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Our Debt Problems Are Far from Solved
Updated: February 11, 2013

Given the deficit reduction enacted in the 2011 Budget Control Act (BCA) and the recent American Taxpayer Relief Act (ATRA), several commentators have suggested that the task of controlling the debt is almost complete.

President Obama recently remarked that "the consensus is we need about $4 trillion to stabilize our debt and our deficit, which means we need about $1.5 trillion more."[1] The Center on Budget and Policy Priorities, meanwhile, has showed that $1.5 trillion of additional deficit reduction would be sufficient to stabilize the debt through 2023, and argued that this amount would be an appropriate target for lawmakers, depending on the policy mix.[2] And then there is columnist Paul Krugman, who writes that the deficit is "a problem that is already, to a large degree, solved."[3]

Recent projections from CBO, however, show just the opposite – that our deficit problems are far from solved (see http://crfb.org/document/report-analysis-cbo%E2%80%99s-budget-and-economic-projections).

While the deficit reduction enacted to date represents notable progress, lawmakers have achieved only slightly more than **half** of the *minimum necessary* deficit reduction to achieve sustainability over the next decade by our estimates. Through 2040, they have enacted about **one quarter** of the deficit reduction needed, and only **one sixth** through 2080. Moreover, much of the enacted savings represents the "low-hanging fruit" of deficit reduction.

Despite the $2.7 trillion in enacted savings, debt remains on an upward path – on course to reach 79 percent of GDP in 2023, exceed 100 percent in the early 2030s, and ever-rising levels thereafter. These levels are clearly unsustainable.

Rather than allowing the debt to grow or just barely stabilizing the debt, lawmakers must put the debt-to-GDP ratio on a clear downward path. This will require at least **$2.4 trillion in new savings** through 2023 and substantially more over the long-term. By doing so, lawmakers would be able to provide wiggle room in case projections change, fiscal flexibility to deal with unforeseen events, and increasing the chances that debt will remain under control through at least the next few decades – not to mention the economic benefits of lower debt levels.

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Agreeing to $2.4 trillion in tax and spending changes will not be easy. But in our view, it is the absolute minimum necessary to ensure the debt is on a sustainable path.

How Much Deficit Reduction Has Been Enacted?

There is no simple answer to the question of how much deficit reduction has been enacted so far. To find the answer, one must decide from what starting point are savings calculated (i.e. August 2010, January 2011, etc.), against what baseline savings are measured (i.e. current policy, current law, etc.), and what pieces of legislation are counted.

In measuring enacted savings, we presume (as does the Senate Budget Committee and CBPP, among others) the 2010 Fiscal Commission report as the starting point – a report that sparked the deficit reduction conversation. We measure savings relative to CBO's August 2010 baseline, as the Fiscal Commission did, and we use a current policy baseline.[4] We also base our analysis on two major pieces of legislation – the American Taxpayer Relief Act (ATRA) and the Budget Control Act (BCA) – as well as savings codified by the BCA but "baked into the baseline" from prior continuing resolutions.

Using this yard stick, policymakers have enacted roughly $2.7 trillion of deficit reduction, including over $800 billion from the ATRA and roughly $1.84 trillion from the Budget Control Act and prior discretionary savings. Importantly, these savings are from 2014 to 2023.

Fig. 1: Deficit Reduction Enacted So Far

	2014-2023
American Taxpayer Relief Act	**$850 billion**
Revenue from higher earners	*$680 billion*
Reduction in discretionary caps	*$10 billion*
Roth 401k conversion provision	*$15 billion*
Reductions in health spending	*$30 billion*
Unemployment benefit extension	*-$10 billion*
Tax extenders	*-$5 billion*
Interest savings	*$130 billion*
Budget Control Act	**$1,075 billion**
Discretionary savings	*$910 billion*
Interest savings	*$170 billion*
Continuing Resolutions in FY2011	**$760 billion**
Discretionary savings	*$635 billion*
Interest savings	*$130 billion*
Total Enacted Savings	**$2.7 trillion**
Memorandum:	
Total Discretionary Savings	*$1,550 billion*
Total Mandatory Savings	*$20 billion*
Total Revenue	*$690 billion*
Total Interest Savings	*$430 billion*

Source: CRFB calculations based on CBO and JCT data.
Note: Numbers may not add due to rounding, and have been updated since original posting to reflect model corrections. Calculated in other ways, savings could be as high as $2.75 trillion through 2023.

Although $2.7 trillion is a very reasonable estimate of enacted savings, it is by no means the only way to measure past savings. It is worth noting that the discretionary savings in this number are in fact calculated from the high point of discretionary spending. Measuring either from a year later *or* from a year earlier would result in a smaller savings number because base discretionary spending (excluding the effects of the stimulus) actually increased between 2009 and 2010 due to larger-than-projected appropriations.

Note also that these savings assume that the sequester will not take effect, since the purpose of the sequester is to force Congress and the President to enact *specific* deficit reduction measures, and lawmakers have not yet allowed the sequester to take effect. Should lawmakers allow the cuts to go off and express a willingness to leave them in place, we would count these savings.

Where the Budget Stands Now and Why the Debt Needs to Be on a Downward Path

As a result of the $2.7 trillion in enacted deficit reduction, the debt-to-GDP ratio is on a path to reach about 79 percent by 2023 under our current policy projections, rather than 91 percent of GDP absent this deficit reduction. Though this represents a notable improvement, it still leaves debt on an upward path – rising from 73 percent of GDP today to nearly **130 percent by 2040**.

Box 1: There Is No Magic Number

In this analysis we present a "minimum necessary savings" path that brings the debt-to-GDP ratio to below 70 percent by 2023. While we support this target, there is nothing particularly special about the number 70 percent. Rather, we believe 70 percent in 2023 to be a rough proxy of what it would take to ensure the debt is on a *clear downward path* as opposed to a stable or slightly upward path. In theory, it would be possible for a plan to put the debt on a clear downward path with a final debt number somewhat above 70 percent – for example if there were substantial upfront stimulus spending. It would also be possible for a plan to reach 70 percent of GDP in 2023 but be on an upward path – for example if those savings were achieved by doubling the size of "sequestration."

Focusing only on the size of a package, or on the debt level in 2023, would be a mistake. Putting the debt-to-GDP ratio on a downward path will depend not only on the size of a package, but also the composition and trajectory. Policies that help to "bend the cost curve" for health spending or adjust programs for population aging are far more likely to succeed in addressing the debt than those reducing discretionary spending. Importantly, policies that promote economic growth can also be helpful by increasing the denominator of the debt-to-GDP ratio. A deficit reduction package should be judged on these parameters, rather than solely what debt target it achieves.

Some have suggested that this debt path could be corrected with an additional $1.5 trillion in savings – ensuring the debt to GDP ratio remains at 73 percent by 2023. Declaring victory with an additional $1.5 trillion would be dangerous, however, since it would leave *no margin for error*, *would result in slower economic growth, would leave little fiscal flexibility, and would have little chance of stabilizing the debt* beyond the ten-year window. For these reasons, we believe the debt must be not only stable, but on a *clear downward path* by the end of the decade.

No Margin for Error – Settling for a stable debt path this decade would leave no margin for error in the case that economic or technical budget projections are off or policymakers enact future deficit-increasing policies. Were growth to be a quarter point slower than projected, as an example, a plan believed to stabilize the debt at 73 percent of GDP in 2023 would actually put it on an upward path at nearly 77 percent in 2023. Higher than expected interest rates or faster health care cost growth could have similar effects. At the same time, Congress is likely to pass future deficit-financed policies not assumed in our current policy baseline, which could further worsen the deficit.[5] And even if those policies are paid for over ten years, they would still worsen the debt since the costs would appear upfront and the savings would take time to accrue.

No Long-Term Stability – Even if $1.5 trillion does stabilize the debt through 2023, it is unlikely to do so beyond the next ten years. As medium and long-term budget challenges posed by population aging and health care cost growth make controlling the debt even more difficult in future decades, debt must be on a clear downward path this decade to create a "running start" in controlling debt and interest payments later on. In addition, addressing our long-term growth trends will require structural and curve-bending reforms that are politically less likely to be present in a smaller package.

In a prior analysis, CRFB showed that an illustrative package of $1.4 trillion through 2022 that combined reductions in health spending with additional spending cuts and revenue would nonetheless increase the debt to GDP ratio to 94 percent of GDP by 2035 rather than holding it stable at 73 percent.[6] Though it may be possible to design a $1.5 trillion package that would hold the debt stable through 2023, doing so would be quite difficult and highly unlikely.

Slower Economic Growth – When the economy is functioning at full capacity, lower debt levels are better for economic growth. A smaller debt stock implies higher national savings and a higher capital stock, which means more economic investment. A larger debt stock, on the other hand, will result in more "crowding out" of investment and slower economic growth. Based on recent estimates from the Congressional Budget Office, in fact, a generic $2.4 trillion deficit is likely to increase GNP in 2023 almost 0.4 points more than a generic $1.5 trillion package.[7]

No Fiscal Flexibility – Even if a $1.5 trillion package were designed to stabilize the debt over the long-term and economic crowding out could be avoided, having debt remain at an elevated level could leave the country economically and budgetarily vulnerable. Although debt at 73 percent may not be a disaster, it would still amount to nearly twice our historical average and well above the international standard of 60 percent. More worryingly, it would leave the country with far less budget flexibility down the road to be able to respond to crises, such as natural disasters, economic downturns, or national security threats.

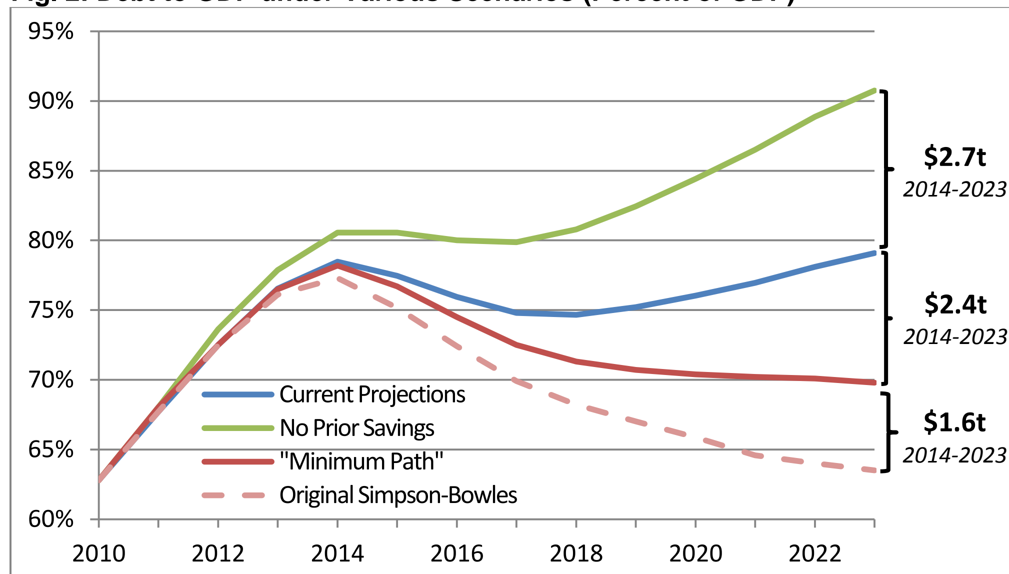
To be sure, it is possible that economic growth could be faster than CBO projects and not affected much by crowd-out, health care costs could grow slower than currently projected, policymakers could act more fiscally responsible than they have historically, and there could be no major wars or disasters in the coming decades. However, responsible budgeting requires being prudent by hedging against downside risk and looking beyond the next decade to the long-term. This is especially true given a political system that tends to phase in changes gradually and which is much better equipped for returning surplus gains through tax cuts and spending increases than doing the reverse. For all of these reasons, and others, it is preferable for debt to be on a clear downward path as a share of the economy.

How Much Additional Deficit Reduction Does the United States Need?

Based on current projections, ensuring debt will be on a clear downward path will likely require reducing the debt-to-GDP ratio to below 70 percent by the end of the ten-year window (see Appendix I) and lower levels thereafter, which implies another $2.4 trillion of debt reduction.

For illustrative purposes, we have contracted a hypothetical "minimum necessary savings" path. That path allows debt to continue to rise to 78 percent of GDP by the end of 2014 but then gradually reduce it to below 70 percent by 2023 and by about 0.5 percentage points annually thereafter. Although there is no magic to the 70 percent number (see Box 1), any higher debt target leaves it ambiguous about whether debt would be stable through the end of the decade or falling (see Appendix I). Beyond 2023, our "minimum necessary savings" path reduces debt to the international standard of 60 percent by about 2040 and the historical average of below 40 percent by the 2080s. Importantly, this would be a far slower pace than what we believe is optimal or warranted.

Fig. 2: Debt to GDP under Various Scenarios (Percent of GDP)

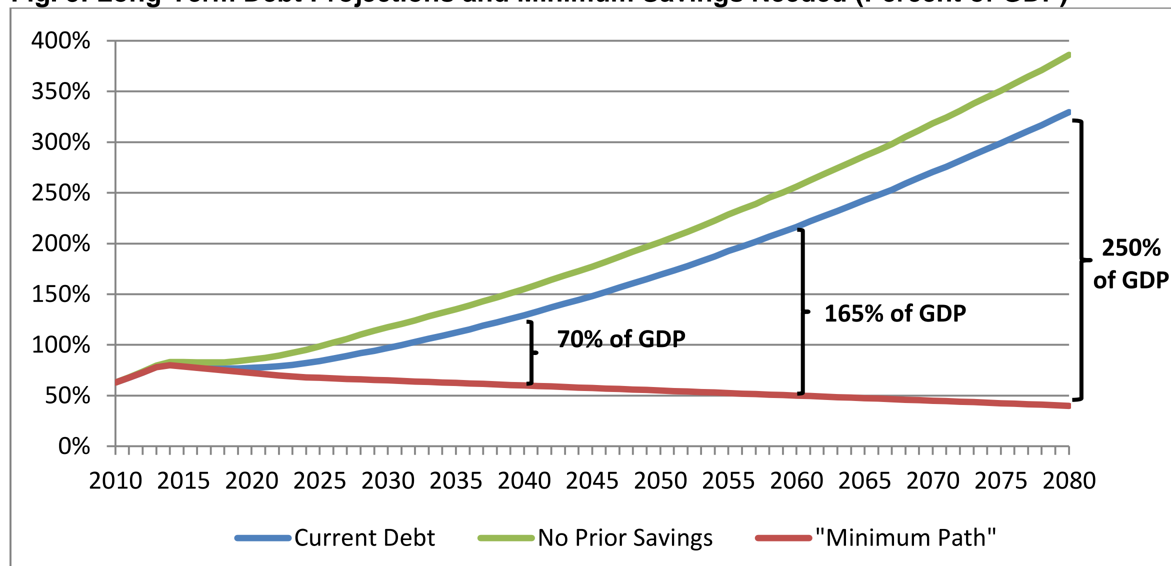


Source: CRFB calculations based on CBO, JCT, and Moment of Truth Project data.
Note: Projections for "No Prior Savings" assume that savings from CRs, BCA, and ATRA are reversed retroactively.

Through 2023, achieving this minimum deficit reduction would require more than **$5 trillion** in total savings. Given that only $2.7 trillion has been enacted to date, lawmakers have enacted only slightly more than **half of what is necessary** this decade**.**

Because the savings achieved so far have come from the discretionary and revenue sources rather than reforms to rapidly-growing entitlements, lawmakers have actually solved a much smaller portion of the long-term problem. Although we have not updated our long-term projections, in our prior projections we estimated that by 2040 we will have only reduced projected debt levels by about **one quarter** of what is necessary, by 2060 we have will have reduced them by only **one fifth**, and by 2080 by only **one sixth**. Note that if the target remained at 60 or 70 percent rate than falling to 40 percent, these numbers would not change substantially.[8] On the other hand, the country is even farther from the finish line if the goal is to achieve the target debt levels set in the Fiscal Commission's recommendations.

Fig. 3: Long-Term Debt Projections and Minimum Savings Needed (Percent of GDP)



If lawmakers allow the sequester to take effect, the minimum savings needed to put the debt on a downward path would be smaller (see Appendix II). In that scenario, lawmakers would have already enacted more than three-quarters of the minimum savings necessary this decade. However, because the sequester does not address the drivers of the growing debt, allowing it to occur would mean we have solved a substantially smaller portion of what is needed by 2040.

Box 2: Why the "Minimum Necessary Savings" Are Not Enough

In this analysis, we put forward an additional $2.4 trillion as the "minimum necessary savings" to put the debt on a downward path. Although an additional $2.4 trillion in savings would represent a major accomplishment in fiscal reform, lawmakers should set out to achieve more savings than the minimum amount needed.

As shown in Figure 4, the minimum savings path would not bring the debt down to historical levels typically seen in the United States for more than 65 years from today. Surely there will be economic events, natural disasters, security needs, and perhaps even viable alternatives to the dollar and U.S. debt before the year 2080, which will require as much budget flexibility as possible.

This is one reason that plans like those advocated by the bipartisan Domenici-Rivlin Task Force or Simpson-Bowles Fiscal Commission produced substantially more than the minimum savings needed. In rough terms, the Simpson-Bowles plan would reduce the debt-to-GDP ratio to 64 percent of GDP by 2023, which would be the equivalent of $5.5 trillion in total savings, and down to 40 percent by 2040. Through a combination of long-term Social Security reform and a cap on health spending, it should further reduce the debt over the long-run. Similarly, the Domenici-Rivlin plan included concrete Medicare and Medicaid reforms to keep the debt at bay.

With a bolder savings target, lawmakers could build in additional wiggle room to respond to new and possibly worse budget and economic outlooks, to enhance future budget flexibility, and to bring the debt down sooner from elevated and potentially more dangerous levels. They could also help to prevent "crowd out," leading to stronger investment and faster growth. As a result, lawmakers should seek to build a budget path as sustainable as possible.

* * * * *

The only way to put debt on a clear downward path over the long-run is to enact substantial deficit reduction with a focus on the drivers of the debt – the growing costs of Social Security, Medicare, and Medicaid – and to combine these reforms with real spending cuts and tax reform in order to offset what growth in entitlement programs does occur. Although we may not be able to solve our fiscal problems all at once, it would be a mistake to shoot low and then declare victory. It would be an even bigger mistake to delay action to fix the national debt. The longer we wait to act, the fewer choices we will have and the tougher those choices will be.

Appendix I:
Deriving the Minimum Debt Target

As stated in Box 1, it would be very difficult to identify a single debt level in 2023 which proved that the budget was on a sustainable path. Determining whether such a path leads to sustainability will require understanding the size, scope, path, and compensation of policy changes.

Achieving sustainability requires putting the debt on a clear downward path relative to the economy. With knowledge only of the **size** of the deficit reduction package, we find that a minimum of $2.4 trillion in deficit reduction – bringing debt-to-GDP below 70 percent by 2023 at the minimum – is necessary to conclude the debt is on a downward path with some confidence.

We reached this conclusion by examining packages of various sizes and testing both how they would affect the debt under our best estimate and how robust they were to deviations from that base case estimate. Specifically, we tested robustness against three models:

- **A fast phase-in model** where the same amount of ten-year savings would be achieved, but after phasing up quickly by 2017 and savings thereafter growing only with inflation.
- **A slower growth model** where the same amount of ten-year savings would be achieved, but economic growth would be 0.1 percentage points slower each year.
- **A Congressional irresponsibility model** which assumes Congress enacted roughly $450 billion of deficit-financed measures over the next decade – the equivalent of continuing the "tax extenders" through 2023 outside of the deficit reduction package.

To see how we determined $2.4 trillion to be the minimum deficit reduction needed, it is worth examining two packages based on these criteria – a $2.4 trillion package which reduces the debt to below 70 percent by 2023 and a $2 trillion package which reduces it to just above 71 percent.

Both packages would put the debt on a downward path under our base case. However, the $2 trillion package would leave debt on an upward path relative to the economy under all three alternative cases. By comparison, $2.4 trillion would be enough to keep debt on a downward path in all four scenarios.

Fig. 4: Debt Projections with $2 Trillion Plan under Several Assumptions (Percent of GDP)

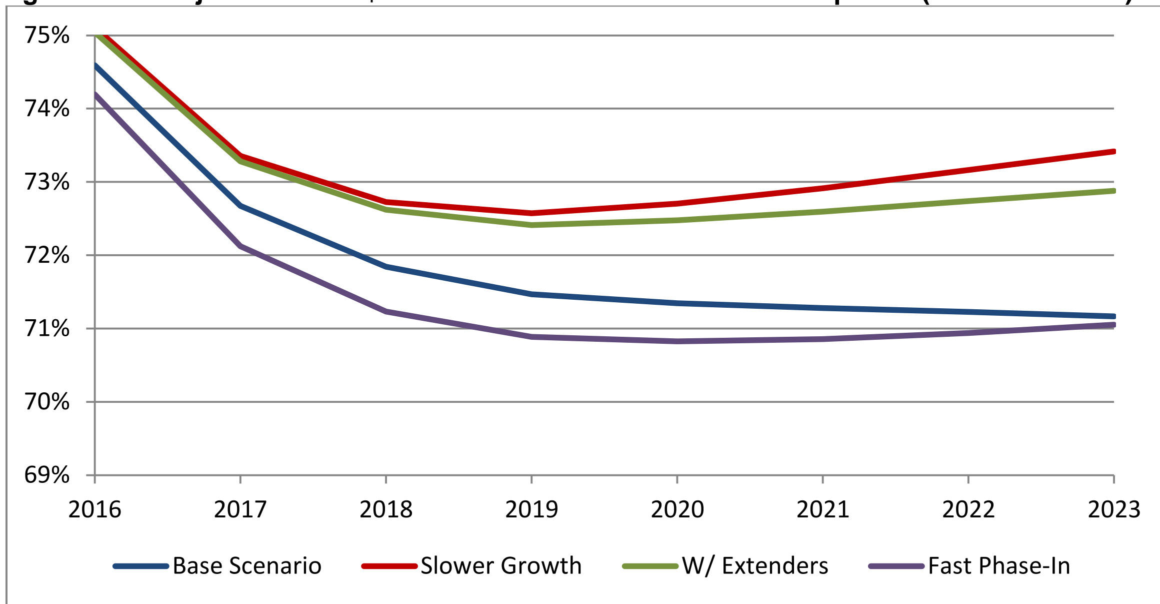
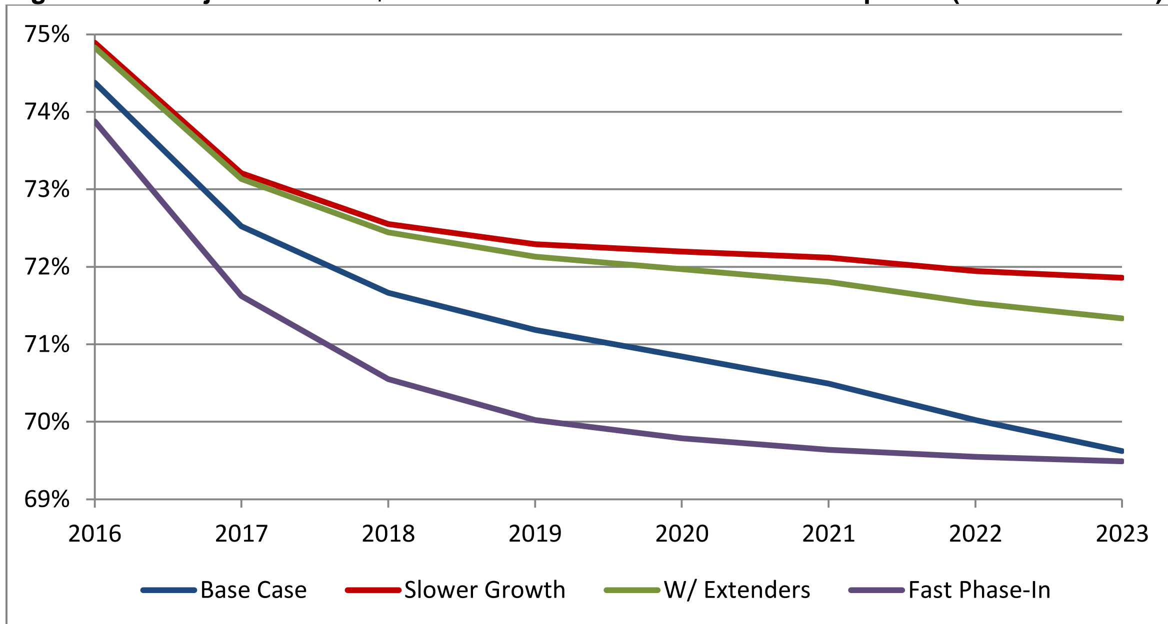


Fig. 5: Debt Projections with $2.4 Trillion Plan under Several Assumptions (Percent of GDP)



Appendix II:
Savings Needed to Stabilize or Reduce the Debt to Specific Levels

Baselines	Debt Level in 2023 (% of GDP)				
	60%	65%	70%	75%	80%
Excluding Past Savings (Billions of Dollars)*					
Current Law					
With war drawdown	$3,650	$2,350	$1,050	n/a	n/a
Without war drawdown	$4,350	$3,050	$1,750	$450	n/a
Current Policy w/ Sequester					
Excluding savings from war drawdown	$3,650	$2,350	$1,050	n/a	n/a
Including savings from war drawdown	$4,300	$3,050	$1,750	$450	n/a
Current Policy					
Excluding savings from war drawdown	$4,900	$3,600	$2,300	$1,000	n/a
Including savings from war drawdown	$5,600	$4,300	$3,000	$1,700	$400
Current Policy w/ Extenders					
Excluding savings from war drawdown	$5,350	$4,050	$2,750	$1,450	$150
Including savings from war drawdown	$6,050	$4,750	$3,450	$2,150	$850
Including Past Savings (Billions of Dollars)*					
Current Law					
With war drawdown	$6,350	$5,050	$3,750	$2,450	$1,150
Without war drawdown	$7,050	$5,750	$4,450	$3,150	$1,850
Current Policy w/ Sequester					
Excluding savings from war drawdown	$6,300	$5,000	$3,750	$2,450	$1,150
Including savings from war drawdown	$7,000	$5,700	$4,400	$3,100	$1,850
Current Policy					
Excluding savings from war drawdown	$7,600	$6,300	$5,000	$3,700	$2,400
Including savings from war drawdown	$8,300	$7,000	$5,700	$4,400	$3,100
Current Policy w/ Extenders					
Excluding savings from war drawdown	$8,050	$6,750	$5,450	$4,150	$2,850
Including savings from war drawdown	$8,700	$7,400	$6,150	$4,850	$3,550

Note: Numbers rounded to nearest $50 billion, and include interest savings that would accrue from reforms. Subtracting a rough rule of thumb of about 15 percent in interest savings from gradual deficit reduction measures, based on CBO's latest interest rate projections, can provide a rough estimate of the non-interest savings needed to achieve various debt levels.

*Past savings incorporates between $2.7 trillion in discretionary, other mandatory, revenue, and interest savings enacted over the past two years over the 2014-2023 period. However, there are several ways to calculate enacted savings, which can produce different estimates.

Baseline Assumptions:
Current Law: All policies expire or activate as scheduled, and no war drawdown.
Current Policy: Sequester repealed, yearly doc fixes, refundable tax credits are continued past 2017, war spending is drawn down, and timing shifts are accounted for.
Current Policy w/Extenders: Sequester repealed, yearly doc fixes, refundable tax credits continued past 2017, other expiring tax provisions (excluding bonus depreciation) are continued, war spending is drawn down, and timing shifts are accounted for.

Endnotes

[1] President Barack Obama, statements made at press conference on January 14, 2013. http://www.washingtonpost.com/politics/president-obamas-news-conference-on-the-debt-ceiling-fiscal-battles-and-gun-control-jan-14-2013-transcript/2013/01/14/9bc1a690-5e65-11e2-90a0-73c8343c6d61_story.html.

[2] CBPP notes that a larger amount of deficit reduction would be preferable if it is well designed, but says that the quality of the policies used to reduce the deficit is important, not just the quantity of deficit reduction achieved. See Richard Kogan, Robert Greenstein, Joel Friedman. "$1.5 Trillion in Deficit Savings Would Stabilize the Debt over the Coming Decade," *Center for Budget and Policy Priorities.* February 11, 2013. http://www.cbpp.org/cms/index.cfm?fa=view&id=3900.

[3] Paul Krugman. "Dwindling Deficits," *New York Times*. January 17, 2013. http://www.nytimes.com/2013/01/18/opinion/krugman-the-dwindling-deficit.html?_r=1&.

[4] Current policy projections assumes the sequester is repealed, annual doc fixes, war spending continues to wind down, expansions in refundable tax credits continue past 2017, and timing shifts are accounted for.

[5] Potential examples abound. Most obviously, policymakers are likely to continue many "tax extenders" on a deficit-financed basis. Some other policies which might be extended and not paid for include bonus depreciation, extensions in expanded unemployment benefits, lower student loan rates, and higher Medicaid payments for providers under PPACA.

[6] Committee for a Responsible Federal Budget. "Putting the Debt on a Downward Path." January 2013. http://crfb.org/blogs/putting-debt-downward-path.

[7] Congressional Budget Office. "macroeconomic Effects of Alternative Budget Paths." February 2013. http://cbo.gov/sites/default/files/cbofiles/attachments/43769_AlternativePaths_2012-2-5.pdf.

[8] Assuming a 70 percent target for both 2040 and 2080, instead of levels shown the minimum savings path, an additional 60 percent of GDP in deficit reduction would be needed by 2040 and an additional 260 percent of GDP by 2080, instead of the 70 percent of GDP and 290 percent shown in Figure 4.