What You Should Know About the Budget Outlook
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The Congressional Budget Office released its latest Budget and Economic Outlook earlier this week. As always, the Outlook provides insight into the fiscal status of the federal government. My three overarching reactions are:

First, because ATRA instituted tax changes that had been widely expected, the official ("current law") baseline is now much more reflective of plausible outcomes than it has been in the past. Hence, the baseline is now a more reliable guide to the fiscal outlook.

Second, unlike in long-term budget scenarios – where rising health care spending is the single most important factor – there is no "smoking gun" in the 10-year projections. Mainly, there is "just" an overall continuing imbalance between spending and taxes. Revenue is not projected to collapse, as it did in 2009-12, but rather to grow to higher-than-historical-average levels. Spending isn't spiraling out of control—it is at the same share of GDP in 2023 as it was in 2012. Large projected cuts in discretionary spending are offset by net interest rising to historically high levels and increases in mandatory spending.

Third, while we do not face an imminent budget *crisis*, the data in the Outlook imply that we are not out of the woods. The 10-year budget outlook remains tenuous. Even if seemingly everything goes right – in economic terms and in political terms – we are still on the edge of dangerously high debt and deficit levels with little room to spare. For example, under the current law baseline, even if:

- Revenues average almost 19 percent of GDP as projected from 2015 through 2023 (a level higher than revenues in all but 5 years since 1982),

- Revenues from the personal income tax rise steadily to 9.8 percent of GDP in 2023 (a figured exceeded only once in U.S. history),

- Defense spending falls to its lowest share of the economy since before WWII,

- Non-defense discretionary spending falls to its lowest share of the economy since before separate records were kept starting in 1962,

- Significant reductions in projected health care cost growth pan out as projected, and

- The economy returns to full employment in 2017 as scheduled and remains there without recession through 2023,

the implications are, nevertheless, that:

- Net interest payments will rise from 1.4 percent of GDP in 2012 to 3.3 percent in 2023 (tied for the highest level in history and a sign of approaching fiscal unsustainability),

- The full-employment deficit would reach 3.8 percent of GDP in 2022 and 2023 (other than in the 2009-12 period, these would be the highest levels except for four of the past 50 years).

- The debt/GDP ratio would be 77 percent by 2023. The ratio would be more than 20 percentage points higher in every year during the next decade than it was for any year between 1957 and 2007, and it would be more than double the 37 percent level it averaged during the 1957-2007 period.

- It would take $1.2 trillion in additional budget savings (beyond the sequester) to get the debt/GDP ratio in 2023 down to its 2012 level of 72.5 percent, and it would take a total of $4.4 trillion in adjustments to reduce the debt/GDP ratio in 2023 to 60 percent.

- Although not shown in the Outlook, which focuses on the 10-year horizon, debt/GDP would be projected to continue to rise sharply and indefinitely beyond 2023.

Under CBO's alternative fiscal policy baseline or my own measure of a current policy baseline (both described below), all of the budget projections are worse.

Here are eleven specific observations on the latest Outlook. (Some basic data and figures are attached to this document.)

(1) The current-law baseline and current-policy baselines are much closer together than before.

--With the passage of the American Taxpayer Relief Act of 2012, much of the difference between the current-law baseline and various current policy scenarios has disappeared. Whereas the January 2012 Outlook showed a $7.9 trillion difference in the 10-year budget totals between current law and what CBO calls their alternative fiscal scenario, the February 2013 Outlook shows only a $2.5 trillion difference. Nearly all of this new certainty comes from the now permanence of several long-standing but temporary tax policies.

--The CBO "alternative fiscal scenario" adjusts the baseline (a) to cancel the sequester, (b) to cancel Medicare cuts related to the sustained growth rate (the "doc fix"), and (c) to extend all expiring tax provisions. My own current policy baseline further adjusts the alternative fiscal scenario (d) to include the effects of a drawdown of military spending and (e) to reduce disaster relief spending from its baseline levels. (That is, CBO's scenario essentially assumes that military overseas levels are maintained and that there is a hurricane Sandy every year for the next 10 years). Taking out these two items reduces the gap between current law and what I am calling "current policy" to just $1.5 trillion over the next 10 years.

(2) Debt/GDP is projected to be high over the next decade.

--Debt as a share of the economy will rise from 73 percent in 2012 to 77 percent in 2023 under current law. (Debt rises to 87 percent of GDP under CBO's alternative fiscal scenario and 83 percent under current policy).

--These levels are high compared to past experience: from 1957 to 2007, the ratio did not exceed 50 percent and averaged just 37 percent of GDP.

--Relative to the magnitude of historical shifts in the ratio and the doubling of the ratio since 2012, the debt/GDP ratio is essentially projected to stabilize at a new, higher level over the next 10 years under the current-law baseline.

--However, although not shown in the Outlook, which focuses on the next 10 years, the debt/GDP level is projected to rise beyond the 10-year window under any plausible scenario.

(3) Total spending is projected to be about the same share of the economy in 2023 as it is in 2012.

--Total spending was 22.8 percent of GDP in 2012, and is projected to fall to 22.2 percent in 2013 and to 21.5 percent in 2017, before rising to 22.9 percent by 2023 under current law.

--Under current policy, total spending will rise slightly over the decade, to 23.1 percent of GDP.

(4) Net interest payments are projected to rise to unprecedented levels.

--Net interest payments rise from 1.4 percent of GDP in 2012 to 3.3 percent in 2023 under current law. The projected rise is due to the increase in the debt/GDP levels in recent years, coupled with an expected rise in interest rates as the economy returns to full employment.

--The projected rise in interest rates is particularly notable given both the low levels of current interest rates and the magnitude of the projected changes. The three-month Treasury bill rate rises to 4.0 percent in 2023 compared to 0.1 percent in 2012. The 10-year Treasury note rate rises to 5.2 percent in 2023 compared to 1.8 percent in 2012. Various measures of the inflation rate are expected to rise by 0.5 percentage points over the same period, so almost all of the projected increases represent higher real rates.

--Net interest payments would rise to 3.5 percent of GDP under the current policy baseline and 3.7 percent of GDP under CBO's alternative fiscal scenario.

--These are *extremely* high levels relative to the past. Net interest payments previously peaked at 3.3 percent of GDP in 1991.

(5) Non-interest spending is projected to fall significantly.

--In 2012, non-interest spending was 21.4 percent of GDP. Under current law, this figure is projected to fall to 19.2 percent by 2018. By 2023 it rises slightly to 19.6 percent, but still remains 1.8 percentage points of GDP lower than the 2012 level.

--Under current policy, non-interest spending is also at 19.6 percent of GDP in 2023.

--This is a higher spending level than the historical average. From 1957 to 2008, non-interest spending averaged about 18.1 percent of GDP.

(6) The decline in non-interest spending is due to dramatic declines in discretionary spending, including both the defense and non-defense portions.

--The projected decrease in discretionary spending is due to the Budget Control Act of 2011. The legislation instituted caps on discretionary spending that would, by itself, reduce discretionary spending to its lowest share of the economy since records separate records were kept in 1962 (see Alternative Fiscal Scenario data). The legislation also instituted, in the absence of further deficit reduction, a broad-based sequester of federal spending – mainly discretionary – that would drive down discretionary spending even further.

--Under current law, discretionary spending will decrease from 8.3 percent of GDP in 2012 to 5.5 percent in 2023. Defense spending is projected to fall from 4.3 percent of GDP to 2.8 percent in 2023. Non-defense discretionary spending is projected to fall from 4.0 percent of GDP in 2012 to 2.7 percent of GDP in 2023.

--Under the current policy baseline, total discretionary spending decreases to 5.3 percent of GDP by 2023.

--All of these figures are remarkably low relative to historical figures. Between 1962 and 2012, the lowest discretionary spending level occurred in 1999 at 6.2 percent of GDP.

(7) Mandatory spending rises, but slower cost growth is projected for Medicare and Medicaid.

--Mandatory spending is projected to rise from 13.1 percent of GDP in 2012 to 14.1 percent in 2022 and 2023. This is a slightly lower than CBO's projection last year for 2022, which was 14.3 percent.

-- The lower mandatory spending is due to slower projected cost growth in Medicare and Medicaid. Last year, CBO expected Medicare and Medicaid to account for about 6.7 percent of GDP in 2022; this year it projects these programs to be 6.3 percent of GDP in 2022. CBO's projections for income security outlays and other mandatory outlays increased by 0.2 percentage points of GDP to partially offset the decrease in Medicare and Medicaid.

(8) Revenues are not only projected to recover from extremely low levels in recent years, but to rise significantly to above average historical levels.

--Due to the recession and slow recovery, federal revenues have been at historic lows, less than 16 percent of GDP, since 2009, representing the lowest share of GDP in more than 60 years. As the economy recovers, and ATRA and health care reform surtaxes kick in, CBO projects revenue will rise to 19.1 percent of GDP by 2015 and expects revenues to remain close to that level for the rest of the decade.

--Receipts averaged 18.0 percent of GDP from 1957 to 2007, and have only exceeded 19 percent of GDP eight times since 1957. Five of these years were during the 1990s at the end of the Clinton administration when real economic growth was particularly strong.

--The assumed extension of temporary tax policies in CBO's alternative fiscal scenario and in the current policy baseline reduce revenue levels to about 18.7 percent of GDP in 2023.

(9) Income tax revenues are projected to grow steadily and stay high

--Revenues from the individual income tax are projected to rise steadily through the decade, reaching 9.8 percent of GDP by 2023 under current law.

--The only years the income tax has ever raised at least 9 percent of GDP in revenue were in 1944 (at the height of the war), 1969 (the income tax surtax), 1980-82 (leading to the Reagan tax cuts) and 1997-2001 (leading to the Bush tax cuts in 2001 and 2003). The current law baseline, though, projects income tax revenues will reach 9.1 percent of GDP in 2017 and rise gradually to 9.8 percent by 2023.

--It is not immediately clear how much extension of temporary tax policies would reduce income tax receipts (as opposed to other receipts), but the effect is bounded at no more than 0.4 percent, so that income tax revenues would still be high relative to political levels.

(10) The growth rates of potential output has fallen.

--CBO has lowered its projection of the growth rate for potential output to 2.3 percent, down from 2.5 percent last year. This hurts the long-term budget outlook.

(11) How much would it take?

-- Under current law, it would take $1.2 trillion of additional budget cuts (beyond the sequester) to obtain in 2023 the 2012 debt/GDP ratio of 72.5 percent.

--It would take $4.4 trillion in budget cuts to get the 2023 debt/GDP ratio down to 60 percent. as proposed by various commissions.

--These numbers are significantly larger under the alternative fiscal scenario and current policy baselines:

Debt/GDP in 2023	Current Law Baseline	Alternative Fiscal Scenario	Current Policy
2012 level (72.5 percent)	1.2 Trillion	3.7 Trillion	2.7 Trillion
60 percent of GDP	4.4 Trillion	7.0 Trillion	5.9 Trillion

--For purposes of comparison, it is worth noting that CBO projects that GDP will total $213 trillion over the 2014-2023 period.

Table 1

Federal Budget Deficits and Debt 2014-2023

	Deficit		Debt in 2023
	$ billions	% of GDP	% of GDP
CBO Baseline	**6,958**	**3.3**	**77.0**
Adjustments for tax policy			
Extend expiring tax provisions	954	0.4	
Net interest	188	0.1	
Total adjustments for tax policy	1,143	0.5	
Adjustments for spending policy			
Freeze Medicare physician payment rates	138	0.1	
Assume automatic cuts do not occur	995	0.5	
Net interest	257	0.1	
Total adjustments for spending policy	1,391	0.7	
CBO Alternative Fiscal Scenario	**9,492**	**4.4**	**86.9**
Adjustments for spending policy			
Drawdown in defense spending	-582	-0.3	
Remove extrapolation of continued disaster relief funding	-302	-0.1	
Net Interest	-161	-0.1	
Current Policy	**8,447**	**4.0**	**82.9**

Table 2: Revenue and Spending: Alternative Baselines, 2012-2023

CBO Baseline

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Unified Budget Deficit	7.0	5.3	3.7	2.4	2.5	2.7	2.9	3.2	3.5	3.6	3.8	3.8
Total Spending	22.8	22.2	21.7	21.6	21.6	21.5	21.7	22.0	22.2	22.4	22.9	22.9
Net Interest	1.4	1.4	1.5	1.5	1.7	2.1	2.5	2.7	2.9	3.1	3.2	3.3
Primary Spending	21.3	20.8	20.3	20.0	19.9	19.5	19.2	19.3	19.3	19.4	19.7	19.6
Mandatory	13.1	13.2	13.2	13.3	13.5	13.3	13.2	13.4	13.5	13.7	14.1	14.1
Medicare / Medicaid	5.2	5.3	5.4	5.4	5.6	5.5	5.6	5.8	5.9	6.0	6.3	6.4
Discretionary	8.3	7.6	7.0	6.7	6.4	6.2	6.0	5.9	5.8	5.7	5.6	5.5
Defense	4.3	4.2	3.6	3.4	3.3	3.1	3.0	3.0	2.9	2.8	2.8	2.8
Non-Defense	4.0	3.9	3.5	3.4	3.2	3.1	3.0	2.9	2.9	2.8	2.8	2.7
Total Revenue	15.8	16.9	18.0	19.1	19.1	18.9	18.8	18.7	18.7	18.9	19.0	19.1
Personal Income Tax	7.3	7.9	8.1	8.7	8.9	9.1	9.2	9.3	9.4	9.6	9.7	9.8
Public Debt	72.5	76.3	77.7	76.3	74.6	73.4	73.1	73.5	74.2	75.0	76.0	77.0

CBO Alternative Fiscal Scenario [1]

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Unified Budget Deficit	7.0	5.5	4.7	3.7	3.7	3.8	4.0	4.5	4.7	4.8	5.1	5.0
Total Spending	22.8	22.4	22.4	22.2	22.3	22.2	22.4	22.7	23.0	23.2	23.7	23.7
Net Interest	1.4	1.4	1.5	1.6	1.8	2.2	2.6	2.9	3.2	3.4	3.6	3.7
Primary Spending	21.3	21.0	20.9	20.7	20.5	20.1	19.8	19.8	19.8	19.9	20.1	20.0
Mandatory	13.1	13.2	13.4	13.5	13.6	13.4	13.3	13.5	13.6	13.8	14.2	14.2
Medicare / Medicaid	5.2	5.4	5.6	5.6	5.7	5.6	5.7	5.9	6.0	6.1	6.4	6.5
Discretionary	8.3	7.8	7.5	7.2	6.9	6.6	6.4	6.3	6.2	6.1	5.9	5.8
Defense	4.3	4.3	3.8	3.7	3.5	3.4	3.3	3.2	3.1	3.1	3.0	2.9
Non-Defense	4.0	3.9	3.6	3.6	3.4	3.3	3.2	3.1	3.0	3.0	2.9	2.8
Total Revenue	15.8	16.9	17.7	18.6	18.6	18.5	18.4	18.3	18.3	18.4	18.6	18.7
Personal Income Tax	7.3	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Adj for tax policy	N/A	0.0	0.3	0.6	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Public Debt	72.5	76.5	78.9	78.7	78.0	77.6	78.3	79.7	81.4	83.1	85.1	86.9

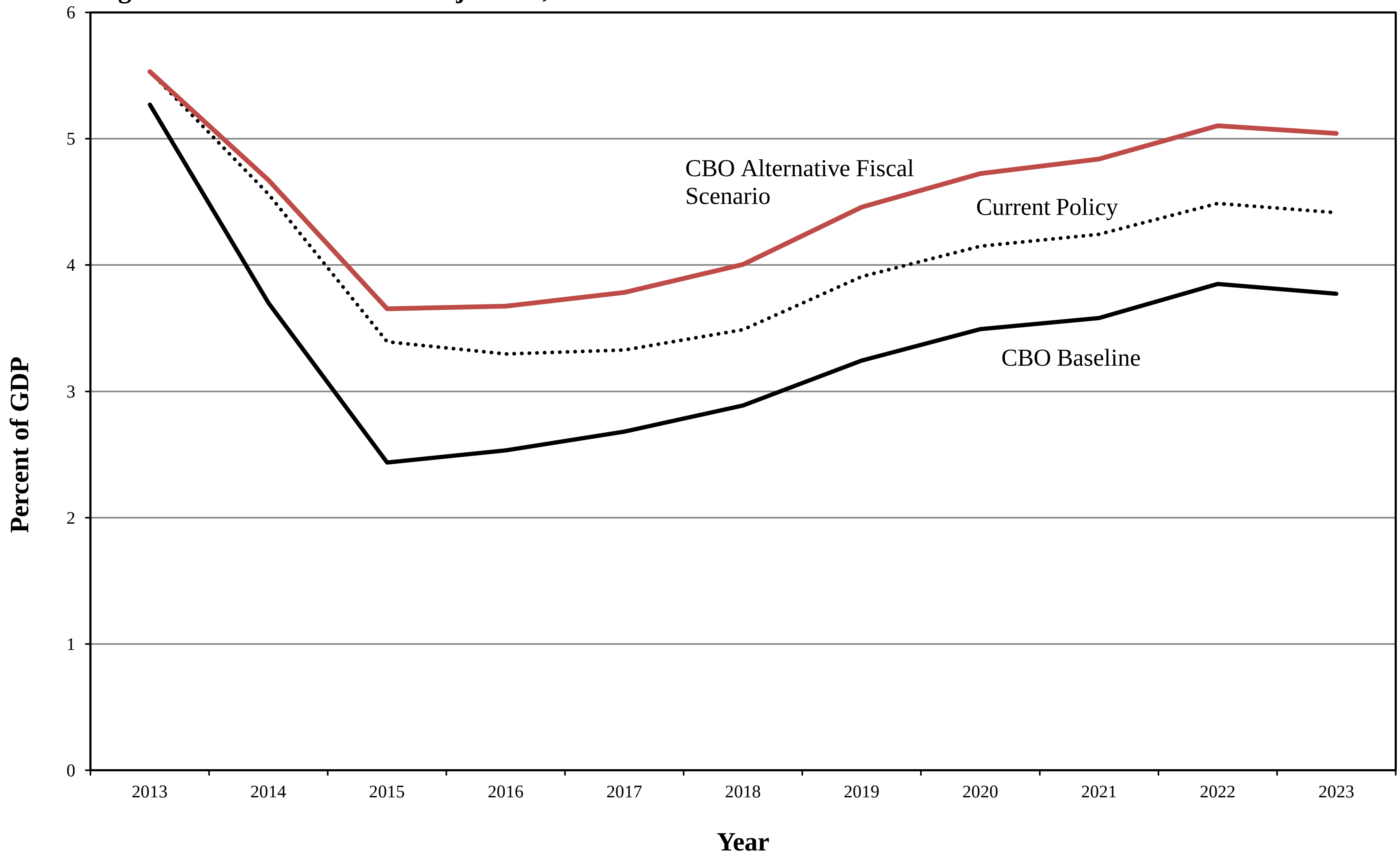
[1] CBO's Alternative Fiscal Scenario adjusts the baseline by (a) removing the sequester, (b) maintaining Medicare's payment rates at the current rate and (c) extending expiring tax provisions.

Current Policy [2]

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Unified Budget Deficit	7.0	5.5	4.6	3.4	3.3	3.3	3.5	3.9	4.1	4.2	4.5	4.4
Total Spending	22.8	22.4	22.3	22.0	21.9	21.8	21.9	22.2	22.4	22.6	23.1	23.1
Net Interest	1.4	1.4	1.5	1.6	1.8	2.1	2.6	2.9	3.1	3.3	3.4	3.5
Primary Spending	21.3	21.0	20.8	20.4	20.2	19.6	19.3	19.3	19.3	19.4	19.7	19.6
Mandatory	13.1	13.2	13.4	13.5	13.6	13.4	13.3	13.5	13.6	13.8	14.2	14.2
Medicare / Medicaid	5.2	5.4	5.6	5.6	5.7	5.6	5.7	5.9	6.0	6.1	6.4	6.5
Discretionary	8.3	7.8	7.4	7.0	6.5	6.2	6.0	5.8	5.7	5.6	5.5	5.3
Defense	4.3	4.3	3.7	3.5	3.3	3.1	3.0	2.9	2.8	2.8	2.7	2.7
Non-Defense	4.0	3.9	3.6	3.5	3.3	3.1	3.0	2.9	2.9	2.8	2.7	2.7
Total Revenue	15.8	16.9	17.7	18.6	18.6	18.5	18.4	18.3	18.3	18.4	18.6	18.7
Personal Income Tax	7.3	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Adj for tax policy	N/A	0.0	0.3	0.6	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Public Debt	72.5	76.5	78.8	78.4	77.3	76.5	76.7	77.6	78.8	80.0	81.5	82.9

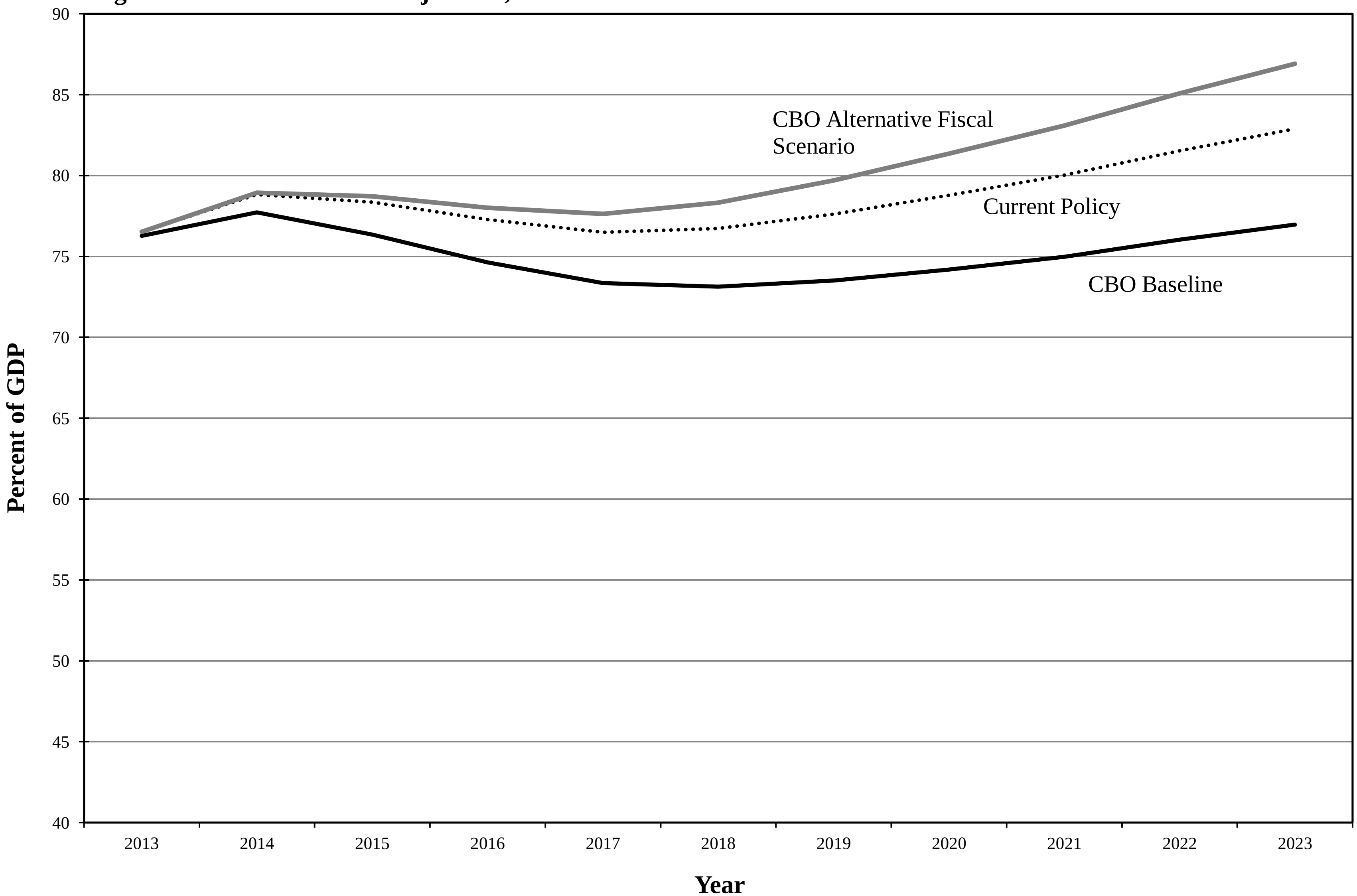
[2] Current Policy baseline starts with CBO's Alternative Fiscal Scenario and includes (a) a reduction in the number of troops deployed overseas and (b) the removal of emergency funding for disaster relief .

Figure 1. Alternative Deficit Projections, 2013-2023



Source: CBO and authors' calculations.

Figure 2. Alternative Debt Projections, 2013-2023



Source: CBO and authors' calculations.

Appendix Table 1

Federal Budget Deficit 2014-2023 [1, 2]
Annual Detail

	Deficit ($ billions)											
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-23
CBO Baseline	**845**	**616**	**430**	**476**	**535**	**605**	**710**	**798**	**854**	**957**	**978**	**6,958**
as percent of nominal GDP	**5.3**	**3.7**	**2.4**	**2.5**	**2.7**	**2.9**	**3.2**	**3.5**	**3.6**	**3.8**	**3.8**	**3.3**
Adjustments for tax policy												
Extend expiring tax provisions	0	58	98	89	83	81	102	103	108	114	120	954
Subtotal	0	58	98	89	83	81	102	103	108	114	120	954
Net interest	0	0	1	4	8	15	19	25	32	38	46	188
Total adjustments for tax policy	0	58	98	93	91	96	121	128	139	152	166	1,143
as percent of nominal GDP	0.0	0.4	0.6	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.5
Adjustments for spending policy												
Freeze Medicare physician payment rates	0	14	16	13	12	12	13	14	14	15	16	138
Assume automatic cuts do not occur	42	89	99	103	104	105	104	104	104	94	89	995
Subtotal	42	102	115	116	117	117	117	118	118	109	105	1,134
Net interest	0	1	2	6	13	22	28	35	43	51	58	257
Total adjustments for spending policy	42	104	116	122	129	138	145	153	161	159	163	1,391
as percent of nominal GDP	0.3	0.6	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.6	0.6	0.7
CBO Alternative Fiscal Scenario [3]	**887**	**778**	**644**	**691**	**755**	**839**	**976**	**1,080**	**1,154**	**1,268**	**1,307**	**9,492**
as a percent of nominal GDP	**5.5**	**4.7**	**3.7**	**3.7**	**3.8**	**4.0**	**4.5**	**4.7**	**4.8**	**5.1**	**5.0**	**4.4**
Adjustments for spending policy												
Drawdown in defense spending	0	-16	-37	-51	-60	-64	-67	-69	-71	-73	-74	-582
Remove extrapolation of continued disaster relief funding	0	-2	-9	-18	-26	-33	-38	-41	-43	-45	-47	-302
Subtotal	0	-18	-46	-69	-86	-97	-105	-110	-114	-118	-121	-884
Net interest	0	0	0	-2	-6	-11	-16	-22	-28	-35	-42	-161
Total adjustments for spending policy	0	-18	-46	-71	-91	-108	-121	-132	-142	-153	-163	-1,045
as percent of nominal GDP	0.0	-0.1	-0.3	-0.4	-0.5	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.5
Current Policy [4]	**887**	**759**	**598**	**619**	**664**	**731**	**856**	**948**	**1,012**	**1,115**	**1,144**	**8,447**
as a percent of nominal GDP	**5.5**	**4.6**	**3.4**	**3.3**	**3.3**	**3.5**	**3.9**	**4.1**	**4.2**	**4.5**	**4.4**	**4.0**
GDP	16,034	16,646	17,632	18,792	19,959	20,943	21,890	22,854	23,842	24,858	25,910	213,326

[1]Columns may not sum to total due to rounding.

[2]The source of these estimates is CBO (February 2013) "The Budget and Economic Outlook: Fiscal Years 2013 to 2023."

[3] CBO's Alternative Fiscal Scenario adjusts the baseline by (a) removing the sequester, (b) maintaining Medicare's payment rates at the current rate and (c) extending expiring tax provisions.

[4] Current Policy baseline starts with CBO Alternative Fiscal Scenario and includes a reduction in the number of troops deployed overseas and the removal of emergency funding for disaster relief .

Appendix Table 2

Public Debt (2014-2023)

(in $ billions)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
1. Public Debt under CBO Baseline	12,229	12,937	13,462	14,025	14,642	15,316	16,092	16,957	17,876	18,902	19,944
as percent of nominal GDP	76.3	77.7	76.3	74.6	73.4	73.1	73.5	74.2	75.0	76.0	77.0
Adjustments for spending policy	42	102	115	116	117	117	117	118	118	109	105
Adjustments for net interest due to spending policy	0	1	2	6	13	22	28	35	43	51	58
Total Adjustments for spending policy	42	104	116	122	129	138	145	153	161	159	163
Public Debt adjusted for spending policy alternatives	12,271	13,083	13,724	14,409	15,155	15,967	16,889	17,906	18,986	20,172	21,377
as percent of nominal GDP	76.5	78.6	77.8	76.7	75.9	76.2	77.2	78.4	79.6	81.1	82.5
Adjustments for tax policy	0	58	98	89	83	81	102	103	108	114	120
Adjustments for net interest due to tax policy	0	0	1	4	8	15	19	25	32	38	46
Total Adjustments for tax policy	0	58	98	93	91	96	121	128	139	152	166
2. Public Debt under CBO Alternative Fiscal Scenario	12,271	13,141	13,881	14,658	15,496	16,403	17,446	18,592	19,811	21,149	22,519
as percent of nominal GDP	76.5	78.9	78.7	78.0	77.6	78.3	79.7	81.4	83.1	85.1	86.9
Adjustments for spending policy	0	-18	-46	-69	-86	-97	-105	-110	-114	-118	-121
Adjustments for net interest due to spending policy	0	0	0	-2	-6	-11	-16	-22	-28	-35	-42
Total Adjustments for spending policy	0	-18	-46	-71	-91	-108	-121	-132	-142	-153	-163
3. Public Debt under Current Policy	12,271	13,123	13,816	14,522	15,268	16,068	16,990	18,005	19,082	20,266	21,474
as percent of nominal GDP	76.5	78.8	78.4	77.3	76.5	76.7	77.6	78.8	80.0	81.5	82.9