CBO's Grim Budget Outlook Underscores the Need for Change

By Alison Acosta Winters

The Congressional Budget Office (CBO) just released its newest forecast for the federal budget.[1] The sobering report projects significant and unaffordable growth in federal spending and debt. We've known for years this problem has been coming; the real news is that it is now on America's doorstep.

This should concern every American because at some point soon, taxpayers will be left holding the bag. Beyond the checkbook reality of dollars and cents, the report sends a troubling message for our future well-being. More government spending and higher government debt create barriers to opportunity for Americans across all walks of life, especially younger generations.

This report should also serve as a wake-up call to those who want to massively expand the government and its role in society. Putting aside the dubious nature of proposals like Medicare for All, the Green New Deal, and "free" college, the simple fact is we can't afford the programs we have now, much less new ones costing additional trillions.

REPORT HIGHLIGHTS

This year's report shows that in fiscal year 2018 total federal spending surpassed $4 trillion for the first time.[2] Revenues grew slightly, reaching $3.3 trillion, while the deficit of $779 billion drove up total federal debt to $21.5 trillion.

These are massive numbers. Consider this: for every household in America, the federal government spends over $32,000, taxes $26,000, and puts $6,000 on the credit card—which already has a tab of $168,000.[3] Families and businesses cannot thrive and prosper on a path like this, and neither can government.

CBO's report indicates that over the next 10 years this gloomy fiscal picture will only worsen. In that relatively small timeframe, total annual spending will grow to $7 trillion, about 70 percent higher than it is today. This spending will place an even greater burden on American workers, families and business owners. The growth will be driven by programs focusing on America's retirees, primarily Social Security and Medicare. By 2029, 50 percent of the budget (excluding interest) will be spent on these mandatory spending programs.

Interest on the debt will skyrocket—nearly tripling from $325 billion to $928 billion a year, a result of higher spending and higher interest rates. Given the large amount of

1. Congressional Budget Office "The Budget and Economic Outlook: 2019 to 2029," Congress of the United States, January 2019. All data from this report unless otherwise referenced.
2. All years are fiscal years unless noted otherwise.
3. Author calculations based on 2018 households, FRED, Federal Reserve Bank of St Louis

waste in federal spending, it is difficult to argue that interest payments add intrinsic value to society, making them the single-most expensive form of government waste.

Tax revenues will also grow, from $3.3 trillion to $5.4 trillion—and that's after assuming Congress will vote to make the individual tax cuts from the Tax Cuts and Jobs Act permanent. But, consistent with past trends, spending growth will continue to outpace revenue growth.[4]

In just three years, the country will return to trillion-dollar deficits. Rather than temporary, they are here to stay and will keep growing—and keep harming Americans—thanks to runaway spending.

This report confirms what we've long known: Federal spending is on an unaffordable path—it must finally be reined in.

SPENDING

Government spending crossed a significant threshold last year, topping $4 trillion for the first time. Absent meaningful changes from Washington, government spending typically grows—if nothing else just to keep pace with inflation. One helpful gauge is how fast spending is growing in relation to the economy. By that measure, 2018 was also significant because it's the last year federal spending as a share of the economy will be at the historical average of 20.3 percent. Next year it will be 20.9 percent and by 2029 it will reach 22.7 percent. That means after 10 years spending will be 12 percent bigger as a share of the economy.

The largest single federal program is Social Security, which will exceed $1 trillion this year. Medicare is $768 billion. Both are larger than defense spending ($664 billion this year, including war spending).

Social Security and Medicare will continue to be the biggest drivers of spending over the next decade. This is caused by the retirement of the baby boomers, people living longer, growth in Social Security benefits, and increasing health care costs.

Besides Social Security and Medicare, other retiree programs include federal and military retirement and health care, along with some features of Medicaid for the elderly. By 2029, 50 percent of the budget (excluding interest payments) will be spent on programs for America's seniors; it was just 35 percent in 2005. This trend will continue far beyond 2029. Spending over half the budget on just a handful of programs makes it difficult for policymakers to respond to other priorities.

The fastest growing part of the budget is actually interest on the debt. This is a direct result of overspending. As ever-larger deficits drive up debt faster and interest rates increase, interest payments also go up. Over the next 10 years, interest on the debt will nearly triple to about $1 trillion. Debt has grown this fast only twice since 1940—during World War II (largely financed through debt) and the 1980s (the defense buildup and federal reserve policy that drove up interest rates to tackle inflation.) While those increases were larger, they were not a result of structural gaps in the budget like we face today.[5] In 2020, the country will spend more on interest than Medicaid; in 2025, interest will be the third largest single expense in the budget—higher even than defense spending.

Automatically dedicating an ever-growing share of the budget to retirees raises real concerns about what the role of government should be and how big it should become. Spending on these programs and on interest places significant pressure on taxes, while simultaneously crowding out spending on other programs such as defense, law enforcement, the judiciary and other priorities. All other spending will shrink as a share of the budget. As a share of the economy, this (discretionary) spending will shrink by about 20 percent, from 6.2 percent today to 4.9 percent in 2029. This means it will be more difficult for policymakers to provide other spending, including core constitutional functions of government.

4. Michael Decker and Alison Acosta Winters, "Speeding Towards Bankruptcy," Freedom Partners and Americans for Prosperity, October, 2018

5. Office of Management and budget, "Historical Tables, Budget of the U.S. Government, Fiscal Year 2019"

TAX REVENUES

Like spending, tax revenues are also estimated to grow, from $3.3 trillion to $5.7 trillion in 2029 if current law remains unchanged.

Over the last 50 years, taxes as a share of the economy have been as low as 14.6 percent (during the great recession) and as high as 20 percent. The historical average is 17.4 percent. Tax revenues are low now at 16.4 percent of GDP but will rise to 18.3 percent of GDP over the next 10 years.

Several outstanding questions exist over tax policy today. Chief among them is whether all policy in the Tax Cuts and Jobs Act will be made permanent. Some policies in the tax reform bill expire by 2025, including the individual income tax rates that lowered effective rates for taxpayers at all income levels. This is a critically important policy question, as temporary tax policy causes unnecessary uncertainty for taxpayers and businesses and should be avoided. Tax revenues would grow from $3.3 trillion in 2018 to $5.4 trillion in 2029 if the tax cuts were made permanent.

Tax cuts have been a fixture of tax policy in America from President Kennedy to President Trump. We must ask ourselves a fundamental question: How much of a claim should the government have on what Americans produce? In other words, how much is fair?

Placing higher burdens on American taxpayers means raising barriers to work, opportunity and success, and would likely beget still more government spending. That should not be the goal. Rather, tax policy should raise enough revenue to fund those proper functions of government with limited interference in the economy, while treating individuals and institutions equally in the process.[6]

DEFICITS AND DEBT

In 2022, deficits will exceed $1 trillion for only the second time in our history. First experienced during the financial crisis, deficits at that level were temporary and caused by a combination of a recession-related downturn in tax revenues and a massive spike in stimulus-related policies. Trillion-dollar deficits today and beyond are structural and caused by the escalating spending noted above, primarily on Social Security and Medicare. Deficits will continue to rise, reaching $1.3 trillion, or 4.4 percent of the economy, by 2029. Deficit growth this high has happened only twice before—during the defense buildup of the 1980s and during the financial crisis.[7]

Deficits at this level, both in dollar terms and as a share of the economy, are extremely unusual for a period of low unemployment and solid economic growth.

The gross national debt in 2018 reached $21.5 trillion. This total consists of the debt held by the public and debt the government owes to itself through trust funds, like that for Social Security.

Debt held by the public is a different measure of debt, one that has more impact on the economy because it is bought and sold by investors across the world. It is also growing, and by 2029 will reach 92.3 percent of the economy. The last time it was this high was just after World War II. But it won't stop there. Without major policy changes, debt will reach 150 percent of the economy in another 20 years. The U.S. has never experienced a level of debt that high.

Such high levels of debt present several serious problems. Higher debt means there is little to no room in the budget for policymakers to respond to emerging policy priorities, such as defending the country from foreign aggression or dealing with other significant unforeseen issues confronting the nation. It also makes it difficult to change tax policy and lower the tax burden.

Debt at these historically high levels, particularly when it is structural, makes it more likely we will experience some kind of budget or financial crisis. If that happens, lawmakers will have little room for policy maneuvering, making the impact of any hardship even more devastating for American families, businesses and the economy.

6. "Comprehensive Tax Reform, Unrigging the Economy," Americans for Prosperity and Freedom Partners, May 2017

7. Office of Management and budget, "Historical Tables, Budget of the U.S. Government, Fiscal Year 2019"

Persistent high debt levels lead to slower growth for important things like job creation and wage growth. It will be harder for small businesses and entrepreneurs to access capital to start a new business or expand an existing one.

We would do well to avoid the mistakes of other countries with high debt. Greece is one example, while Puerto Rico, although it's a territory, not a sovereign country, is more recent. Both let their budget policies drive debt so high that lawmakers and public alike were faced with seemingly intractable economic and societal challenges and draconian policy solutions, including sharp reductions to government benefits and social safety net programs and dramatic tax increases.

TAXES IN THE FUTURE

While tax revenues will continue to grow under current policy—even above their historical average—some suggest raising taxes further to pay for increased spending and to reduce deficits. This would create harsh barriers for our families, workers and entrepreneurs, and reduce opportunity. What's more, the simple math is daunting!

For example, policymakers could increase federal payroll taxes. Since they fund Social Security and Medicare, this might seem to make sense. But the increases required just to stabilize the debt at current levels over the next decade would be staggering and require more than doubling the combined employee and employer rates from 15.3 percent to 33.5 percent.[8] This would significantly reduce take-home pay for all American workers and put considerable downward pressure on wage growth. A value-added tax or VAT, which many European countries have, would need to be 17 percent. Similar to a sales tax, a VAT is paid on every single purchase made by an individual or a business, sharply reducing the purchasing power of every American consumer. Either tax would need to be continually hiked to keep up with spending.

Taxes of this magnitude would be an unaffordable burden for Americans. With more workers moving into retirement, those who must pick up the tab will be the future—younger Americans. These harmful policies would hit them at, perhaps, the worst possible time: when they are building careers, starting families or saving for a house or their own retirement. Instead, we must change the path of government spending.

DIFFERENT PATH

This report should serve as a sobering reminder to us all: the federal government is on an unaffordable and unsustainable budgetary path—and it only gets steeper in the coming years. Policymakers must do more than pay lip-service to the debt and then, like those before them, kick the can down the road. That includes policymakers who would prefer to ignore the glaring issues and dramatically expand government.

There is a better way. Policymakers should heed this reminder and seize it as an opportunity to get rid of waste and eliminate corporate welfare that rigs the system in favor of the well-connected at the expense of everyone else. But that will not be enough. They must also rise to the challenge and reshape federal programs so they work better for all Americans—including seniors—and be more affordable for younger generations. The future of our nation depends on it.

8. Brian Riedl, "A Comprehensive Federal Budget Plan to Avert a Debt Crisis," Manhattan Institute, September, 2018