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FEDERAL DEBT ON UNSUSTAINABLE PATH UNDER CURRENT POLICIES

Policymakers Could Stabilize Debt Over Coming Decade By Letting Bush Tax Cuts Expire

By James R. Horney and Kathy A. Ruffing

The latest projections from the Congressional Budget Office (CBO) confirm what we already knew: the federal budget is on an unsustainable path.[1] If we continue current policies — including a further extension of the Bush tax cuts, which policymakers recently extended through 2012 — deficits will remain high throughout the decade and the debt will rise to 95 percent of Gross Domestic Product (GDP) by 2021. If instead policymakers let the Bush tax cuts lapse after 2012, as economists such as Martin Feldstein and Peter Orszag have suggested — or pay for any elements of those tax cuts they want to continue — the debt would barely grow as a share of GDP over the rest of the decade. (Substantial additional steps would be needed to keep the budget from returning to an unsustainable path in the decades after that.) The choice belongs to Congress.

Huge Deficits and Buildup of Debt Will Continue Under Current Policies

If policymakers continue current policies, deficits will total nearly $13 trillion in the decade between 2012 and 2021. That figure is larger than the "headline" number in CBO's report (which shows deficits of $8.5 trillion over that period) because of the rules CBO uses in constructing its baseline.

Those rules, which the George H.W. Bush Administration and Congress agreed upon in 1990, state that the CBO baseline generally should reflect: (1) a continuation of current laws that govern taxes and mandatory (entitlement) spending, and (2) a continuation of funding for discretionary (appropriated) programs at the current year's level, adjusted for inflation.

Sometimes, however, current *laws* fail to reflect current *policies*. That has been especially true in recent years because of Congress's growing tendency to enact legislation on a temporary basis. In those cases, CBO generally must assume in its baseline that such temporary provisions will expire as scheduled by law, *even if Congress's regular policy has been to extend them.*

[1] Congressional Budget Office, *The Economic and Budget Outlook*, January 2011 (online at www.cbo.gov).

As a result, CBO's new baseline assumes the following:

- That Congress will allow all of the 2001 and 2003 tax cuts and other temporary tax provisions to expire. The Bush tax cuts, originally slated to expire after 2010, were recently extended for two years.

- That the alternative minimum tax (AMT) — which will affect about 4 million tax returns in 2011 — will snare about 33 million tax filers in 2012 and even more thereafter. Congress has repeatedly prevented an explosion in the AMT by enacting a series of temporary "patches."

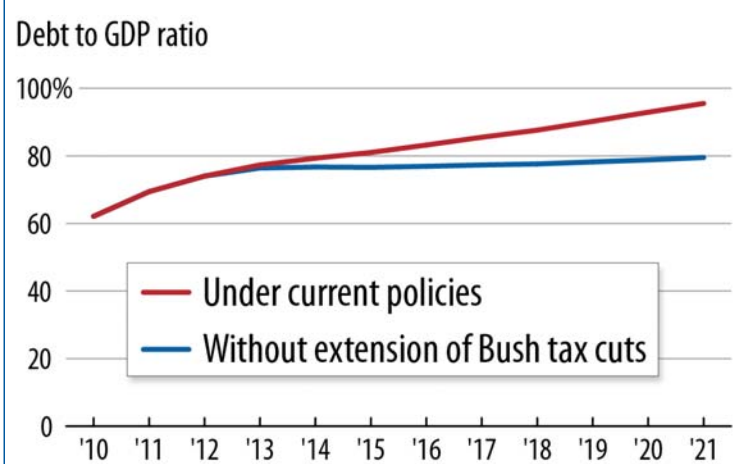
- That the reductions in physician fees called for under Medicare's "sustainable growth rate" (SGR) formula — including a 28 percent cut scheduled for 2012— will take effect. Congress has repeatedly stepped in to prevent or overturn such reductions since 2003.

- That defense appropriations enacted for 2011, which include large amounts for operations in Iraq and Afghanistan, will remain at current levels, adjusted for inflation, throughout the coming decade. This does not reflect the planned drawdown in troops, now underway in Iraq.

Adjusting the baseline to paint a clearer picture of what will happen if current policies are continued — using CBO's own estimates for the cost of such policies (including CBO's scenario for war funding under the planned drawdown of troops) — shows that we are on track to run deficits of nearly $13 trillion over the 2012-2021 decade. Deficits would run around 5.5 to 6 percent of GDP even after the economy recovers, and debt would climb to 95 percent of GDP. (See Figure 1.)

Figure 1

Rise in Debt Could Be Halted Over Next Decade By Letting Bush Tax Cuts Expire



Source: Center on Budget and Policy Priorities based on data from the Congressional Budget Office.

There's nothing novel about adjusting the CBO baseline in this fashion. Although they differ in details, many other independent budget analysts and institutions — including the Brookings Institution, the Concord Coalition, the Committee for a Responsible Federal Budget, and a recent National Academy of Sciences panel — adopt very similar assumptions in order to depict the budget outlook under current policies.

Letting the Bush Tax Cuts Expire Would Stabilize Debt Over Coming Decade

The 2001 and 2003 tax cuts, enacted in President George W. Bush's first term, were slated to expire after 2010. Faced with high unemployment and a fragile economic recovery, policymakers in

December extended them for two years, through 2012. (The legislation also included a two-year extension of some tax cuts included in the 2009 recovery legislation, a one-year reduction in the Social Security payroll tax for employees, a one-year extension of emergency unemployment insurance benefits, and a temporary change in depreciation rules for business investment.)

When these tax breaks expire again, Congress should do the right thing and either let them lapse — for *everybody*, not just upper-income people (those with incomes over $200,000 for an individual or $250,000 for a couple) — or pay for those tax-cut measures it wishes to extend. (It would, in fact, be desirable to continue some elements of the tax cut, while offsetting their cost.) By late 2012, the economy should have recovered sufficiently to absorb that reduction in purchasing power. And by that one simple step, Congress would put deficits and debt close to a sustainable path for the next decade.

By itself, of course, that action wouldn't solve our fiscal challenges. Congress ought to tackle fundamental tax reform in order to make the tax code simpler and fairer while also ensuring that it raises more revenue than the federal government would collect under permanent law (that is, without the Bush tax cuts). In addition, Congress will need to use findings from demonstrations, pilots, and research on cost containment conducted under the health reform law to take strong steps to slow the growth of health-care costs throughout the U.S. health care system, in public-sector and private-sector health care alike; these rising costs are the greatest threat to the nation's fiscal future. And Congress needs to address the long-term imbalance in Social Security, which poses a smaller but still significant challenge.

Any changes in eligibility or benefits in Medicare and Social Security will need to be designed very carefully and phased in gradually, with ample notice to workers and recipients. Letting the Bush tax cuts lapse would stabilize the debt quickly and give policymakers time to get the rest of the job done right.

APPENDIX TABLE

Budget Outlook Under Current Policies (By fiscal year, in billions of dollars)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total, 2012-21
CBO baseline deficit	1,480	1,100	704	533	551	659	617	610	696	739	763	8,451
Adjustments:												
Phasedown in Iraq and Afghanistan[a]	0	-21	-54	-87	-113	-129	-137	-142	-147	-150	-153	-1,134
Maintain Medicare physician fees at 2011 levels	0	12	19	19	21	24	25	28	31	34	36	249
Extend expiring income-, estate-, and gift-tax provisions[b]	0	2	118	245	276	287	297	306	314	323	333	2,502
Index AMT to inflation	0	9	94	46	51	56	63	70	80	90	102	661
Interaction[c]	0	0	11	53	59	67	75	84	93	102	111	657
Extend other expiring tax provisions	0	12	77	113	100	87	80	75	72	71	73	759
Additional debt service	0	0	5	17	36	57	81	107	135	165	198	803
Total adjustments	0	15	270	407	430	449	484	527	578	636	701	4,497
Deficit under current policies	1,480	1,114	974	941	981	1,108	1,101	1,138	1,274	1,374	1,464	12,948
Debt held by public, CBO baseline	10,430	11,598	12,386	12,996	13,625	14,358	15,064	15,767	16,557	17,392	18,253	
Debt held by public under current policies	10,430	11,612	12,670	13,687	14,747	15,929	17,119	18,350	19,717	21,188	22,751	

Source: Center on Budget and Policy Priorities, based on Congressional Budget Office, *The Economic and Budget Outlook* (January 2011), Tables S-1 and 1-7.

a. Assumes phasedown to 45,000 troops by 2015.

b. Assumes extension of income-tax provisions in Title I and estate- and gift-tax provisions in Title III of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Public Law 111-312), which are scheduled to expire after 2012. Does not assume extension of temporary payroll-tax relief in Title VII.

c. Because of interactions, the cost of extending the 2001 and 2003 tax cuts *and* providing AMT relief is greater than the sum of enacting those provisions separately.

Note: CBO=Congressional Budget Office, AMT=Alternative Minimum Tax.