COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Our Long-Term Debt Problems Are Very Far from Solved
November 20, 2013

The national debt remains on an unsustainable long-term path. Recent short-term improvements have temporarily stabilized the debt, but our debt problems remain far from solved.[i] At 73 percent of GDP, the federal debt is about double what it was in 2007 and is the highest since the aftermath of World War II.

Over the next decade, it will take **$2.2 trillion** in savings to replace the sequester and put debt on a clear downward path relative to the economy. If sequestration remains in place, roughly $1.5 trillion in deficit reduction would still be required.

Over the long run, the outlook is even worse. Under CRFB's projections, debt will rise from 69 percent of GDP in 2018 to 73 percent of GDP in 2023, exceed the size of the economy by 2035, and be twice the size of the economy by the 2060s. Under a more pessimistic but still plausible scenario, debt could *triple* the size of the economy in the 2060s and continue to grow thereafter.[ii]

Controlling the country's growing long-term debt levels will require a combination of policies including slowing health care cost growth and addressing the aging of the population. In regards to the long-term outlook, Congressional Budget Office Director Doug Elmendorf recently made clear that "the fundamental federal budgetary challenge has hardly been addressed."[iii]

In this analysis, we identify five main takeaways for policymakers and the public:

- Despite projections of historically low discretionary spending levels and historically high revenue levels, the federal debt is growing unsustainably over the long run due to health care cost growth and population aging.
- Deficit reduction enacted to date has helped reduce current and future *levels* of debt (though levels are still at historical highs), but done little to change the long-term *trajectory* of debt.
- While we need $2.2 trillion in savings over the next decade to get control of the debt, those policies will need to yield closer to **$13 trillion** of deficit reduction over the next two decades to put the debt on a clear downward path relative to the economy.
- No plausible rate of economic growth can reverse growing debt levels.
- Acting now can allow policymakers to make smaller and more gradual changes spread over more generations.

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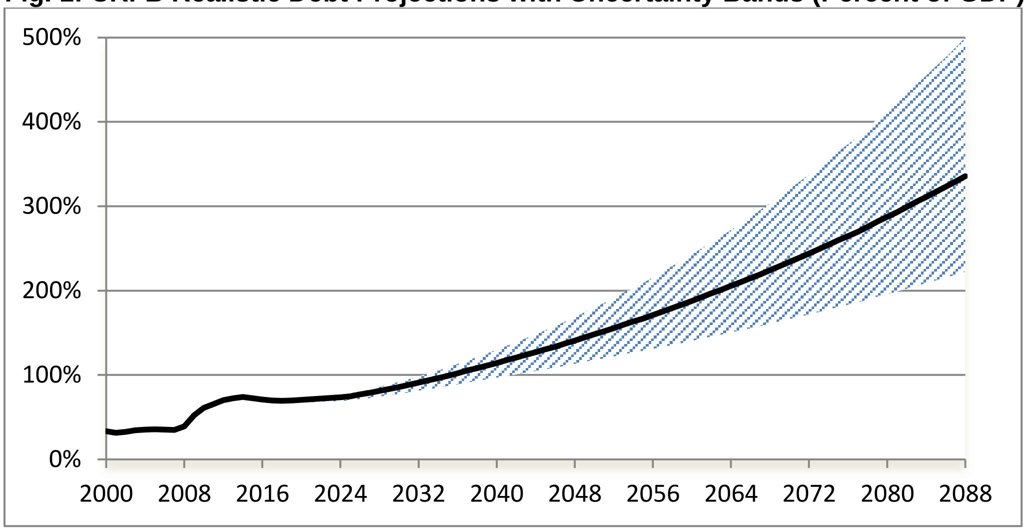
Growing Long-Term Debt Levels

Many have tried to make the argument that with the recent fiscal improvements (deficits dropped from 6.8 percent of GDP in 2012 to 3.9 percent in 2013) our debt problems are under control. While our projections show debt declining as a share of GDP over the next few years, debt will begin to rise again after 2018 for as far as the eye can see. Under our base projections, debt will rise from 69 percent of GDP in 2018 to 73 percent by 2023, about 100 percent of GDP by 2035, roughly 150 percent by 2050 and continue on a rapid ascent indefinitely. Under a more pessimistic but still plausible scenario, debt could reach 100 percent of GDP as soon as 2033 and 180 percent by 2050. (See Appendix I for more details on the CRFB Realistic Baseline).

Fig. 1: CRFB Realistic Debt Projections with Uncertainty Bands (Percent of GDP)



The long-term debt problem is the result of a structural deficit that will begin to grow rapidly after the economy recovers. As a result of an aging population, growing health care costs, and rising interest costs, spending will increase from 22.9 percent of GDP in 2023 to 26.3 percent by 2035 and nearly 30.5 percent by 2050 (compared to historical average of 20.4 percent of GDP), despite historically low spending on discretionary programs. Revenues will also rise from 18.5 percent of GDP in 2023 to 19.5 percent by 2035 and 20.8 percent by 2050 (compared to a historical average of 17.4 percent of GDP), but not quickly enough to keep up with spending.

As a result, deficits will balloon, reaching 3.5 percent of GDP by 2023, 6.9 percent by 2035 and 9.8 percent by 2050. Avoiding these very high deficits will require closing the gap between revenue and spending by raising taxes, reducing outlays, or more likely some combination of the two.

Fig. 2: Spending and Revenues as a Share of GDP in the CRFB Realistic Baseline

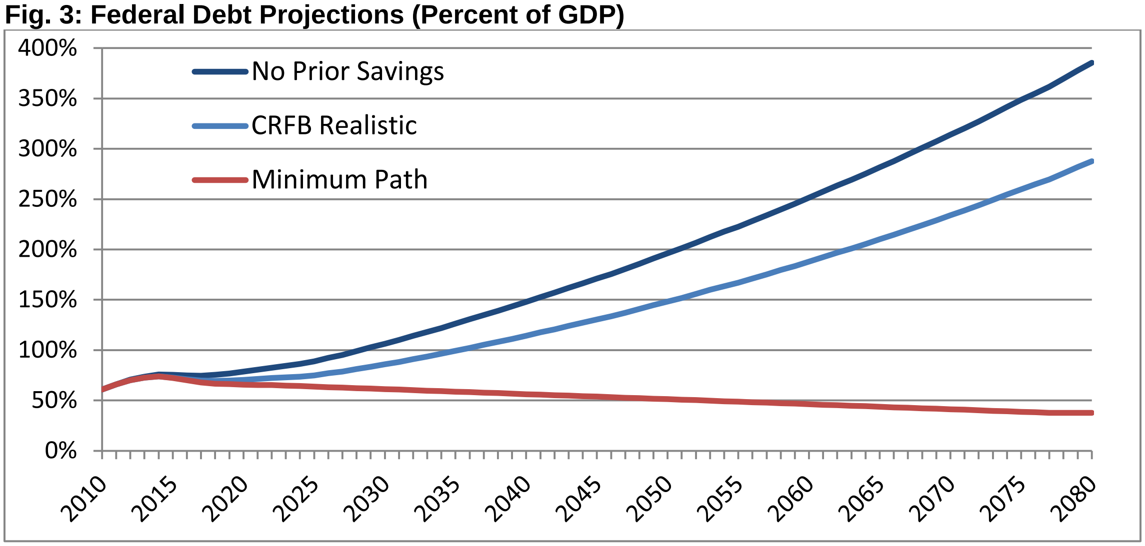
	2000	2013	2023	2035	2050	2085	1973-2012 Average
Spending	17.6%	20.8%	22.0%	26.3%	30.5%	41.6%	20.4%
Revenue	19.9%	17.0%	18.5%	19.5%	20.8%	23.7%	17.4%
Deficits	-2.3%	3.9%	3.5%	6.9%	9.8%	17.9%	3.0%

Note: Negative values for deficits indicate budget surpluses.

More Long-Term Deficit Reduction Is Needed

Importantly, progress has been made in slowing the growth of debt over the short and medium term. In concert with a recovering economy, discretionary spending caps and tax increases on wealthier earners over the past few years have reduced deficits by more than $2.7 trillion through 2023 - $3.9 trillion including the impact of sequestration in future years. As a result, we have accomplished **over half** of what we estimate would be needed to put the debt on a clear downward path over the next decade (excluding the impact of the sequester).[iv] Yet, because these policies are largely short-term in nature, they accomplished only **one-third** of what is necessary through 2050 and only **one-quarter** of what is necessary through 2080.

Fig. 3: Federal Debt Projections (Percent of GDP)



The deficit reduction enacted to date will significantly reduce projected debt ***levels*** in the coming years, but do little to change the overall ***trajectory*** of our national debt. Most of the $2.7 trillion in enacted savings comes from the defense and non-defense discretionary budget, which already represent a shrinking share of the budget, and from tax increases that cannot grow nearly as fast as our health and retirement programs. An additional $1.2 trillion in savings comes from an across-the-board sequestration, which does not grow over time and ends in 2021.

As a result, debt levels are on a better path this decade but are still projected to explode over the long run. By our calculations, an additional **$2.2 trillion** of deficit reduction this decade would be sufficient to replace the sequester and put the debt on a clear and robust downward path relative to the economy. Continuing that path for another ten years would require more than **$11 trillion** in savings the next decade and more than **$29 trillion** in the third decade. As a share of GDP, deficits (including interest) must be reduced by roughly **1 percent of GDP** this decade, **3.5 percent** next decade, **6 percent** in the third decade, and **13 percent** over 75 years.

On a ***present value basis*** – also known as the "fiscal gap" – we estimate annual primary (non-interest) deficits would have to be reduced *immediately* and continuously by ***3 percent of GDP*** in order to bring the debt to historical levels over the next 75 years.

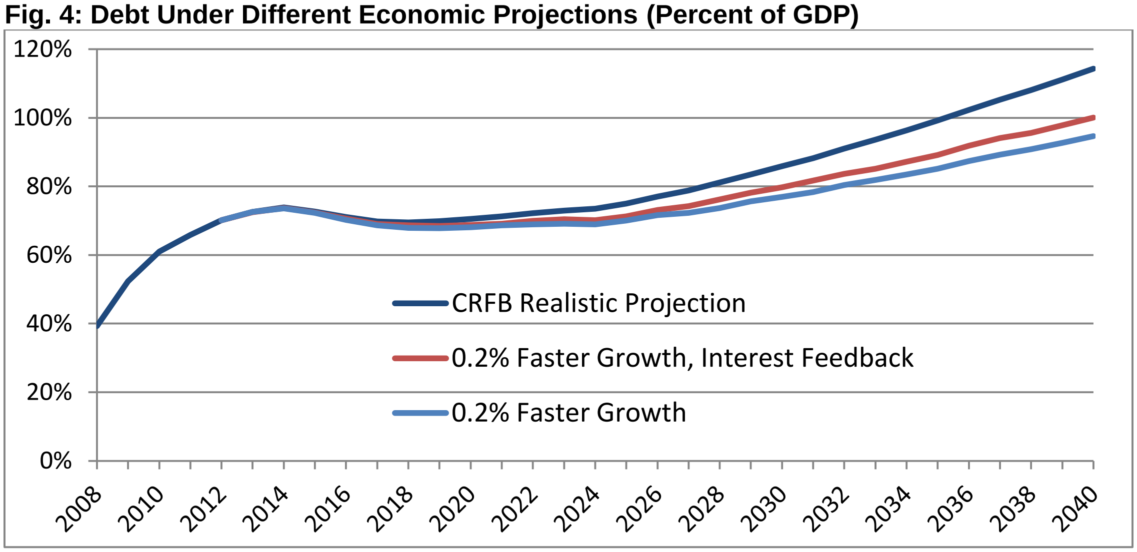
Economic Growth Cannot Solve Our Long-Term Debt Problems

Given the difficult choices necessary to reduce the 75-year fiscal gap by 3 percent of GDP, some have suggested that increasing economic growth as an alternative to deficit reduction policies. Policymakers *should* be pursuing growth strategies, as they would not only improve our fiscal picture but also would increase employment and incomes if successful. However, faster economic growth alone will not solve the problem. This is true for at least four reasons:

1. Many "growth strategies" are focused on accelerating the short-term recovery rather than permanently increasing economic growth
2. Even ambitious policy changes are likely to have only modest (though still important) effects on long-term economic growth
3. Because many spending programs grow more quickly as the economy does, faster growth will have a limited effect on long-term deficits
4. Allowing debt to accumulate will hurt the economy, working against the goal of other growth strategies

As an example, assume we were able to increase annual productivity growth by 15 percent, from 1.3 percent annually to 1.5 percent. In this scenario, debt would grow more slowly, but would remain on an upward path. Instead of reaching 114 percent of GDP in 2040, it would reach between 95 and 100 percent, depending whether or not interest rates rose as a result.

Fig. 4: Debt Under Different Economic Projections (Percent of GDP)



Source: CRFB calculations based on CBO data.

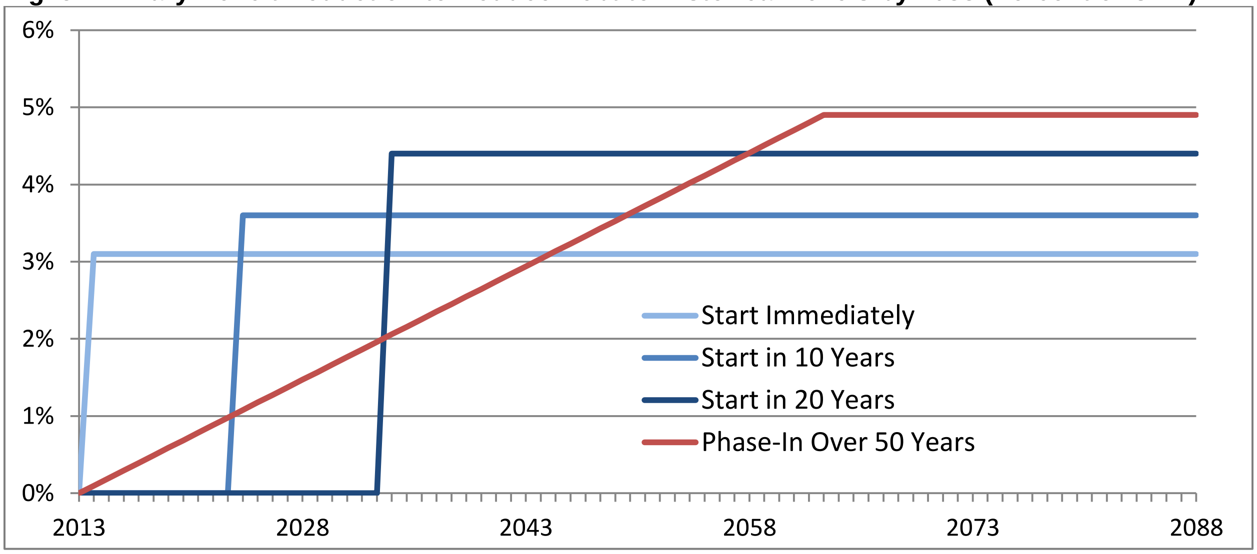
Importantly, these estimates are based on economic assumptions that implicitly assume we find a solution to our growing debt woes. CBO estimates that if debt accumulates as under current law, rather than stabilizing, GNP would be more than 4 percent smaller in 2038 due to the crowding out of private investment. Conversely, a comprehensive deficit reduction plan that reduced the debt relative to the economy, replaced the sequester with more targeted cuts, reformed the tax to reduce distortions, and reformed entitlements to encourage work and savings could significantly boost economic growth.[v]

The Problem Is Long-Term, But Solutions Must Start Today

With debt projected to decline as a share of the economy between 2014 and 2018, some have argued we should take a "wait and see" approach to addressing the debt over the long term. Unfortunately, the cost of waiting to make long-term reforms would be substantial for a number of reasons.

First, the cost of closing the long-term fiscal gap rises over time as lawmakers lose the ability to take advantage of compound interest. For example, immediate and permanent spending cuts, tax increases, or some combination of both (excluding interest) of 3.1 percent of GDP would be sufficient to bring the debt to historical levels by 2088. Waiting ten years, however, would require adjustments of 3.6 percent of GDP and waiting twenty years would require 4.4 percent. If policymakers were to phase in savings over 50 years starting today – a much more likely scenario – an adjustment of nearly 5 percent of GDP would be necessary. That adjustment would rise to almost 5.5 percent of GDP if delayed by a decade.

Fig. 5: Primary Deficit Reduction to Reduce Debt to Historical Levels by 2088 (Percent of GDP)



Source: CRFB calculations based on CRFB's Long-Term Realistic Baseline.

Waiting to enact long-term reforms will not only increase the amount of deficit reduction necessary, but will make it more difficult to achieve. For our entitlement programs for retirees, waiting longer means all of the benefit adjustments or revenue changes must fall on future generations. With fewer people to share the same burden, the result is either fewer savings or larger cuts per person.

Generally, most deficit reduction measures with broad political support generate savings by slowing or freezing growth in various programs or provisions, or else by phasing in reductions gradually. In addition, many measures grandfather current beneficiaries. Enacting policies today would allow policies to be phased in gradually, which would not only be more politically viable but also give the public and the economy time to adjust to any changes.

Conclusion: It's Time to "Go Long"

As policymakers have pursued comprehensive deficit reduction in recent years, we've asked them to "Go Big" in order to achieve the savings necessary to put the debt on a clear downward path relative to the economy this decade and beyond.

Substantial progress has been made in this effort. Since August of 2010, Congress has enacted over *$2.7 trillion* of deficit reduction by our estimates – and close to $3.9 trillion if the sequester is counted. As a result, only $1.5 to $2.2 trillion of further deficit reduction is needed to put the debt on a clear downward path at the end of this decade.

Unfortunately, enacted savings so far were achieved without regards to our other two suggestions – that policymakers "go smart" by pursuing pro-growth reforms and "go long" to address our most fundamental fiscal challenges. Instead, deficit reduction so far has been achieved through tax and spending measures that are unfavorable to economic growth, do little to slow growing debt levels over the long run, and in some cases *end* before our greatest long-term fiscal challenges begin.

Thus policymakers should prioritize long-term reforms now. This not only includes identifying the $2.2 trillion necessary to replace the sequester (though some of these savings could come from keeping the sequester) and reduce the debt this decade, but also working toward finding the **$11 trillion** in deficit reduction needed to keep the debt on a declining path next decade. Policymakers need not enact all this deficit reduction immediately – and even small improvements can help – but they must ultimately achieve this amount of savings.

In a subsequent paper, CRFB will discuss various ways to measure the long-term impact of policy changes and help to identify those changes that can offer the most significant improvement in the long-term outlook.

The pursuit of these policies must start today. While the temptation to wait might be substantial, so too would the cost of delaying action.

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[i] Committee for a Responsible Federal Budget (CRFB). "Our Debt Problems Are Still Far from Solved." May 15, 2013. http://crfb.org/document/report-our-debt-problems-are-still-far-solved.

[ii] CRFB, "Introducing CRFB's Latest Long-Term Realistic Baseline." Blog post, September 26, 2013. http://crfb.org/blogs/introducing-crfbs-latest-long-term-realistic-baseline-0.

[iii] Doug Elmendorf, Testimony Before the Budget Conference Committee, November 13, 2013.

[iv] Committee for a Responsible Federal Budget (CRFB). "Our Debt Problems Are Still Far from Solved." May 15, 2013. http://crfb.org/document/report-our-debt-problems-are-still-far-solved.

[v] CRFB, "New Simpson-Bowles Plan Would Boost Economic Growth, Not Slow It." Blog post, April 24, 2013. http://crfb.org/blogs/new-simpson-bowles-plan-would-boost-economic-growth-not-slow-it.

Appendix: The Long-Term CRFB Realistic Baseline

The long-term projections in this paper are based on the "CRFB Realistic Baseline," which makes assumptions that differ from current law. This baseline assumes cuts from sequestration and the Sustainable Growth Rate will be waived, spending on the wars and Hurricane Sandy relief will decline, and the refundable tax credit expansions scheduled to expire in 2017 will continue. Over the long run, this baseline assumes the Affordable Care Act (ACA) is partially successful in controlling health care growth, Social Security spending tracks scheduled benefits, and other spending grows with GDP.

Fig. 6: Policy Assumptions in the CRFB Realistic Baseline

	CBO Extended Baseline	CRFB Realistic
Sequestration	Retained	Repealed
Sustainable Growth Rate	24% Physician Pay Cut in 2014	Permanent "Doc Fix" at Freeze
War Spending	Grows with Inflation	Gradually Drawn Down
Hurricane Sandy Spending	Grows with Inflation	No Further Spending on Sandy
Expiring Refundable Tax Credits	Allowed to Expire in 2017	Continued Permanently
Long-Term Disc. Spending	Grows with GDP	Grows with GDP
Long-Term Health Spending	ACA cost controls fully successful through 2029	ACA cost controls partially successful through 2029
Long-Term Other Mand. Spending	Gradually Declines as Share of GDP	Grows with GDP
Long-Term Revenue Growth	Grows Assuming Current Tax Code	Grows Assuming Current Tax Code
Memo: Low-Debt Assumptions	**Sequester retained, mandatory grows as in Extended Baseline**	
Memo: High-Debt Assumptions	**Tax extenders continued, revenue slowed, and health care growth raised**	

Given the amount of uncertainty surrounding these assumptions, we've also created high- and low-debt "bands" that differ from our base projections. The high-debt band assumes the normal "tax extenders" are continued, revenue is frozen as a share of GDP over the long run, and health spending follows CBO's Alternative Fiscal Scenario. The low-debt band assumes the sequestration is continued, and mandatory spending follows current law assumptions.

Fiscal metrics for the CRFB realistic projections and bands are shown in the table below:

Fig. 7: CRFB Realistic as a Percent of GDP with Ranges

	2013	2023	2035	2050	2065	2080
CRFB Realistic Baseline						
Outlays	20.8%	22.0%	26.3%	30.5%	35.7%	41.6%
Revenue	17.0%	18.5%	19.5%	20.8%	22.3%	23.7%
Deficit	-3.9%	-3.5%	-6.9%	-9.8%	-13.4%	-17.9%
Debt	73%	73%	99%	148%	210%	288%
Low and High Ranges of CRFB Realistic						
Outlays	21%	21% to 22%	25% to 27%	28% to 32%	31% to 39%	35% to 48%
Revenue	17%	18% to 19%	19% to 20%	19% to 21%	20% to 22%	20% to 24%
Deficit	-4%	-3 to -4%	-5% to -8%	-7% to -13%	-9% to -19%	-11% to -27%
Debt	73%	69% to 75%	87% to 109%	118% to 180%	153% to 279%	196% to 413%