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CBO Confirms: Long-Run Fiscal Outlook Remains Grim

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On December 13, the Congressional Budget Office (CBO) released yet another report painstakingly demonstrating that current fiscal policies are unsustainable over the long term.[1] The bottom line is made clear in the first sentence of the first chapter:

> Significant uncertainty surrounds long-term fiscal projections, but under any plausible scenario, the federal budget is on an unsustainable path—that is, federal debt will grow much faster than the economy over the long run.

The CBO report joins a long list of publications on the topic published by a diverse group of commentators including the Bush Administration and the General Accountability Office.[2]

The CBO paints a fairly encouraging picture of the near-term budget situation, even with the 2001 and 2003 tax cuts extended. But this near-term outlook should not divert the nation's attention from its serious long-term fiscal problems. Beyond any doubt, as the CBO once again makes clear, the nation has promised far more in its Medicare, Medicaid, and Social Security programs than it can afford.

Entitlement Growth Is Unsustainable. The long-term federal budget is unsustainable and unaffordable not because of an expected dearth of revenues, or because defense spending is exceptional by historical standards, or for any other reason associated with the day-to-day spending of the federal government. The long-term federal budget is in serious trouble primarily because spending on Medicare and Medicaid is projected to grow far more rapidly than the economy. This is due to a combination of rising health care costs and the coming retirement of the Baby Boomers. Spending on Social Security is also expected to grow more rapidly than the economy, though less so than Medicare and Medicaid.

This point is made clear by two particulars in the report:

- The CBO projects "that under current law, federal spending on Medicare and Medicaid measured as a share of GDP will rise from 4 percent today to 12 percent in 2050 and 19 percent in 2082—which, as a share of the economy, *is roughly equivalent to the total amount the federal government spends today.*" [Italics added]
- The CBO projects that Social Security spending "will increase from about 4 percent of GDP today to about 6 percent in 25 years and then will roughly stabilize at that rate thereafter."

The Sources of Unsustainability. The coming retirement of the Baby Boomers (individuals born between 1947 and 1962) will have a substantial and long-anticipated effect on federal retirement programs. For example, the share of people age 65 or

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www.heritage.org/Research/Budget/wm1749.cfm

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older is projected to grow from 12 percent in 2007 to 19 percent in 2030. This senior boom is especially relevant to the fiscal shortfall in Social Security.

Continuing a recent theme of CBO analyses,[3] the dominant source of excess cost growth in federal entitlement programs is the sustained and extraordinary long-term increase in health care costs. According to CBO projections, the excess cost growth in health care is responsible for about 80 percent of the projected increase in Medicare, Medicaid, and Social Security spending as a share of gross domestic product (GDP) through 2082. The strong implication is that broad, incremental free-market reforms to health care—reforms that produce greater efficiencies in health care delivery—could slow health care cost growth, which would then have a significant, beneficial effect on the long-run budget outlook.[4] These reforms to health care markets, however, must be accompanied by significant reforms to the entitlement programs themselves.

A Brief Foray in Dubious Analysis. While the broad thrust of the CBO report is sound and helpful to the debate, the report is not without its peculiarities—the following excerpts in particular:

> Differences between the economic costs of one policy for achieving long-term fiscal sustainability and those of another are generally modest in comparison with the costs of allowing deficits to grow to unsustainable levels. In particular, the difference in economic costs between acting to address projected deficits (by either reducing spending or raising revenues) and failing to do so is generally much larger than the cost implications of pursuing one approach to deficit reduction rather than another.[5]

Medicare and Medicaid are unsustainable in their current form, and reforms will surely be enacted at some point to correct them, because failure to do so would be catastrophic. On these points there is broad agreement.

However, the above excerpt suggests that the macroeconomic costs of inaction *necessarily exceed* the costs of whatever action Congress might consider. To put it diplomatically, this is a baseless and obviously errant claim. One can easily imagine tax increases that would have the same Armageddon-like consequences for the economy as would inaction on these spending programs.

The report goes on to state the following:

> Nonetheless, a policy of reducing the growth of spending would in general impose smaller macroeconomic costs than one of increasing tax rates, although the economic effects would depend in part on the specific measures that were adopted.

This statement is simpler—and even more clearly in error. It is true that raising taxes would certainly have more deleterious effects on the economy than cutting spending—and that the extent of the effects would depend on the specific measures adopted. But it is simply wrong to state that reducing spending would impose macroeconomic costs. Reducing government spending would, at worst, have no effect on the economy; it would more likely strengthen long-term economic growth.

Action Required, the Sooner the Better. A rare and encouraging feature of the long-term fiscal outlook debate is the broad consensus about the nature and size of the problem. In addition to work by the Administration, the CBO, and the GAO, a collaboration of think tanks including The Heritage Foun-

1. Congressional Budget Office, "The Long-Term Budget Outlook," December 2007, at *www.cbo.gov/ftpdocs/88xx/doc8877/12-13-LTBO.pdf.*
2. See, for example, Office of Management and Budget, "The Nation's Fiscal Outlook," February 2007; and United States Comptroller General David Walker, "America's Fiscal Future," December 5, 2007, *www.gao.gov/cghome/d08339cg.pdf.*
3. See, for example, Congressional Budget Office "The Long-Term Outlook for Health Care Spending," November 2007, at *www.cbo.gov/ftpdocs/87xx/doc8758/11-13-LT-Health.pdf.*
4. For a discussion of one set of health care reforms, see Stuart M. Butler and Nina Owcharenko, "Making Health Care Affordable: Bush's Bold Health Tax Reform Plan," Heritage Foundation *WebMemo* No. 1316, January 22, 2007, at *www.heritage.org/Research/HealthCare/wm1316.cfm.*
5. "The Long-Term Budget Outlook," p. 7.

dation has embarked on a national outreach effort. The Fiscal Wake-Up Tour aims to bring this message directly to the American people and to discuss various solutions.[6] Key members of the Tour also include the Brookings Foundation and the Concord Coalition. Other organizations and activists are also engaged in the issue through separate efforts. These various endeavors from across the political spectrum underscore the widespread agreement as to the seriousness of the problem, even though views vary when it comes to solutions.[7]

The autopilot solution for dealing with the coming fiscal shortfall is to issue more and more government debt. The CBO report explains why this approach is not an option. The autopilot solution would push the ratio of federal debt to GDP into levels commonly found in failing, dictatorial, third-world countries. Therefore, the remaining solutions are tax increases, slowing the growth in spending directly, and reducing the distortions in the health care market that are causing excessive growth in health care costs. The latter two are more sensible, because tax hikes of sufficient size to be relevant to the solution could devastate the economy.

One possible take-away from the CBO report is that America's long-term budget problems are nearly unsolvable. This conclusion is neither warranted nor responsible. At the same time, it would be unnecessary and probably unwise for Congress and the Administration to approach the issue through a single, "Big Bang" legislative effort. Health care reforms aimed at improving quality and slowing cost growth can be adopted incrementally. Reforms to Medicare, Medicaid, and Social Security can also be adopted separately and incrementally. By moving toward solutions through steady, sustained, and incremental reforms, the nation can and ultimately will get its long-run fiscal house in order.

Conclusion. The long-run budget outlook is grim, and the CBO report is important if only to restate this consensus view. Next year and in the years to come, Congress and the Administration need to work together to achieve meaningful reforms that put Social Security on a sustainable path. They also need to adopt substantive, market-based reforms to slow the growth of health care costs. Among its many benefits, slowing the growth of health care costs will make it easier for Congress to pass reforms to make Medicare and Medicaid sustainable.

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6. For background information on the Fiscal Wake-Up Tour, see *www.concordcoalition.org/events/fiscal-wake-up/index.html.*
7. For a discussion of some policy options, see Stuart M. Butler, "Solutions to Our Long-Term Fiscal Challenges," Testimony before the Committee on the Budget, United States Senate, January 31, 2007, at *www.heritage.org/Research/Budget/tst013107a.cfm.*