Budget Watch
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Florida TaxWatch

A GROWING FEDERAL DEBT PUTS THE NATION AT RISK

The *2016 Long-Term Budget Outlook*, released this month by the bipartisan Congressional Budget Office (CBO), paints a bleak picture of nation's fiscal future. It concludes that under the current laws governing taxing and spending, the United States will experience steadily and rapidly increasing federal budget deficits and debt, posing "substantial risks for the nation."

The federal debt now totals almost $14 trillion.[1] The Great Recession led to federal debt increasing from 39 percent of Gross Domestic Product (GDP) in 2008[2] to 75 percent today. Without significant fiscal reform, CBO projects that debt will reach 86 percent of GDP in ten years and reach 141 percent by 2046. The nation's previous high debt level was 106 percent of GDP right after World War II.

In dollars, America's debt is forecast to reach an astonishing $87.9 trillion[3] in 30 years. This is more than $200,000 for each of the 400 million men, women, and children expected to live in the United States in 2046.

Simply, the deficit and debt will rise because government spending will increase faster than government revenue. The main drivers of spending and the resultant debt growth are Social Security, federal health care spending (primarily Medicare), and interest on the debt.

As the baby boom generation ages and life expectancy increases, the percent of the population over age 65 will grow sharply, adding significant costs to Social Security and Medicare. The CBO estimates that by 2046, approximately half of all federal non-interest spending will go to benefits for those 65 or older. Although healthcare costs per beneficiary are growing slower than in the past, they are still expected to outpace growth in GDP, adding to the cost of federal health programs.

Currently, spending on Social Security, Medicaid and other health programs, and the interest on our debt takes up just over half of the federal budget. CBO estimates that in thirty years, these items will take up 73 percent of the federal budget and 104 percent of federal revenues. In other words, the federal government will incur a budget deficit just paying for these programs.

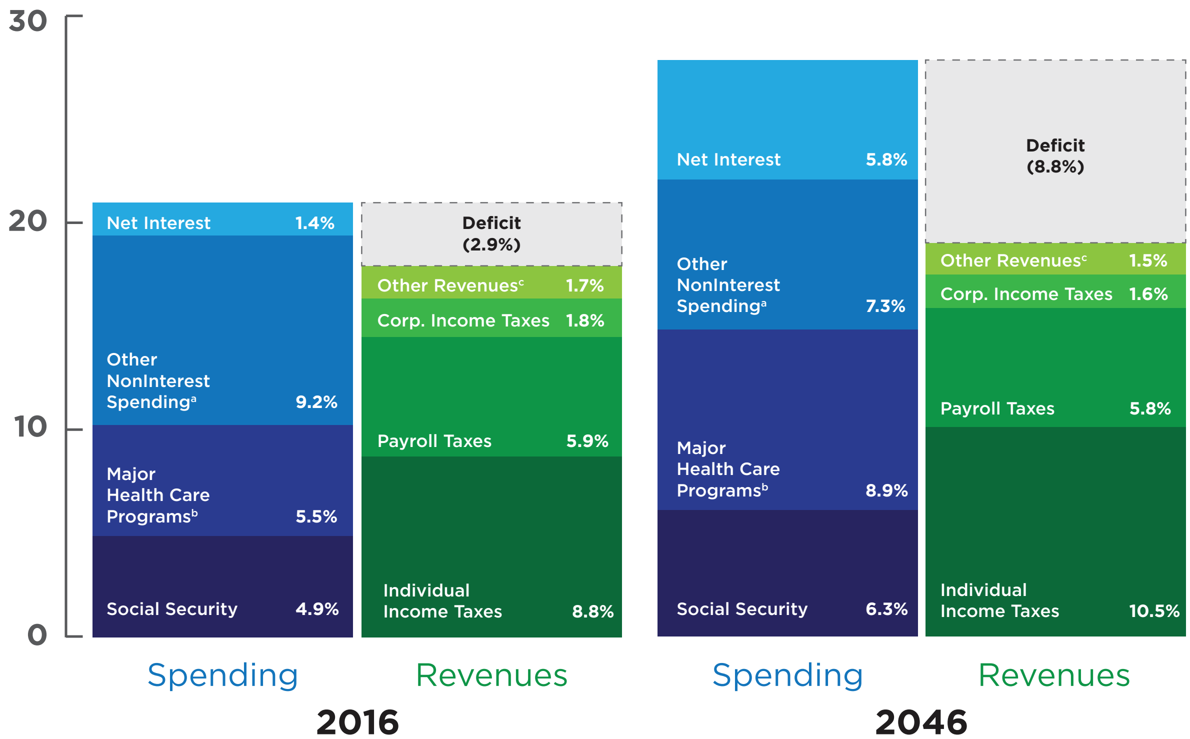
1 This is the amount of debt held by the public, which is the debt used in the CBO report. There is another $5.4 trillion in intergovernmental debt, which is mostly money the government borrows from its own trust funds
2 Dates in this *Budget Watch* are federal fiscal years ending on September 30 of the year cited.
3 Because the CBO report expresses spending, revenues, deficits and the debt as a percent of GDP, most of the dollar amounts in this *Budget Watch* were calculated by Florida TaxWatch using supplemental data from the CBO.

BUDGET DEFICITS ARE ON THE RISE AGAIN

The federal budget deficit had been declining steadily in recent years, as the nation recovered from the financial crisis and recession. After reaching a high of $1.5 trillion in 2009, the deficit fell for six straight years, reaching $439 billion in FY 2015. However, the 2016 deficit jumped to $537 billion. The increase was mostly due to the year-end budget deal which extended numerous tax cuts for both businesses and individuals. This deal is estimated to reduce revenues by $680 billion over ten years. Also, due to the larger debt, interest payments will be increased by $150 billion over ten years.[4] Due largely to spending on the programs discussed above, CBO now expects budget deficits to begin rising again. Currently 2.9 percent of GDP, the deficit is expect to grow to $1.4 trillion (4.9 percent of GDP) in ten years and exceed the previous all-time high[5] by 2026, reaching $1.6 trillion. In 30 years, the deficit is forecast to be 8.8 percent of GDP, or $5.5 trillion. Every year there is a budget deficit, the federal debt grows.

The Federal Budget Under the Extended Baseline

Percentage of Gross Domestic Product



Source: Congressional Budget Office. Chart reproduced by Florida TaxWatch.
The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2026 and then extending most of the concepts underlying those baseline projections for the rest of the long-term projection period.
a. Consists of all federal spending other than that for Social Security, the major health care programs, and net interest.
b. Consists of spending on Medicare (net of offsetting receipts), Medicaid, and the Children's Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.
c. Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

4 The Committee for a Responsible Federal Budget, *Report: The 2016 CBO Long-Term Budget Outlook*, July 12, 2016.
5 In nominal dollars

FEDERAL SPENDING

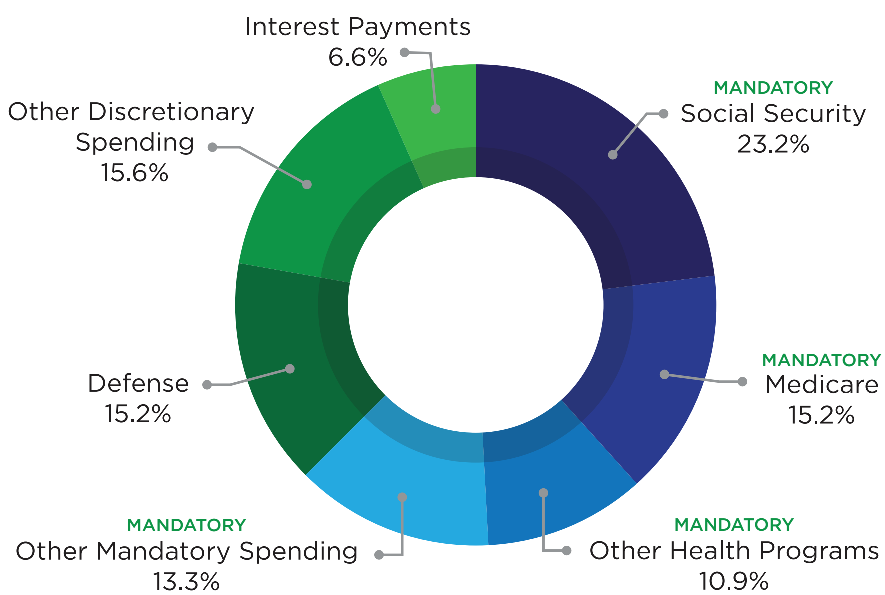
Federal spending (other than net interest costs) has averaged 18 percent of GDP over the last 50 years. However, due to both underlying demographic trends and the effects of the financial crisis, spending has well exceeded historical levels since 2009. After reaching a high of 23 percent in 2009, spending has settled in at about 20 percent and is expected to remain close to that level through the next decade. Beginning in 2026, spending growth should accelerate, reaching 22.4 percent by 2046. When interest payments are included, total federal spending would reach 28.2 percent of GDP. Only during World War II did government spending take up a larger portion of the economy.

Total federal spending totals $3.9 trillion in 2016. It is estimated spending will grow to $5.2 trillion in ten years and reach $12.1 trillion in 2046.

During this time, it is estimated that mandatory spending will increase, while discretionary spending will decrease.[6] This is due in part to the discretionary funding constraints of the Budget Control Act of 2011[7]. Mandatory spending comprises more the 60 percent of total non-interest spending.

Where Does $3.9 Trillion in Federal Spending Go?

FY2016



Source: Florida TaxWatch calculations from Congressional Budget Office data.

6 Mandatory spending is determined by eligibility rules, benefit formulas, etc. that are already set in law. Discretionary spending is governed by annual appropriations acts. Mandatory spending includes Social Security, Medicare, Medicaid, Children Health Insurance Program (CHIP), subsidies paid through the Affordable Care Act, federal retirement benefits, some veterans programs, the Supplemental Nutrition Assistance Program (SNAP), unemployment insurance, and refundable tax credits. Discretionary spending includes defense, education, transportation, housing, some health care (veterans, public health, research), justice, international programs, and the environment.

7 Some discretionary funding, such as war-related activities, are not covered by the Act.

Social Security – The largest federal program, Social Security provides benefits to 60 million Americans. The program's mandatory outlays total $911 billion in 2016, nearly a quarter of all federal spending. Due to an aging population,[8] Social Security spending is expected to rise to 5.9 percent of GDP by 2026 and 6.3 percent by 2046. The program's outlays will exceed revenues by an estimated 31 percent in ten years. The CBO further estimates it would take an immediate and permanent increase in payroll taxes of 3.2 percentage points (or an equal decrease in benefits) to pay benefits and maintain necessary trust fund balances for the next 25 years.

Major Health Care Programs – In 2016, spending on these programs equals 5.5 percent of GDP, or just over $1 trillion. Net Medicare outlays accounts for the lion's share of this spending—$592 billion. Medicaid, CHIP, and insurance subsidies require another $425 billion. This spending is forecast to reach 8.8 percent of GDP ($5.5 trillion) by 2046. Medicare accounts for 60 percent of this spending growth.

Other Mandatory Spending – As opposed to Social Security, health care and interest costs, other federal spending is expected to decline (relative to GDP) over the CBO forecast horizon. Other mandatory spending is expected to decrease from 2.8 percent of GDP this year to 2.5 percent in ten years. It is projected to fall to 2.1 by 2046. Part of the decline is due to an expected decrease in beneficiaries in some large programs such as SNAP. Refundable tax credits[9] are also expected to decrease. Since these are indexed to inflation—or not indexed at all—incomes rising faster than inflation will decrease the relative number of beneficiaries.

Discretionary Spending - Over the years, the share of discretionary spending has fallen from 67 percent of total spending in 1966 to 31 percent today. This points out one of the difficulties in getting federal spending under control—less than a third of spending is subject to annual appropriation. The rest is on autopilot.

Discretionary spending totals $1.2 trillion in 2016, 6.5 percent of GDP. Already well below its historical 50-year average of 8.7 percent of GDP, discretionary spending is expected to continue to decline, reaching 5.2 percent in ten years, then remaining constant through the rest of the forecast. About half of discretionary spending goes to defense and that proportion is not expected to change. Defense spending peaked at 9.1 percent of GDP in 1968 (Vietnam War) and fell to a low of 2.9 percent in 2000 (end of Cold War). Actions in Iraq and Afghanistan pushed defense spending to 4.7 percent in 2010.

It should be mentioned that the Budget Control Act of 2011 expires in 2021, meaning discretionary spending will be determined by lawmakers' actions, not affected by legal spending constraints. This makes the forecasting of discretionary funding more difficult.

Federal Interest Costs – Despite a huge federal debt, extremely low interest rates have kept interest payments at historically low levels relative to GDP. However, due to ever increasing budget deficits, America's debt is growing and will continue to grow, as will the corresponding interest payments by the federal government. In addition, interest rates are expected to go higher, further adding to interest costs.

8 The number of people aged 65 or older will increase by 37 percent by 2026 and 75 percent by 2046.

9 These credits, such as the earned income credit and the child tax credit are counted as spending when they exceed the amount owed in taxes.

In 2016, interest payments total $259 billion (1.4 percent of GDP). These costs are expected to more than triple over the next ten years to $831 billion, resulting in the share of GDP to more than double to 3.0 percent. By 2046, interest payments will equal 5.8 percent of GDP ($3.6 trillion).

It is estimated that the portion of federal spending devoted to interest will quadruple over the next 30 years and will exceed net Medicare spending in 2046.

FEDERAL REVENUES

Like spending, federal revenues under current law are expected to rise faster than GDP over the next 30 years, but at a much lower rate. The federal government will collect $3.4 trillion in revenue during 2016. Almost half of this ($1.6 trillion) comes from individual income taxes. Payroll taxes (Social Security and Medicare) account for $1.1 trillion, and the next largest revenue is corporate income taxes ($333 billion). The rest of Uncle Sam's revenue come from excise taxes, custom duties, estate and gift taxes, miscellaneous fees and fines, and the net income of the Federal Reserve System.

Revenues as a percent of GDP have been very stable over time. Over the last 50 years, revenues have averaged 17 percent of GDP, with a range of only 15-20 percent. Currently at 18.2 percent of GDP, revenues are expected to maintain this level for the next ten years. Then they are expected to begin rising slowly, reaching 19.2 percent by 2046. Very small decreases in payroll taxes and corporate income taxes would be more than offset by increasing personal income taxes. This is due to "bracket creep," where income rises faster than inflation, pushing taxpayers into higher indexed tax brackets. Bracket creep will result in taxpayers at all income levels paying a higher share of their income in taxes than similar taxpayers do now. This comes with some negative economic effects. CBO estimates that higher marginal tax rates on both labor and capital will dampen economic growth, resulting in less tax revenue than would otherwise be collected.

In addition, baby boomers will withdraw money from retirement accounts, receive pensions, and collect deferred compensation. Much of this income will be taxable, boosting tax receipts. Also, the Affordable Care Act's "Cadillac Tax," will begin in 2020 after being delayed two years. This is the tax on high-priced employer-provided health plans.

FEDERAL DEBT IS A MAJOR CONCERN AND TIME IS OF THE ESSENCE

Thirty years is a long-time to estimate anything. The CBO concedes that even small changes in its many assumptions would have a measurable impact on this forecast, either up or down. However, it is clear that the federal government is spending more money than it brings in and there is no reason to believe that will not continue under current law.

This creates a viscious circle: higher spending leads to higher deficits, which lead to increased debt, which leads to increased interest spending, which leads to even higher spending, deficits, and debt.

Several major federal trust funds are headed for bankruptcy. These include the Highway Trust Fund (2021), the Social Security Disability Insurance trust fund (2022), the Medicare Part A trust fund (2026), and the Social Security Old Age and Survivors Insurance trust fund (2030).

Current federal fiscal policies are not sustainable. CBO estimates the debt will rise to 1.5 times the size of GDP by 2046. This would equal $200,000 for every person in the United States. The CBO report highlights many negative consequences of large government debt:

- Reducing national savings and income;
- Shrinking the economy;
- Driving up interest rates;
- Increasing government interest costs, putting pressure on other areas of the budget;
- Limiting lawmakers ability to respond to unforeseen events; and
- Making another fiscal crisis more likely.

Reducing the debt to manageable levels is a daunting task. Achieving this would require some combination of reduced spending, lower benefits, or increased revenues. None of these are things politicians like to face.

CBO estimates that in order to keep the debt at its current level (75 percent of GDP), there would have to be some recurring combination of reduced spending or increased revenue of $330 billion in 2017. This is 8 percent of the current federal budget. To bring the debt level down to the 50-year average (37 percent of GDP), $560 billion (14 percent of the budget) would be needed.

CBO also warns that it will be expensive to wait. Waiting just five years would require 24 percent more (relative to GDP) in cuts or revenues just to stabilize the debt level. In ten years, it would require 59 percent more.

Now is the time to reduce the debt. Unfortunately, the issue is nowhere near the top of today's political debate. In fact, neither candidate for President has put forth a debt reduction plan, or even discussed it in a significant way. In fact, both candidates' proposals would increase the national debt.[10] Politicians are talking about jobs, the economy and national security. They must acknowledge that a skyrocketing federal debt compromises all of these vital interests. ■

10 Committee for a Responsible Federal Budget, *Promises and Price Tags: A Fiscal Guide to the 2016 Election*, June 27, 2016.

ABOUT FLORIDA TAXWATCH

As an independent, nonpartisan, nonprofit taxpayer research institute and government watchdog, it is the mission of Florida TaxWatch to provide the citizens of Florida and public officials with high quality, independent research and analysis of issues related to state and local government taxation, expenditures, policies, and programs. Florida TaxWatch works to improve the productivity and accountability of Florida government. Its research recommends productivity enhancements and explains the statewide impact of fiscal and economic policies and practices on citizens and businesses.

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