CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas W. Elmendorf, Director

August 3, 2010

Honorable Kent Conrad
Chairman
Committee on the Budget
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

In responding to questions raised by Congressional staff and outside analysts, the Congressional Budget Office (CBO) has found some errors in one section of its report *The Long-Term Budget Outlook*, which was released on June 30, 2010. To correct those errors, CBO is issuing a revised version of the report.

The errors did not affect CBO's primary findings—the long-term budget projections under the extended-baseline scenario and the alternative fiscal scenario—as discussed in the summary of the report, nor did they affect numbers presented in any of the tables. Rather, the errors were limited to the analysis of how the projected growth of debt would reduce, or crowd out, private investment and thereby lower gross domestic product (GDP) in the United States. The corrected estimates of the effects of crowding out on GDP are smaller than those shown in the original report. Also, the effects of crowding out on gross national product (which equals GDP plus income received from other countries minus income sent abroad) are now shown; those effects were discussed in last year's *Long-Term Budget Outlook* (released in June 2009) but were not included in the original publication this year.

A discussion of the original and revised projections of the crowding-out effects is attached. The changes affect Figures 1-5 and 1-6 of the report and related text. A complete copy of the revised report will be transmitted to you; the changes appear on pages 19 through 22.

I apologize for any confusion caused by these errors. If you have any questions, please contact me or Bob Sunshine.

Sincerely,

Douglas W. Elmendorf

Douglas W. Elmendorf
Director

Attachment

Identical letter sent to the Honorable John M. Spratt Jr.

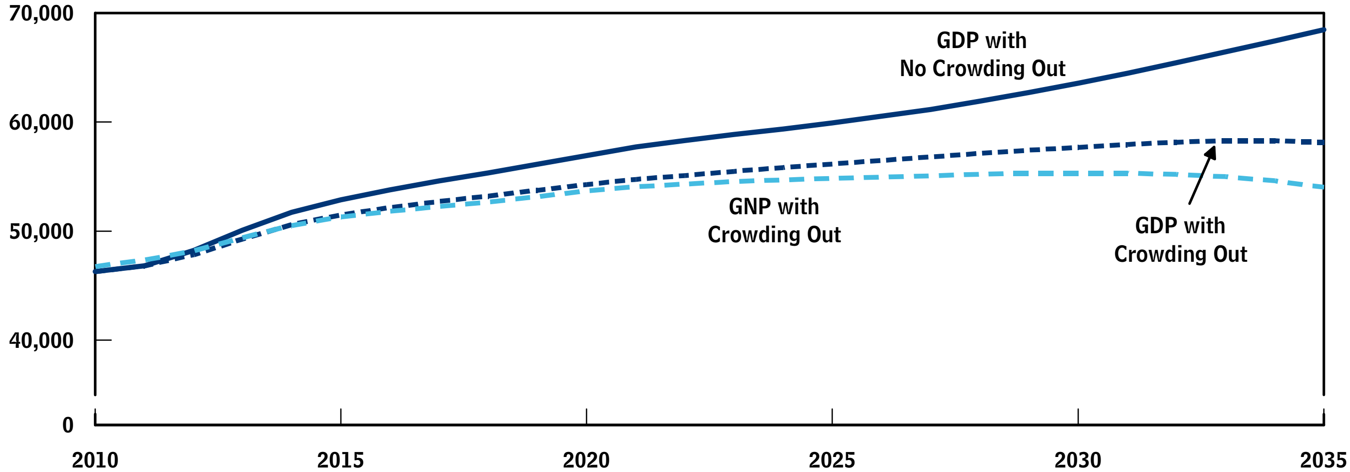
cc: Honorable Judd Gregg
Ranking Member

Attachment:
Original and Revised Projections of Crowding-Out Effects in *The Long-Term Budget Outlook*, 2010

Figure 1-5. (Revised, August 3, 2010)

The Effects of Crowding Out on Real GDP and GNP per Person Under CBO's Alternative Fiscal Scenario

(2010 dollars)



Source: Congressional Budget Office.

Notes: "Crowding out" refers to the fact that government borrowing (to finance deficits) tends to crowd out private investment in productive capital, leading to a smaller capital stock and lower output and income in the long run than would otherwise occur.

The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 3 of *The Long-Term Budget Outlook*, June 2010).

The values for GNP with no crowding out (not shown here) are about the same as those for GDP with no crowding out.

GDP = gross domestic product; GNP = gross national product.

Increased government borrowing tends to crowd out private investment in productive capital, leading to a smaller capital stock and lower output in the long run than would otherwise be the case. Under CBO's alternative fiscal scenario, crowding out would reduce inflation-adjusted gross domestic product (GDP) per person by 6 percent in 2025 and by 15 percent in 2035, CBO estimates. (CBO's long-term budget scenarios are described in Table 1-1 on page 3 of *The Long-Term Budget Outlook*.)

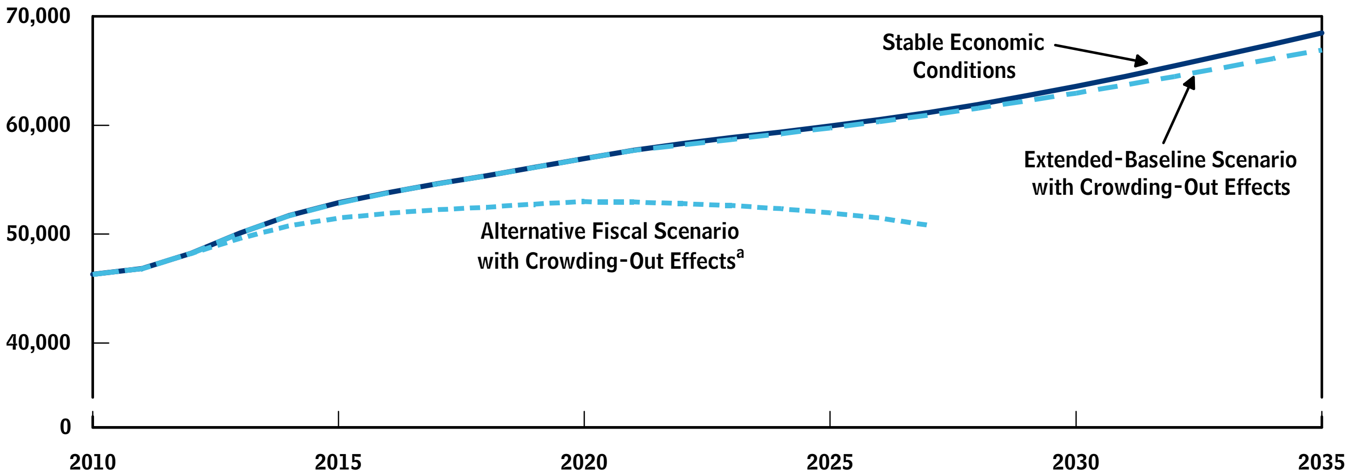
Because part of the growing budget deficits projected for coming years would be financed by capital inflows from other countries, a rising portion of GDP would have to be sent abroad as profits or interest on those capital inflows and thus would not be available to U.S. households. For that reason, the effects of crowding out on GDP (which is equal to all income earned from productive activities in the United States) would be smaller than the effects on gross national product (GNP, which equals GDP plus income received from other countries minus income sent abroad). Under the alternative fiscal scenario, crowding out would reduce inflation-adjusted GNP per person by 8 percent in 2025 and by 21 percent in 2035, CBO estimates.

Under CBO's extended-baseline scenario, crowding-out effects would be quite small. Inflation-adjusted GDP and GNP per person would be slightly lower than they would be with no crowding out.

Figure 1-5. (Original, June 30, 2010)

Real GDP per Capita Under Stable Economic Conditions or with Crowding-Out Effects

(2010 dollars)



Source: Congressional Budget Office.

Notes: "Crowding out" refers to the fact that government borrowing (to finance deficits) tends to crowd out private investment in productive capital, leading to a smaller capital stock and lower output in the long run than would otherwise occur. The stable economic conditions that CBO used in making its long-term budget projections under both scenarios included assumptions—after 2020—of a constant real (inflation-adjusted) interest rate on federal debt and steady growth rates for real wages and output.

The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2020 (with adjustments for the recently enacted health care legislation) and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 3 of *The Long-Term Budget Outlook*, June 2010).

GDP = gross domestic product.

a. Results could not be estimated beyond 2027 for the alternative fiscal scenario with crowding-out effects because the simple crowding-out assumption used in this analysis does not yield realistic results in later years under that scenario.

Comparing the original (June 30, 2010) and revised (August 3, 2010) versions of Figure 1-5:

- The projection labeled "Stable Economic Conditions" in the original is identical to the projection labeled "GDP with No Crowding Out" in the revision.

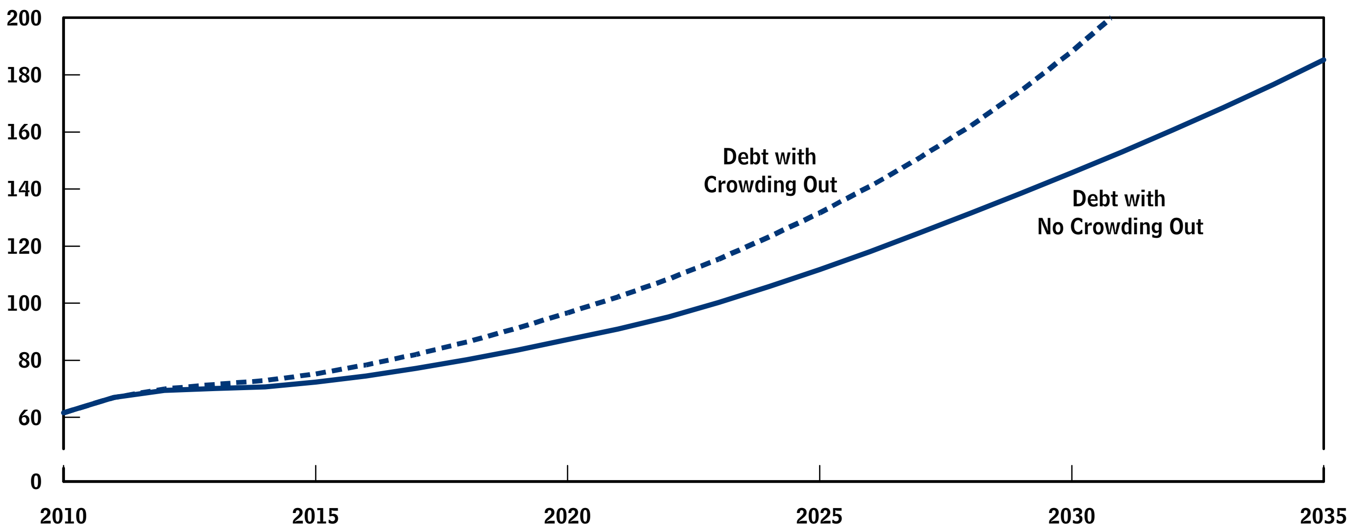
- For the projection in the original figure labeled "Extended-Baseline Scenario with Crowding-Out Effects," no corresponding projection is shown in the revised figure. As in the original, the revised estimates of the effects of crowding out on GDP per person under the extended-baseline scenario are small, and there is little difference between the revised estimates of GDP with and without crowding out.

- The projection labeled "Alternative Fiscal Scenario with Crowding-Out Effects" in the original figure corresponds to the projection labeled "GDP with Crowding Out" in the revision. The original projection included errors that have been corrected in the revision. The revised estimates reflect less crowding out, and GDP in each year is higher. In the original projection, results could not be estimated beyond 2027; the revised estimates extend beyond 2035.

Figure 1-6. (Revised, August 3, 2010)

The Effects of Crowding Out on Federal Debt Held by the Public Under CBO's Alternative Fiscal Scenario

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: "Crowding out" refers to the fact that government borrowing (to finance deficits) tends to crowd out private investment in productive capital, leading to a smaller capital stock and lower output and income in the long run than would otherwise occur.

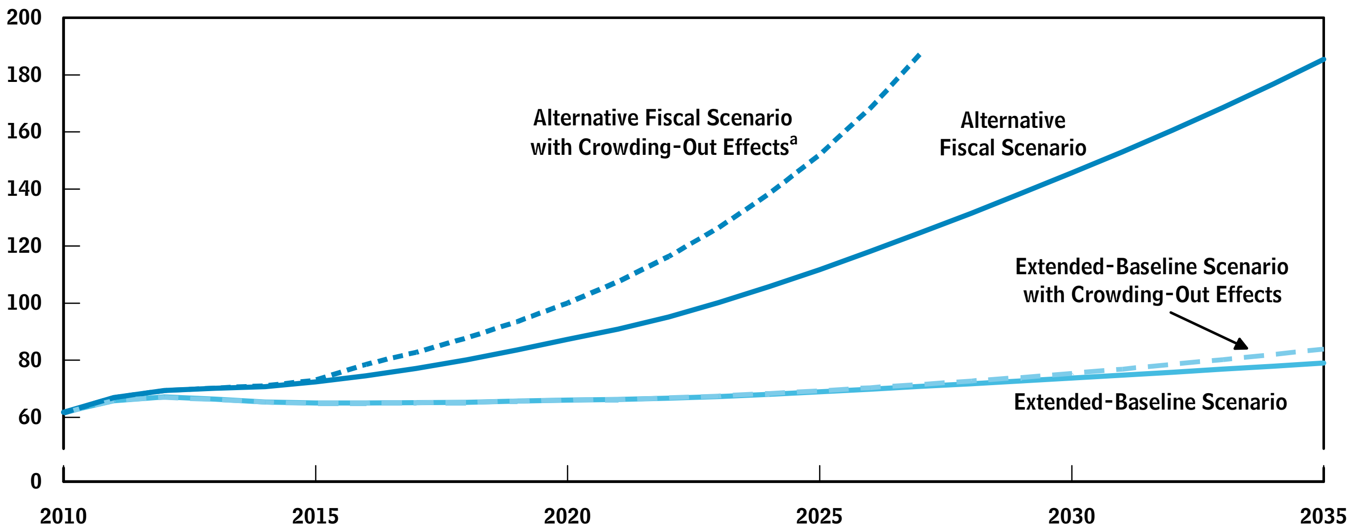
The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 3 of *The Long-Term Budget Outlook*, June 2010).

Incorporating the lower output and higher interest rates implied by crowding out would accelerate the projected growth of debt as a percentage of GDP. As a result, under the alternative fiscal scenario, debt as a percentage of GDP would be substantially higher with crowding out than it would be with no crowding out.

Figure 1-6. (Original, June 30, 2010)

Federal Debt Held by the Public With and Without Crowding-Out Effects

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: "Crowding out" refers to the fact that government borrowing (to finance deficits) tends to crowd out private investment in productive capital, leading to a smaller capital stock and lower output in the long run than would otherwise occur. The stable economic conditions that CBO used in making its long-term budget projections under both scenarios included assumptions—after 2020—of a constant real (inflation-adjusted) interest rate on federal debt and steady growth rates for real wages and output.

The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2020 (with adjustments for the recently enacted health care legislation) and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 3 of *The Long-Term Budget Outlook*, June 2010).

a. Results could not be estimated beyond 2027 for the alternative fiscal scenario with crowding-out effects because the simple crowding-out assumption used in this analysis does not yield realistic results in later years under that scenario.

Comparing the original (June 30, 2010) and revised (August 3, 2010) versions of Figure 1-6:

- The projection labeled "Alternative Fiscal Scenario" in the original is identical to the projection labeled "Debt with No Crowding Out" in the revision.

- Projections like those in the original figure labeled "Extended-Baseline Scenario" and "Extended-Baseline Scenario with Crowding-Out Effects" are not shown in the revised figure. Estimates of the extended baseline scenario with no crowding out are not affected by the revision. As in the original, the revised estimates of the effects of crowding out on federal debt held by the public under the extended-baseline scenario are small, and the estimates of debt with and without crowding out are similar.

- The projection labeled "Alternative Fiscal Scenario with Crowding-Out Effects" in the original figure corresponds to the projection labeled "Debt with Crowding Out" in the revision. The original projection included errors that have been corrected in the revision. The revised estimates reflect less crowding out, and debt in each year is lower. In the original projection, results could not be estimated after 2027; the revised estimates extend beyond 2035 but are shown only until they reach 200 percent of GDP, during 2031.