.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/08-22-2012-Update_to_Outlook.pdf) (accessed August 22, 2012).
2. See Patrick Louis Knudsen, "Another Temporary Budget Deal: Don't Blame a 'Broken' Process," The Heritage Foundation, The Foundry, August 1, 2012, <http://blog.heritage.org/2012/08/01/another-temporary-budget-deal-dont-blame-a-broken-process/>.
3. The Heritage Foundation, "Taxmageddon," <http://www.heritage.org/issues/taxes/taxmageddon>.
4. See Michaela Bendikova, "Even If Transparent, Sequestration Still a Bad Policy," The Heritage Foundation, The Foundry, August 9, 2012, <http://blog.heritage.org/2012/08/09/even-if-transparent-sequestration-still-a-bad-policy/>.