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CBO'S BUDGET UPDATE

THE LOOMING LOST DECADE

Deficits and Debt Explode; Jobs and Economy Stagnate

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The Congressional Budget Office [CBO] released its updated budget and economic outlook. Key highlights from the report include:

- This year's deficit is estimated to be \$1.3 trillion. As a share of the economy, the deficit is 9.1 percent, roughly three times the average of the past 40 years.
- The debt held by the public is projected to rise to \$9 trillion – or 62 percent of the economy – this year, nearly twice the 40-year historical average. Total debt, including borrowing from the Social Security trust fund and other Federal funds, will rise to \$13.5 trillion.
- The CBO also estimates that economic growth will remain sluggish over the next few years, and unemployment will remain unbearably high for years to come. The looming tax increases and health care overhaul both contribute to slower growth and fewer jobs. The unemployment rate is projected to remain at 9 percent or higher for the next two years, and does not return to pre-recession levels until the latter part of the decade.

According to House Budget Committee Ranking Republican Paul Ryan: “[The CBO] confirmed what we have feared: that Congress and the administration have put us on the path to our own lost decade.”¹

The following describes additional details on CBO's [*The Budget and Economic Outlook – Fiscal Years 2010-2020: An Update.*](#)

THE BUDGET OUTLOOK

By convention, CBO's “baseline” estimates reflect “current law,” which assumes that all policy changes scheduled to occur will, in fact, occur – however unlikely that outcome may be. Under current law, income tax rates would rise to levels that existed before 2001; the child tax credit would be cut in half; the estate tax would return; payments to physicians providing care to Medicare beneficiaries would be cut by 26 percent; and relief from the alternative minimum tax [AMT] would expire and lead to an average tax increase of \$3,900 for 23 million taxpayers.²

Because no one expects current law to be left unchanged, the CBO baseline does not produce a good picture of what the likely fiscal path will be. As a result, CBO's projections for fiscal year 2010 – where there is little chance for Congress or the administration to make significant policy changes – are the most relevant.

Authorized by Paul D. Ryan, Ranking Republican

To get an idea of the outlook beyond 2010, CBO provides other potential spending and tax scenarios, including one in which today's tax rates – established under the 2001 and 2003 tax laws – are extended forward without change. This projection, reflecting no tax increases, provides an arguably more neutral revenue baseline for comparison with the estimated growth in spending.

- *Deficits.* This year's deficit is projected to reach \$1.3 trillion, and on its current path, Federal spending will exceed revenue generated under current law by \$6.2 trillion through 2020, CBO's report says (see Table 1). Next year's deficit in that scenario will reach \$1.1 trillion, about \$70 billion more than CBO projected in January.

But these figures assume a \$3.9 trillion tax increase over 10 years from the increase in tax rates scheduled to occur in January. If current tax rates were kept the same as they are today – with no tax increases – spending would outrun tax revenue by an additional \$10 trillion over 10 years, CBO's figures show.

Table 1: CBO's 'Current-Law' Projections of Spending, Revenues, and Deficits, 2010-20

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2011-20
In Billions of Dollars												
Revenues	2,143	2,648	2,953	3,236	3,561	3,743	3,975	4,201	4,421	4,640	4,856	38,234
Outlays	3,485	3,714	3,618	3,760	4,000	4,250	4,560	4,780	4,983	5,274	5,541	44,480
Deficits	1,342	1,066	665	525	438	507	585	579	562	634	685	6,246
Debt Held by the Public	9,031	10,007	10,790	11,422	11,950	12,544	13,214	13,885	14,546	15,281	16,073	n/a
As Percentages of Gross Domestic Product												
Revenues	14.6	17.5	18.7	19.4	20.1	20.1	20.4	20.6	20.8	20.9	21.0	20.1
Outlays	23.8	24.5	23.0	22.5	22.5	22.8	23.4	23.4	23.4	23.8	23.9	23.3
Deficits	9.1	7.0	4.2	3.1	2.5	2.7	3.0	2.8	2.6	2.9	3.0	3.3
Debt Held by the Public	61.6	66.1	68.5	68.4	67.3	67.3	67.7	68.1	68.3	68.8	69.4	n/a

Note: These figures reflect CBO's "current-law" projections, which assume, among other things, that current tax rates will rise, the alternative minimum tax will expand, and overall taxes will increase by \$3.9 trillion over the next 10 years.

Source: Congressional Budget Office: *The Budget and Economic Outlook - Fiscal Years 2010-20: An Update*

- *Debt.* Relative to the 2008 level (\$5.8 trillion), debt held by the public rises to \$9 trillion. As a share of the economy, the debt rises to 62 percent of gross domestic product [GDP] in 2010. The forty-year historical average is 36.2 percent. Total debt, including borrowings from the Social Security Trust Fund and other funds, rises to \$13.5 trillion in 2010.

- *Spending.* Due to the explosion in spending from the \$814 billion stimulus bill, the double-digit increases in non-defense appropriations, and other increases, spending will reach \$3.5 trillion in 2010. As a share of the economy, spending in 2010 will be 23.8 percent of GDP, compared to a forty-year historical average of 20.7 percent.
- *Revenues and Tax Increases.* Despite a weak economy, revenues rise by \$38 billion in 2010 after dropping two years in a row. As noted, CBO's "current-law" baseline assumes tax increases in excess of \$3.9 trillion over the next 10 years, mainly due to a scheduled rise in tax rates and expansion of the AMT. On that path, Federal taxes would total \$4.9 trillion in 2020, or 21 percent of GDP, their highest burden on the economy in history.

ECONOMIC ASSUMPTIONS

CBO's latest economic forecast, coming 18 months after the passage of a stimulus bill purportedly designed to turn the economy around and spark a renewal in job creation, paints a sobering picture. The economy is expected to remain weak for quite some time, causing the unemployment rate to linger at a painfully high level. Meanwhile, CBO points out that certain legislative initiatives, such as the recently-passed health care bill and the expected lapse of 2001 and 2003 tax relief measures, will hamper growth prospects and labor force participation over the longer-term. All in all, the assessment generally confirms the fear among some analysts that the U.S. may be flirting with its own "lost decade," an extended period of sub-par economic growth and persistently high unemployment.

- *Economic Growth.* CBO projects real GDP to grow by 3.0 percent this year before declining to just over 2.0 percent in 2011, anemic relative to the usual robust growth following a recession. The fallback in growth next year is due to the planned lapse of tax relief measures, which will shave a full percentage point off of GDP, according to CBO.
- *Unemployment.* Unemployment continues to be the most discouraging aspect of the report. CBO expects "sluggish" employment growth for the next few years, and projects the unemployment rate to remain at or above 9.0 percent this year and next. As job creation is expected to remain weak for some time, the unemployment rate will linger at a high level and only dip back to a pre-recession level of 5.0 percent in the latter part of the decade.
- *Impact of Tax Hikes.* CBO estimates that the planned tax hikes next year will cause the economy to grow slower than it otherwise would, resulting in a higher unemployment rate. The tax hikes will trim GDP growth by roughly 1 percentage point next year, which translates to \$237 billion in lost income to American families, workers, and businesses. In the absence of tax hikes next year, CBO estimates that the unemployment rate would be as much as 0.8 percentage points lower by late 2011. Given that the U.S. labor force is over 153 million, the difference between a 9.1 percent unemployment rate (as CBO predicts for 2011) and an 8.3 percent unemployment rate is roughly 1.2 million jobs.
- *Inflation.* CBO has lowered its expectation for near-term inflation rates, now expecting the consumer price index [CPI] to range between 1.0 and 1.6 percent over the next few years. At the same time, CBO has increased its forecast for inflation rates later this decade (i.e. over 2.0 percent CPI growth) due in part to the risk that the Federal Reserve's

unprecedented monetary stimulus during this recession could cause higher inflation expectations or a future asset bubble down the road.

- *Interest Rates.* CBO projects that the rates on long and short-term Treasuries will remain low for the next few years. These rates will normalize and begin to drift upward throughout the decade, as growth picks up along with inflation, so that the 10-year Treasury is expected to yield nearly 6.0 percent by 2020.

Table 2: CBO Economic Assumptions
(percentage change, year to year)

	Forecast		Projected Annual Average	
	2010	2011	2012-14	2015-20
Real GDP (year/year)	3.0	2.1	4.1	2.4
Consumer Price Index	1.6	1.0	1.7	2.3
Unemployment Rate	9.5	9.0	6.7	5.0
91-Day Treasury Bills	0.2	0.2	2.8	4.9
10-Year Treasury Notes	3.4	3.5	4.7	5.9

Source: Congressional Budget Office: *The Budget and Economic Outlook - Fiscal Years 2010-20: An Update.*

¹ Source: House Budget Committee Ranking Member Paul Ryan statement on CBO's Budget and Economic Outlook Update: http://www.house.gov/budget_republicans/cbouupdate8192010.pdf

² Source: Congressional Budget Office, *The Alternative Minimum Tax*, Economic and Budget Issue Brief, January 15, 2010 http://www.cbo.gov/ftpdocs/108xx/doc10800/01-15-AMT_Brief.pdf.

This document was prepared by the Republican staff of the Committee on the Budget, U.S. House of Representatives. It has not been approved by the full committee and may not reflect the views of individual committee members.