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Are We There Yet?: On a Path to Closing America's Long-Run Deficit

David Kamin
NYU School of Law, kamin@nyu.edu

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http://lsr.nellco.org/nyu_plltwp/359

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Are We There Yet? On a Path to Closing America’s Long-Run Deficit

By David Kamin



David Kamin

David Kamin is an assistant professor at New York University School of Law. Until recently, he served at the White House as special assistant to the president for economic policy, focusing on budget and tax policy.

Many decry the fact that policymakers are nowhere close to addressing the long-term fiscal shortfall and as evidence they point to the Congressional Budget Office’s projection of enormous long-term deficits under current policy. This report contends that the minimum deficit reduction incorporated in leading progressive and conservative budgets can put us on a path toward closing the long-term deficit. A significant gap would remain even if consensus were fully realized. However, this report describes a plausible path for further cutting the long-term deficit, as well as important revenue and spending backstops. Finally, it explains that while the country can and should try to reach a fiscally sustainable path, because of the uncertainty surrounding many of those reforms — especially the restructuring of the healthcare system — we cannot expect an immediate solution.

Photo credit: Juliana Thomas.

IV. The Path Forward	66
A. The Bargaining Space	66
B. Further Steps — and Backstops	67
V. Conclusion	69
Appendix: CBO’s Alternative Fiscal Scenario vs. Minimum ‘Consensus’ Deficit Reduction	
	70

I. Introduction

It is the classic refrain on the long car ride: “Are we there yet?” Policymakers are now under the gun of large tax increases and spending cuts scheduled for the end of the year, and as they enter yet another round of high-stakes budget negotiations, that same question will inevitably be asked about our long-term fiscal future: “Are we there yet?” Or, put differently and just a bit more technically: “Are the tax increases and spending cuts under discussion sufficient to address the long-term fiscal problem?”

Many budget observers, including those writing in these pages, have concluded that a very large change is needed; that following the current policy course is a recipe for disaster; and that the measures political leaders on both sides of the aisle have seriously considered are entirely insufficient.¹ In other words, they answer the question by saying, “We are nowhere close to addressing the long-term fiscal shortfall.”

This report takes a different view and contends that a set of “consensus” deficit reduction measures (the minimum deficit reduction incorporated in *both* leading progressive and conservative budgets) can put us on a path toward closing the long-run fiscal gap. In fact, several of these measures are already embodied in current law. While a sizable gap would remain even if this consensus were fully realized, there is a plausible path for shrinking the long-term deficit further — with important revenue and spending backstops to potentially help along the way. Finally, this report argues that to an important degree, the question posed in its title is the wrong one, for now. When it comes to the long-term

Table of Contents

I. Introduction	53
II. The Long-Term Deficit: CBO Projections	55
A. Current Law Versus Current Policy	55
B. Medium- Versus Long-Term Adjustments	56
C. Why a Focus on the Long-Term Deficit?	58
III. Steps Toward a Solution	58
A. ‘Consensus’ Deficit Reduction	58
B. Reducing the Growth Rate of Medicare	60
C. Ramping Down Discretionary Spending	63
D. Other Mandatory Spending	64
E. Revenues Equal to About 19 Percent of GDP	65

¹See, e.g., Alan J. Auerbach and William G. Gale, “Tempting Fate: The Federal Budget Outlook,” *Tax Notes*, July 25, 2011, p. 375, *Doc 2011-15113*, or *2011 TNT 143-7* (arguing that avoiding a fiscal crisis “will require significant and sustained changes to spending and revenue policies — much larger changes than have received serious consideration in the policy process to date”).

deficit, we can and should put ourselves on a path toward sustainability, but we cannot guarantee arrival at our destination. That is because of the vast uncertainty that surrounds many of these reforms, especially the restructuring of the healthcare system.

This analysis starts off with the Congressional Budget Office projections, which tend to be the lodestar in budget debates. In June the CBO released its latest annual long-run projection for the federal budget.² Based on “current policies,” the CBO projection showed a gaping long-run fiscal shortfall equivalent to just fewer than 9 percent of GDP over the next 75 years. In other words, according to the CBO, stabilizing the debt-to-GDP ratio over the long run would require a combination of \$1.3 trillion in spending cuts and revenue increases *per year and starting immediately* — and growing with the economy. It is numbers like these that often (and rightly, given their magnitude) lead to calls for major budget reforms that go well beyond any current bipartisan consensus.³

However, that “current policy” projection does not recognize much of the progress that policymakers have already made. This report contrasts the CBO’s current policy projection to a projection that embodies what I define as “consensus” deficit reduction measures in the leading progressive and conservative budget proposals (President Obama’s budget and the House budget resolution, respectively). These measures cut the long-term deficit in half relative to the CBO’s current policy projection. Note that several of these proposals, such as considerably slowing Medicare growth and ramping down discretionary spending, are already embod-

ied in current law, at least in some form. The CBO’s current policy projection essentially assumes that these enacted measures are reversed by Congress and not replaced with other deficit reduction — thus undoing progress that has been made.

This projection also helps define the future bargaining space, assuming progressive and conservative forces both continue to hold power in the budget negotiations. Relative to this consensus, stabilizing the debt-to-GDP ratio over the next decade would involve adjusting revenues up and spending down by about 5 percent over the next decade. That grows to an adjustment in the range of 15 percent of revenues and spending toward the end of the 75-year projection window. No doubt, over the long term these are significant adjustments, but they are not necessarily overwhelming ones.

From here, this report lays out two steps that would cut the long-term deficit in half again. The first step is to stabilize the debt over the next decade. The point is not to “assume away” the deficit problem, but rather to ask how large long-term adjustments must be — assuming we meet medium-term deficit reduction goals. The second step is to restore solvency to Social Security. Policymakers have yet to reach a consensus on Social Security (and, in fact, neither Obama nor Republican congressional leadership have offered specific plans), but it seems likely that policymakers will eventually act to preserve the system’s solvency.

Finally, this report explores two backstops that could help close much, if not all, of the remaining long-term fiscal shortfall, even in the absence of any additional deficit reduction measures. One is on the tax side: Over the long term, revenue would automatically increase as a share of the economy in the absence of additional tax cuts — and this backstop was recently expanded significantly in the Patient Protection and Affordable Care Act (PPACA). The second is on the spending side: Over the long term, discretionary spending would fall significantly as a share of the economy if appropriations are not increased above the official current services baseline (or even if it grows somewhat faster than that — for example, with inflation and population).

To be clear, we do face a significant long-term fiscal challenge. Achieving fiscal sustainability will require tough choices. However, those decisions must inevitably be made; that is the one certainty in long-term projections — what is unsustainable will not be sustained. The questions are how that transition will occur and whether it will be a smooth or rough one. Policymakers have already taken steps toward answering the “how.” Denying that progress — or automatically assuming that it will be reversed — fails to give credit where credit is

²CBO, “The 2012 Long-Term Budget Outlook” (June 2012), *Doc 2012-12113*, *2012 TNT 109-23*. In August the CBO released the mid-year update to its 10-year budget projection. That update showed a moderate improvement in the budget outlook caused by “economic and technical” factors. Specifically, it shows an almost 0.4 percent improvement in the deficit under CBO’s baseline projection toward the end of the 10-year projection window. The CBO did not update its long-term projection. This report uses numbers consistent with the CBO’s June report, because that is CBO’s last long-term projection. If changed to reflect CBO’s latest medium-term budget outlook, the deficit projections in this report would be modestly improved. See CBO, “An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022,” tbl. A-1, at 50 (Aug. 2012), *Doc 2012-17803*, *2012 TNT 164-13*.

³See, e.g., “The Congressional Budget Office’s Long-Term Budget Outlook: Hearing Before the House Budget Committee,” 112th Congress (2012) (statement of Chair Paul Ryan, R-Wis.) (“The report is sobering and the warnings are dire. . . . Unfortunately, the Administration has no definitive solution to the problem we face, but merely obstruction to those who do put forth good faith solutions. . . . We reject the empty promises and continued inaction in the face of a crisis”).

due. It also strains logic, because it denies improvement even when improvement is absolutely requisite. Moreover, the approach of denial or assumed reversal can justify ever-more-radical solutions, even when the ones on the table might work.

Importantly, the long-term deficit problem is exactly that — long term. We will not know for some time whether some of the most important measures — such as slowing healthcare cost growth — will function as intended. But that is acceptable and inevitable. When it comes to the long-term deficit, policymakers can, at most, set out a desired path and be ready to adjust it depending on outcomes. When it comes to setting a desired path, we are much closer than many realize, and we have long-term fiscal backstops at our disposal that often go unrecognized.

II. The Long-Term Deficit: CBO Projections

A. Current Law Versus Current Policy

Each year, the CBO releases a long-term projection of the federal budget — projections that are familiar to policymakers and budget analysts and now serve as center points in the fiscal debate.⁴

The most recent projection released in June depicts two radically different paths for the budget. The first is the “extended baseline scenario” — something akin to “current law” — and this shows a long-term fiscal situation that is under control. In fact, this projection indicates that spending could be permanently *increased* and taxes permanently *cut* by 1 percent of GDP and still maintain a stable debt-to-GDP ratio over the next 75 years (a measure known as the “fiscal gap” or, in this case, perhaps better called the “fiscal surplus”).⁵ CBO’s other path is the “extended alternative fiscal scenario,” which depicts deficits exploding in the years ahead, requiring radical change to avoid that outcome. Under this policy scenario, taxes must be permanently raised and spending cut by nearly 9 percent of GDP to maintain a stable debt-to-GDP ratio over the next 75 years — a massive adjustment.

What to make of these two very different visions of the budget trajectory?

The extended baseline scenario is widely — and rightly — dismissed by analysts and policymakers as a fiction that is unrepresentative of the federal government’s fiscal position.⁶ The baseline is now

replete with cliffs and expirations that few if any policymakers intend to occur. On the tax side, this scenario assumes that the 2001 and 2003 tax cuts entirely expire at the end of this year and that the alternative minimum tax is allowed to explode to cover about 30 million taxpayers as of this year.⁷ On the spending side, the \$1 trillion sequester in the Budget Control Act (BCA) is assumed to take effect in January,⁸ and healthcare costs are held at bay by a combination of an immediate, nearly 30 percent cut in physician reimbursements in Medicare under the much-maligned sustainable growth rate (SGR) formula and healthcare reform’s formula-based limits on Medicare.⁹ No prominent policymakers come close to endorsing this full combination of policies.

The fact that “current law” cannot be used as a benchmark is widely accepted. As a result, the CBO supplies an “alternative fiscal scenario,” which many now use as a benchmark of America’s fiscal trajectory. In the CBO’s own words, that scenario assumes “that certain policies that have been in place for a number of years will be continued and that some provisions of law that might be difficult to sustain for a long period will be modified, thus maintaining what some analysts might consider ‘current policies,’ as opposed to ‘current laws.’”¹⁰ Among other changes relative to current law, the alternative fiscal scenario involves continuing almost all the tax cuts now in place and, on the spending side, undoing the \$1 trillion spending sequester and the automatic cutback in Medicare under the SGR that are scheduled for the end of this year.¹¹

For the most part, this alternative fiscal scenario is what analysts, policymakers, and reporters emphasize as best representing the current fiscal trajectory — and under it, the deficits are large and growing. Appendix Table 1 lists the assumptions under the alternative fiscal scenario (and compares

Hearing Before the Senate Budget Committee,” 112th Congress (2012) (remarks of Chair Kent Conrad, D-N.D.) (focusing only on the CBO’s alternative fiscal scenario in describing the budget outlook).

⁷See CBO, *supra* note 2, at 80-84 (describing revenue assumptions in the extended baseline scenario). See also CBO, “The Budget and Economic Outlook: Fiscal Years 2012 to 2022,” at 82-83 (Jan. 2012), *Doc 2012-1855*, 2012 TNT 21-26 (describing scheduled changes in tax law incorporated in the baseline scenario).

⁸For details on sequestration, see CBO, “Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act” (Sept. 2011).

⁹CBO, *supra* note 2, at 47-49 (detailing Medicare assumptions in the extended baseline scenario).

¹⁰*Id.* at 2.

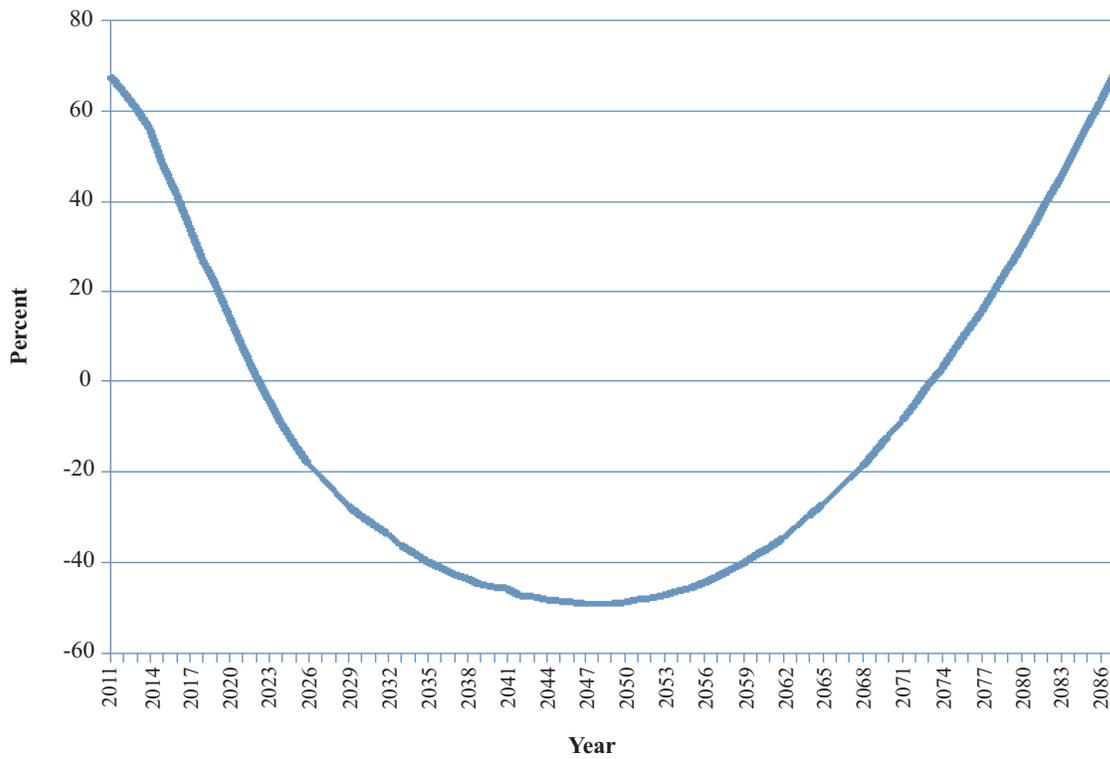
¹¹*Id.* at 8, tbl. 1-1 (comparing the alternative fiscal scenario and extended baseline scenario).

⁴CBO, *supra* note 2.

⁵*Id.* at 21, tbl. 1-3.

⁶As the CBO itself describes, “Many budget analysts believe that the extended alternative fiscal scenario is more representative of the fiscal policies that are now (or have recently been) in effect than is the extended baseline scenario.” *Id.* at 3. See, e.g., “The Budget and Economic Outlook: Fiscal Years 2012-2022: (Footnote continued in next column.)

Figure 1. Debt Yo-Yo Effect of an Immediate 9 Percent Fiscal Adjustment Under CBO's Alternative Fiscal Scenario (Debt as a Share of the Economy)



Source: Author's calculations.

those to the “consensus” deficit reduction measures that this report describes later).

To be clear, the alternative fiscal scenario — or any projection of large, long-run deficits — is not in fact a depiction of what would ever happen over time. What is unsustainable must eventually end, and the deficits and debt under this projection rise to levels that markets simply would never bear. Instead, it is meant as a picture of the degree to which policymakers must (and inevitably will) change policy from the current course.

B. Medium- Versus Long-Term Adjustments

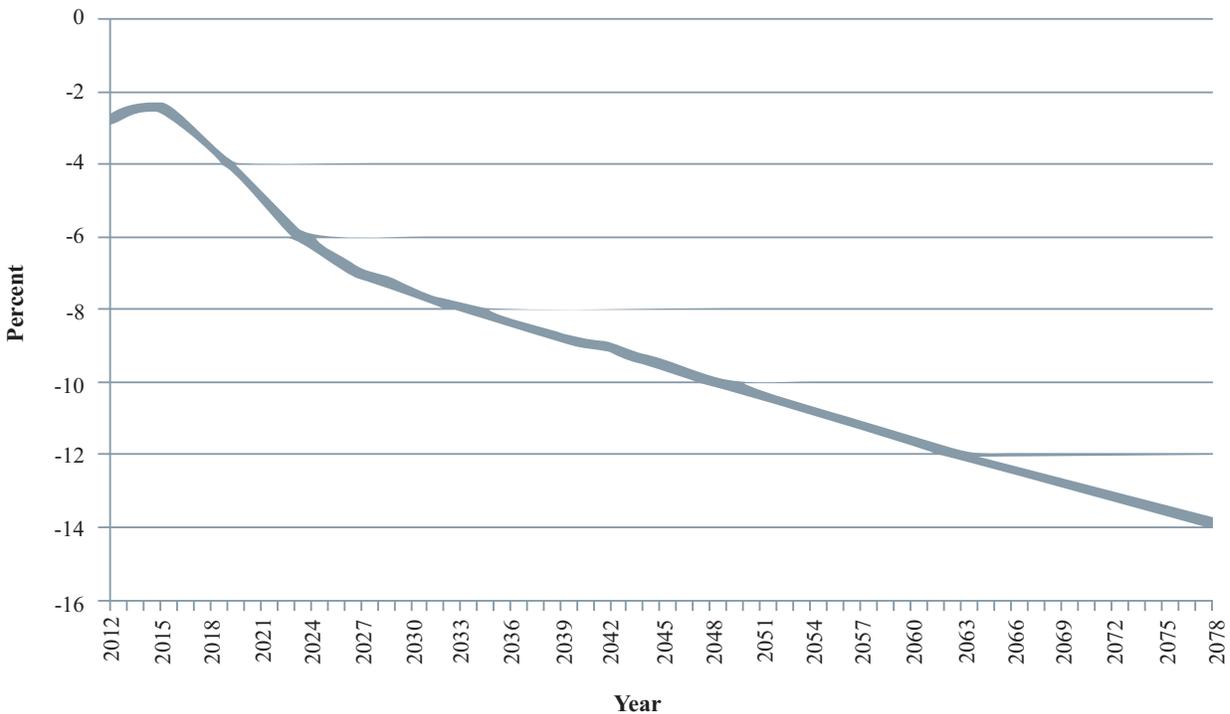
This report focuses on the long-term deficit, as opposed to the medium-term one. However, the CBO and budget analysts tend to measure the long-term deficit by a metric — the fiscal gap — that does not differentiate based on time.¹² The fiscal

gap represents the necessary *immediate* adjustment in spending and taxes to hold the debt-to-GDP ratio constant over a given period. As noted, the CBO calculates that the fiscal gap under current policies stands at nearly 9 percent of GDP over the next 75 years — a massive deficit. Analysts often focus on this as the long-term shortfall, but focusing on this alone elides a key point: the issue of timing.

While the long-term gap may be nearly 9 percent of GDP, an adjustment of this size now, through either tax increases or spending cuts, would generate a yo-yo effect on the debt — first way down and then way up. Figure 1 illustrates what would happen. An adjustment of that size now would produce surpluses in the next decade; the debt would be paid off by the early 2020s; and the federal government would proceed to build up net assets equal to nearly 50 percent of GDP by around 2050. From there, however, the fiscal position would deteriorate and debt would rocket back up. Yes, the debt at the end of the period would be the same as now, but only after it yo-yoed for 75 years. Note that this pattern is largely the result of a combination of the retirement of the baby boomers and compounding healthcare costs driving up spending over the very

¹²Auerbach was the first to develop the fiscal gap as a measure of long-term fiscal sustainability; see Auerbach, “The U.S. Fiscal Problem: Where We Are, How We Got Here, and Where We’re Going,” in 9 *NBER Macroeconomics Ann.* 141 (1994), and it has been widely adopted by other analysts since then, including the CBO.

Figure 2. Achieving Debt Stability in Each Decade: Policy Adjustment Needed as a Share of GDP Under CBO's Alternative Fiscal Scenario (10-Year Forward-Looking Rolling Average)



Source: Author's calculations.

long term, and the mismatch between this and an immediate 9 percent of GDP adjustment in revenues and spending.

From an economic and social perspective, the “optimal” pattern of deficits is a difficult question to answer — and a completely smooth pattern of deficits and debt may not be the right one. It depends in part on views about generational equity (how much to transfer from one generation to another) and efficiency (it is more efficient to have smooth marginal tax rates over time).¹³ Further, some economists may question the significance of annual cash deficits and debt as a metric at all, noting that cash flows may matter less to fiscal

sustainability and are much more easily manipulated than long-term measures of the deficit and debt.¹⁴

However, no policymakers — nor prominent deficit reduction advocates in Washington — have called for plans that would generate a yo-yo pattern like the one illustrated above, with historically unprecedented surpluses upfront and large deficits far out in the projection window. While the pattern of leading deficit reduction plans are not the same (nor is the magnitude of the deficit reduction), they are all characterized by a goal of relatively constant deficits over time (certainly relative to the above yo-yo pattern), once the deficit declines from its current heights. That is all that should be needed to achieve fiscal sustainability and avoid a loss of confidence in the federal government’s ability to pay. Thus, in the ongoing deficit-reduction debates,

¹³For a helpful overview of these issues, see generally Daniel Shaviro, “The Long-Term U.S. Fiscal Gap: Is the Main Concern Generational Inequity?” 77 *Geo. Wash. L. Rev.* 1298 (2009). See also Auerbach, “Long-Term Objectives for Government Debt,” in 65 *FinanzArchiv: Public Finance Analysis* 472, 490-494 (2009) (describing something akin to the yo-yo pattern as the optimal one for debt in the United States, while recognizing the practical difficulties of adhering to such a path).

¹⁴Shaviro, *supra* note 13, at 1301-1303 (“Deficits are a bad measure, no matter what substantive underlying concern motivates examining them, because they rely on short-term attributes of government cash flow that lack fundamental economic significance”).

timing matters to a degree that is not recognized in summary measures like the fiscal gap.

An alternative way to look at the long-term fiscal shortfall is in terms of the amount of deficit reduction policies — program cuts and revenue increases — needed to hold the debt-to-GDP ratio constant over shorter periods. Figure 2 shows this based on the CBO's alternative fiscal scenario — and using a forward-looking 10-year rolling average of the policy adjustment needed. It shows an adjustment of roughly 2 to 3 percent of GDP needed over the next decade. In the second decade, that increases to about 5 percent of GDP, with the rise driven largely by the CBO's assumption that discretionary spending returns to its historical average (an assumption discussed later). Finally, over the long term, the adjustment goes up dramatically as healthcare costs compound and the full effect of the baby boomers' retirement is felt: up to 10 percent of GDP in the 2050s and about 14 percent of GDP toward the end of the 75-year projection window.

C. Why a Focus on the Long-Term Deficit?

This report makes the long-term deficit its focus — and not because the medium term is not important or challenging. Rather, it focuses on the long term largely because the problems of stabilizing the debt over the long term and the medium term are different.

Over the next decade, the fiscal challenge is to shift from expansionary fiscal policy to moderate deficit reduction, without endangering the current recovery. The policy change needed to stabilize the debt as a share of the economy over the next decade is about 2 to 3 percent of GDP relative to the CBO's current policy projection. There is precedent for adjustments of that size. For example, the 1990 and 1993 budget packages produced combined deficit reduction of about 3 percent of GDP when fully phased in.¹⁵ For the most part, this medium-term deficit reduction will have to be achieved through measures that are quick to phase in, such as revenue increases and some spending cuts.

By contrast, the adjustment required in the long term is larger — and without any precedent in recent federal policymaking. When it comes to the long-term deficit, structural reforms of the major federal programs likely will play a much greater

role. It is this long-term deficit that motivates many to call for a fundamental revamping of the major entitlement programs.

This report explores the size of this long-term shortfall in light of recent policymaking. Size matters when it comes to the long-term deficit. Policymakers, and Obama especially, have claimed that they have made significant progress on the long-term deficit. Through healthcare reform, they say they have tackled one of the key drivers of long-run deficits — healthcare cost growth.¹⁶ Further, the administration has described last year's BCA as gradually reducing discretionary spending to its lowest level as a share of the economy on record (going back to the early 1960s).¹⁷ If despite these measures, the long-term deficit remains as vast as the CBO indicates, it suggests much more radical action is needed.

However, as explored in the next sections, the long-term shortfall is, in key senses, significantly smaller than it appears in the CBO's alternative fiscal scenario. There is some consensus around a set of measures, some of which are already enacted, that could be major steps toward taming the long-term deficit. To be clear, these measures would require great effort to enforce and to enact (although some are already in current law). Moreover, it is not clear how some will play out; only time will tell. But these estimates suggest that we have already made real progress on the long-term deficit; that there is opportunity for greater progress in a budget deal to come; and that the policies on the table are not necessarily mis-scaled to the problem at hand.

III. Steps Toward a Solution

A. 'Consensus' Deficit Reduction

This report offers an alternative projection of the long-term deficit based on "consensus" deficit reduction measures, for key areas: Medicare, discretionary spending, other mandatory spending, and revenues. I define these as deficit reduction measures that are incorporated in *both* the leading progressive and conservative proposals for deficit reduction now on the table — this year's president's budget and House budget resolution. It is essentially a least common denominator package of deficit reduction. Each of these budgets contains more deficit reduction than the other in different

¹⁵This calculation is based on the CBO estimates of the 1990 and 1993 deficit reduction packages. For these estimates, see CBO, "The Economic and Budget Outlook: Fiscal Years 1992-1996," at 66, tbl. III-3 (1991) (estimating deficit reduction from the 1990 package); CBO, "The Economic and Budget Outlook: An Update," 29, tbl. 2-2 (1993), Doc 93-9582, 93 TNT 187-4 (estimating deficit reduction from the 1993 package).

¹⁶See, e.g., The White House, "Deficit-Reducing Health Care Reform."

¹⁷See, e.g., The White House, "Lowering Discretionary Spending."

	Fiscal Adjustment Needed to Stabilize Debt Over Given Periods (Percentage of GDP)				
	75-Year Fiscal Gap (2012-2087)	2012-2022	2023-2037	2038-2062	2063-2087
Fiscal gap: CBO's alternative fiscal scenario	8.7%	2.4%	6.4%	9.7%	13%
Consensus Deficit Reduction Measures (Relative to CBO's Alternative Fiscal Scenario)					
1. Reduce Medicare growth rate	-1.5%	-0.1%	-0.6%	-1.6%	-2.9%
<i>Note:</i> Relative to historical excess cost growth	-3.3%	-0.5%	-1.5%	-3.2%	-6.6%
2. Discretionary spending cuts continued and war ramped down	-1.7%	-0.4%	-1.8%	-2%	-2%
3. Other mandatory spending maintaining current policy.	-0.6%	0%	-0.6%	-0.7%	-0.7%
4. Revenue equal to House budget resolution (19 percent of GDP in the long term)	-0.5%	-0.3%	-0.5%	-0.5%	-0.5%
Remaining fiscal gap	4.5%	1.6%	3%	4.9%	6.9%
<i>Source:</i> Author's calculations.					

areas. The projection offered by this report chooses the least from each and then shows how far that takes us.¹⁸

This consensus implies a significantly smaller long-run fiscal shortfall than indicated by the CBO's alternative fiscal scenario. As shown in Table 1, the consensus deficit reduction measures cut the 75-year fiscal gap roughly in half compared with what the CBO projects. Note that Table 1 shows a 75-year fiscal gap but also divides the fiscal gap into smaller periods. This differentiates the medium and long term. For example, these calculations show that for the 25-year period from 2063 through 2087, a total fiscal adjustment of 13 percent of GDP is needed to stabilize the debt under the CBO's alternative fiscal scenario (and assuming the debt had been held stable up to that point). Current consensus policies cut that amount in half.

Some might question whether this minimum deficit reduction package is at all meaningful. It could be seen as a mere figment of imagination and unmoored from reality. However, the CBO's alter-

native fiscal scenario, to which many policymakers and analysts assign considerable stock, is itself an imagining — and less meaningful in important ways than this minimum deficit reduction scenario. By projecting a continuation of unsustainable “current policy,” even when policymakers appear to be ready to change it (and, in some cases, have already enacted that change into law), the alternative fiscal scenario tends to deny improvement. It is to some degree a treadmill: The more Congress acts to change the fiscal picture, the more the CBO and other budget analysts assume that policymakers eventually will undo that.

Note that this report is not meant to be a wholesale criticism of the CBO. The CBO has been put in an impossible position. “Current law” (or something akin to it) was the CBO's longtime lodestar in its budget projections, and it was a plausible, if not always perfect, representation of the current policy course — and it minimized the degree of political judgment the CBO had to employ. In the 2000s, several policy decisions undermined the current law baseline as a representation of current policy. This included (1) the 2001 and 2003 tax cuts, which were enacted with the now-infamous 2010 expiration date (recently extended to the end of 2012) as a way to game the cost estimate; (2) a series of year-by-year temporary patches to the AMT to keep it from expanding to hit many middle-income earners; and (3) policymakers' year after year turning off the cuts to physician payments under the Medicare SGR formula but without enacting a permanent fix.

As current policy became increasingly separated from current law, the CBO joined other budget analysts in highlighting alternative projections that

¹⁸This consensus projection stands in contrast to the CBO's alternative fiscal scenario. Importantly, several other budget analysts also estimate smaller long-term fiscal gaps than the CBO does. For example, Auerbach and Gale have, most recently, estimated the 75-year fiscal gap to be between 5.2 and 6.8 percent of GDP under their current policy scenario. Auerbach and Gale, “The Federal Budget Outlook: No News Is Bad News,” Tax Policy Center, at 22, tbl. 3 (June 14, 2012), *Doc 2012-3438, 2012 TNT 34-62*. Their estimate is lower than the CBO's because, as in this analysis, they assume lower discretionary and other mandatory spending than the CBO does. Perhaps the greatest difference between this analysis and that of Auerbach and Gale is one of emphasis. Auerbach and Gale emphasize the size of the fiscal shortfall that remains, but they do not highlight the distance that has already been traveled and the plausible path forward, as well as the backstops that can kick in over time.

assumed current policies were continued.¹⁹ This brought with it calls to discern the actual course of policy. Understandably, this made it difficult for the CBO to differentiate between real (or what I call “consensus”) deficit reduction measures, which represent actual progress on the deficit, from changes for which there is no consensus and that are unlikely to be implemented.

This report is meant to clarify where we are based on the existing consensus. The remainder of this section discusses that consensus policy by policy, when it differs from what the CBO assumes.

B. Reducing the Growth Rate of Medicare

In the midst of the ongoing budget battles, the leading progressive and conservative budget plans have actually reached something of a consensus on the desired size, although not form, of Medicare — a consensus that has been largely overlooked. Both the president’s budget and the House budget resolution propose roughly the same rate of Medicare growth over the long run, which is a significant slowdown from the historical norm. So even while the two plans envision very different structures for the program, there is something of an agreement on the desirable amount of spending under Medicare. Thus the fight over Medicare is not so much about the size of the program but instead about how the program looks and who bears the burden of cuts.

Both the president’s plan and the House budget resolution cap Medicare “excess cost growth” at a rate of 0.5 percent over the long run.²⁰ Excess cost growth is the amount by which the growth of healthcare costs per capita exceeds the growth of GDP per capita.²¹ Excess cost growth of 0.5 percent would represent a significant break from the past. In recent decades, excess cost growth in Medicare

has averaged about 1.5 percentage points, adjusting for the age composition of the Medicare program. This closely mirrors the growth rate in the private sector.²² Because growth rates compound with time, reducing that rate by 1 percentage point from the recent historical trend has a significant effect on long-run deficits.

This section reviews these two very different plans to arrive at that excess cost growth target, and it considers their deficit effects. It then concludes by rejecting the criticism that plans to contain healthcare costs are really budget gimmicks, while at the same time arguing that the problem of unsustainable growth in healthcare costs cannot entirely be solved now.

1. Similar spending targets. It would, of course, set off guffaws to say that the two parties are approaching Medicare in the same way. Differences over Medicare continue to be at the center of the political debate. However, to repeat the point, the disagreement is not, for the most part, about the desired size of the program but instead about its form.

Obama’s approach to containing Medicare builds on the cost-containment measures that were already enacted in the PPACA. Many other articles have already described comprehensively the cost controls put in place there, and this report will not reiterate those in detail.²³ The takeaway is that the PPACA and the president’s budget largely seek to contain healthcare costs by reforming Medicare’s payment systems. These reforms both seek to change incentives for healthcare providers (such as by reducing payments to hospitals with high readmission rates and bundling payments to hospitals for services) and also more bluntly reduce payments to providers by, among other measures, reducing the growth rate of those payments to account for broader economic productivity growth. Finally, as a backstop to these reforms, the PPACA created an independent body, the Independent Payment Advisory Board, empowered to continue to change Medicare payment policies to hold Medicare growth within a specified target, and without the need for any action from Congress. That target was set at an excess cost growth rate of 1 percent

¹⁹In fact, several of the early criticisms of the CBO’s baseline scenario — as being an unrealistic depiction of the current fiscal course — were published in these pages. See, e.g., Gale and Peter R. Orszag, “Perspectives on the Budget Outlook,” *Tax Notes*, Feb. 10, 2003, p. 1005 (“The official projections significantly misrepresent the government’s underlying fiscal position because of unrealistic assumptions regarding the continuation of current policy”).

²⁰Office of Management and Budget, “Fiscal Year 2013 Budget of the United States Government,” 35 (2012) (proposing 0.5 percent target for excess cost growth); House Committee on the Budget, “The Path to Prosperity: A Blueprint for American Renewal, Fiscal Year 2013 Budget Resolution,” at 53 (Mar. 20, 2012), *Doc 2012-5826*, 2012 *TNT* 55-22 (“As a backup, the per capita cost of this reformed program for seniors reaching eligibility after 2023 could not exceed nominal GDP growth plus 0.5 percent. The President has repeatedly proposed empowering IPAB to hold Medicare growth to the same growth rate”).

²¹Note, however, that the House budget resolution would also allow an adjustment in the growth rates for the health status of those in the Medicare program while the president’s budget would not.

²²See CBO, *supra* note 2, at 53, tbl. 3-1.

²³For a summary of the PPACA’s cost-control elements, see generally Orszag and Ezekiel J. Emanuel, “Health Care Reform and Cost Control,” 363 *N.E. J. Med.* 601 (2010).

starting in 2020 (and lower than that from 2015-2019), and the president's budget proposes to lower this long-run target to a maximum of 0.5 percentage points.²⁴

The House budget resolution takes a decidedly different tack to arrive at a similar total Medicare spending level. First, despite Republicans having called for repealing the entire PPACA (and having sharply criticized several of the Medicare savings measures incorporated in that bill, which produce considerable savings), the House budget resolution fully incorporates those savings over the next decade or more — or, at the least, those savings are more than fully replaced with other largely unspecified savings. Second, starting in 2023, the House budget resolution calls for turning Medicare into a premium support system for new enrollees. In brief, this would involve giving a voucher worth a fixed amount of money to new enrollees (with the amount based on competitive bids from insurance companies to provide the same level of care as in the current Medicare program), and beneficiaries could choose to buy into either traditional Medicare or the private plans. The dollar value of these vouchers would be set to grow no faster than GDP plus 0.5 percentage points (also adjusted for risk and thus growing somewhat faster than under the president's plan). Finally, the House budget resolution calls for increasing the Medicare eligibility age to 67 between 2023 and 2034.²⁵

These two approaches to reducing Medicare costs are quite different. Obama's approach focuses largely on healthcare providers, both reducing payments and restructuring their incentives, and its backstop involves more of that. By contrast, the House budget resolution sees efficiencies in having insurance companies compete and in having beneficiaries choose among them. As its backstop, the House budget resolution would reduce the value of payments to beneficiaries (with those beneficiaries presumably making up the difference). There should be a considerable debate about which of these strategies is superior as a way to both successfully contain federal government costs and improve the healthcare system. But to repeat a key (and often

missed) point, *both* proposals target roughly the same rate of long-run federal healthcare cost growth.

When it comes to the desired size of the system, the proposals most significantly differ in two respects. First, the House budget resolution raises the retirement age to 67. According to public reports, Obama agreed to this as part of the deficit reduction talks last summer.²⁶ However, because that is not part of his budget, I do not count that here as part of the minimum deficit reduction package.²⁷ Second, while both the House budget resolution and the president's budget target the same excess cost growth rate, the House budget resolution in fact appears to allow for an adjustment for the risk profile of the Medicare population, while the president's budget does not. For purposes of the minimum deficit reduction package, I assume that adjustment is allowed (otherwise deficit reduction would be greater).

2. Effects on the long-term deficit. Based on the proposals in the president's budget and the House budget resolution, I define the minimum Medicare deficit reduction package as one that includes additional upfront Medicare savings (as in both the president's budget and the House budget resolution) and then holds long-term excess cost growth to 0.5 percent (adjusted for the changing age distribution in Medicare). This represents a significant break from the past and, if achieved, would produce considerable savings over the long term.

Compared with continued excess cost growth of 1.5 percentage points (the norm for the last few decades), a reduction to 0.5 percentage points would cut the long-run deficit by about 3 percentage points of GDP over the next 75 years, or 6 percentage points toward the end of the 75-year projection period. However, the effect relative to the

²⁶See, e.g., Lori Montgomery, "Partisan Divide on Debt Talks Growing Deeper," *The Washington Post*, at A1 (noting that Obama's "offer included raising the Medicare eligibility age").

²⁷While significant, increasing the eligibility age to 67 does not produce an order-of-magnitude difference in the envisioned size of the program. The CBO estimates that increasing the Medicare eligibility age to 67 would on net produce budget savings equal to about 4 to 5 percent of Medicare's costs. See CBO, "Raising the Ages of Eligibility for Medicare and Social Security," 6-7 (2012) (estimating that increasing the eligibility age to 67 would reduce Medicare costs by about 5 percent but with about one-quarter of those savings offset by higher costs in other programs). Under the House budget resolution, savings may be at the higher end of the 4 to 5 percent range, because the resolution also eliminates or severely reduces the other federal programs (Medicaid and the federal health tax credits) that may otherwise experience cost increases from that policy. In any case, the savings pale in comparison to projected growth in the Medicare program and the compounding effects from significantly reducing the program's growth rate over time.

²⁴See OMB, *supra* note 20, at 33-37 (detailing the additional cost-containment measures proposed in the president's budget, including lowering the Independent Payment Advisory Board target).

²⁵See House Committee on the Budget, *supra* note 20, at 52-55 (describing the budget resolution's Medicare plan). See also House Committee on the Budget, "Report on the Concurrent Resolution on the Budget — 2013," H. Rep. No. 112-421, at 96-98 (2012) (also detailing the budget resolution's Medicare plan).

CBO's alternative fiscal scenario is smaller. The CBO already assumes a slowdown in healthcare cost growth. For the next decade, the CBO's alternative fiscal scenario includes full implementation of the PPACA (although not of the SGR formula, which has been overridden year after year). After that, the CBO scenario assumes that the PPACA's cost controls are no longer fully implemented but that excess cost growth nonetheless gradually ramps down to 1 percentage point, even absent additional federal action.²⁸ Relative to this scenario, capping excess cost growth at 0.5 percentage points and enacting additional Medicare savings this decade would reduce the long-run deficit by about 1.5 percentage points, or about 3 percentage points near the end of the 75-year projection window.

To be clear, the Medicare program would still grow considerably even with these cost controls in place. The retirement of the baby boomers, combined with continued excess cost growth, would drive Medicare spending from about 3 percent of GDP today to 5 percent of GDP as of 2050, and approaching 7 percent of GDP toward the end of the 75-year window. This growth would continue to put pressure on the federal budget, but it remains a significant improvement over unbound cost growth at historical rates.

3. Gimmick, solution, or something else? On the one hand, there is great skepticism that measures constraining healthcare cost growth will be successfully implemented. Policies to do so are sometimes described as gimmicks. On the other hand, there is also great desire for policymakers to entirely solve the long-term fiscal shortfall and put forward hard and fast solutions to constrain healthcare cost growth. Both notions are wrongheaded in important ways and can distort policymaking.

Something between the two poles is probably right. Several of the ideas now on the table (of which important elements are enacted) are credible attempts at structural reform to the healthcare system. However, we will not know for some time whether they have been successful. There are no hard and fast solutions, and policies being sold as such may in fact be the least effective and least sustainable.

Skeptics of current reform measures tend to rely on two pieces of evidence to argue that savings will not stick. The first piece of evidence is history, specifically, Medicare's SGR formula. That formula for restricting physician payments was put in place as part of the Balanced Budget Act of 1997. It was meant to cap growth of physician payments and would apply an automatic cut if that growth rate

were exceeded. The SGR cut was triggered in every year starting in 2002, and in all but the first year, Congress overrode the SGR cut, which is now expected to be a cut of nearly 30 percent next year (having compounded over time).²⁹ Second, skeptics point to projections from sources, like the Medicare actuary, showing that the existing cost controls in the PPACA (specifically, the productivity adjustments) may cause a substantial share of providers to eventually begin accruing losses. From this they conclude the savings are unsustainable.³⁰ It is for these reasons that many analysts, including those at the CBO, assume measures like those in the PPACA will eventually be turned off.

However, that logic would essentially deny most significant progress on controlling future healthcare costs, even as analysts describe the current trajectory as unsustainable. It is a Catch-22 for policymakers. The more they do, the less they are believed. When it comes to history, the SGR formula actually turns out to be the exception rather than the rule. According to analysis by the Center on Budget and Policy Priorities, the SGR formula — which was never intended to significantly reduce physician payments — is one of the few Medicare cost savers that were enacted and then eventually rolled back. Most Medicare savings have stuck.³¹ Further, recent SGR fixes have been fully paid for, meaning the SGR formula is no longer the budget gimmick that it perhaps once was. And looking forward, analysts may be correct that changing the rate of healthcare cost growth will involve fundamental shifts in the cost structure of healthcare providers, and some of this may be painful to the degree of being unsustainable. But again, returns to the key point — that we are between a rock and a

²⁹For a history of the SGR and Congress's actions to override it, see Congressional Research Service, "Medicare Physician Payment Updates and the Sustainable Growth Rate (SGR) System" (2011).

³⁰See, e.g., Richard S. Foster, "Estimated Financial Effects of the Patient Protection and Affordable Care Act," Centers for Medicare & Medicaid Services, at 10 (2010) ("Simulations by the Office of the Actuary suggest that roughly 15 percent of Part A providers would become unprofitable within the 10-year projection period as a result of the productivity adjustments"); John D. Shatto and M. Kent Clemens, "Projected Medicare Expenditures Under Illustrative Scenarios With Alternative Payment Updates to Medicare Providers," Centers for Medicare & Medicaid Services, at 1 (2012) ("There is a strong likelihood that the productivity adjustments will not be sustainable in the long range").

³¹See generally James R. Horney and Paul N. Van de Water, "House-Passed and Senate Health Bills Reduce Deficit, Slow Health Care Costs, and Include Realistic Medicare Savings," CBPP (2009) ("Every significant deficit-reduction package in the last 20 years has included Medicare savings, most of which have been implemented as planned").

²⁸CBO, *supra* note 2, at 57.

hard place. What is unsustainable must eventually end, and it cannot be the case that every time policymakers take a step toward legislating a sustainable path for overall healthcare costs, they are legislating a gimmick into law.

As for those who desire a relatively hard and fast solution to healthcare cost growth and the long-term deficit it drives, their desire is understandable. A hard and fast solution would allay uncertainty — giving greater confidence to the credit markets lending to the government and giving confidence to participants in the healthcare market who must adapt to the new system.

However, a hard and fast solution is unattainable. There is reason to be uncertain about the effects of structural reform in the healthcare system. The skeptics are right about that. Structural reform like this simply has not been accomplished before. Only time will tell how successful reform will be, and analysts and policymakers must be ready to adjust. The desire for hard and fast solutions can in fact be counterproductive. It tends to push toward over-reliance on “budgeting by formula” by setting top-down healthcare targets without directly addressing the underlying incentives that drive inefficient healthcare consumption. That is because reforms to change incentives can seem uncertain; a simple formula for changing the growth of the program, in contrast, can appear more reliable. But it is the change in incentives — and the resulting reduction in inefficient and sometimes counterproductive medical care — that makes it possible to target aggressive formulas. The formula is a back-stop, and if it becomes the centerpiece, it is less likely to be successful.³²

In sum, both the leading progressive and conservative budgets have set out similar overall targets for Medicare and put forward plans to structurally change the healthcare system to hit those targets. These targets and reforms should not be dismissed (as some critics do). Still, no one should think that the process of transforming the healthcare system is or can be at an end if these measures are fully enacted. That is not a flaw in the plans; instead, it is the nature of structural change.

³²See, e.g., Orszag, “How Health Care Can Save or Sink America: The Case for Reform and Fiscal Sustainability,” 90 *Foreign Affairs* 42, 44 (2011) (Simply reducing “payments to providers — hospitals, doctors, and pharmaceutical companies . . . can work, often quite well, in the short run. It is inherently limited over the medium and long term, however, unless accompanied by other measures to reduce the underlying quantity of services provided”).

C. Ramping Down Discretionary Spending

Under both the president’s budget and the House budget resolution, discretionary spending — spending that is annually appropriated to federal agencies — would fall to its lowest level on record as a share of the economy in the last four decades (which is as far back as records on that spending go). This spending is often the center of policy debates about the budget, in part because Congress must annually deal with these spending bills. As a result, analysts correctly point out, the role of discretionary spending can be overstated relative to mandatory programs. However, discretionary spending still remains a significant portion of the budget. This year it was roughly 40 percent of total noninterest spending. So the ramp-down in discretionary spending under both budgets would produce significant deficit reduction.

Over the long term, the CBO does not incorporate any ramp-down of discretionary spending in its alternative fiscal scenario. Rather, it assumes that once this decade is over, discretionary spending (as well as some portions of mandatory spending) will return to its historical average over the last 20 years — or 2 percentage points of GDP higher than in either the president’s budget or the House budget resolution as of the end of the decade.

This report briefly reviews how the two budgets arrive at historically low discretionary spending as a share of the economy what effect this has on the long-term deficit, and then asks whether we should assume that these levels will be maintained over the long run.

1. How the budgets arrive at historically low spending. Current law already incorporates much of the ramp-down in discretionary spending. That was signed into law in the BCA last year — the deal for increasing the debt limit at the time. That law capped annual appropriations for a decade, at levels well below inflation (and even further below GDP growth). Relative to the 2010 base funding level (excluding emergencies), the BCA will cut discretionary funding as a share of the economy by 30 percent by the end of the decade. Roughly half of that cut (as a share of the economy) will already be in place for the upcoming fiscal year in terms of budget authority. This cut does not include the automatic sequestration scheduled to go into effect at the beginning of next year because of the failure of last year’s deficit reduction supercommittee. Both

the president's budget and the House budget resolution propose to replace this sequestration with alternative deficit reduction.³³

In addition to the BCA, both budgets incorporate the same assumption about a ramp-down in overseas military operations (appropriations for which are not capped in the BCA). After an appropriation of nearly \$130 billion this year (and just under \$100 billion requested for next year), the budgets assume about \$45 billion in funding per year for the remainder of the decade, and the president's budget proposes caps to enforce this aggregate level of war funding over the next decade.³⁴

The House budget resolution proposes even lower discretionary spending. While it increases defense spending relative to the president's budget and existing caps, it proposes much lower non-defense spending — more than offsetting the increase in defense spending. As a result, over the next decade, total discretionary spending in the House budget resolution is 8 percent below that agreed to in the BCA and proposed by Obama.

Importantly, policymakers seem to intend these historically low rates of discretionary spending to continue into the future. In its long-term projection of the budget, the administration shows discretionary spending remaining at its 2022 level as a share of the economy for the remainder of the projection window and in alternative projections, it assumes even slower growth — although it does call these long-term paths “merely illustrative.”³⁵ The House Budget Committee also released a long-term projection of its budget resolution, and this assumes that discretionary spending grows only with inflation after this decade (and so continues to fall as a share of the economy).³⁶

2. Effects on the long-term deficit. As noted, the ramp-down in both the president's budget and the House budget resolution take discretionary spending to its lowest level as a share of the economy on record by 2022 — and about 2 percentage points below the average over the last 20 years as a share of the economy. The CBO's alternative fiscal scenario assumes this is “given back” over the long-term — that in the 2020s, policymakers (contrary to

apparent current intentions) return discretionary spending to its recent historical average. An alternative assumption, which I consider the minimum consensus in light of current law and long-term projections of both the president's budget and the House budget resolution, is that discretionary spending is held constant as a share of the economy from 2022 onward. This consensus, relative to the CBO's alternative fiscal scenario, reduces the long-term deficit by just under 2 percent of GDP.

3. Are these spending levels credible? Of course, just because policymakers say they intend to keep discretionary spending at historic lows does not necessarily mean it will occur. However, there at least two reasons to accept the current consensus as the course we are on.

First, there is the logical conundrum that as the major mandatory programs grow as a share of the economy, policymakers must break from historical averages in other parts of the budget to put us on a sustainable path. In some combination, spending in other parts of the budget must be lower and revenues must be higher. It is a hard and fast mathematical rule. So when policymakers reach a consensus to change discretionary spending relative to its historical average, we must understand that those changes are not merely recommended; they are absolutely necessary in some combination with higher revenues.

Second, future policymakers will also face pressure to maintain something like the current course, even though many may want to invest more in programs. As detailed below, the CBO's baseline for discretionary spending over the official 10-year budget window grows only with inflation. So just holding discretionary spending constant as a share of the economy in the next decade would appear as a significant spending *increase* relative to that baseline. Especially in the face of continued deficits, there would be pressure not to enact large increases in discretionary spending relative to the official baseline.

In short, until policymakers actually reverse themselves on discretionary spending (and for the moment, they, if anything, appear to be going in the opposite direction), a projection of our current fiscal course should incorporate the effects of the spending ramp-down.

D. Other Mandatory Spending

As with discretionary spending, the CBO's alternative fiscal scenario assumes that “other mandatory spending” — spending outside Medicare, Medicaid, the health exchanges, and Social Security (and covering disparate areas ranging from refundable tax credits to unemployment insurance to deposit insurance) — eventually rises back to its 20-year historical average as a share of the economy.

³³See, OMB, *supra* note 20, at 24 (proposing to replace sequestration); House Committee on the Budget, *supra* note 20, at 94-98 (also proposing to replace current sequestration).

³⁴For details on the war funding request, see OMB, *supra* note 20, at 89-91.

³⁵See OMB, “Fiscal Year 2013 Analytical Perspectives Budget of the United States Government,” at 60-61 (2012), *Doc 2012-2944*, 2012 TNT 30-43.

³⁶CBO, “The Long-Term Budgetary Impacts of Paths for Federal Revenue and Spending Specified by Chairman Ryan,” 4 (2012), *Doc 2012-5867*, 2012 TNT 55-17.

This assumption is particularly odd, given the way the CBO calculates other mandatory spending. The result is to effectively assume a level of program spending that is considerably above average historical levels and certainly above any long-term level now being proposed by policymakers.

If current policies are continued,³⁷ other mandatory spending would be about 2.5 percent of GDP at the end of this decade under the CBO projections.³⁸ This is just below the average of the last 20 years of 2.7 percent (and at the average excluding years affected by the Great Recession and the financial bailout). However, the CBO in its alternative fiscal scenario assumes that this spending rises to 3.3 percent of GDP once the coming decade is over, which is well above the recent historical average.

The reason the CBO projects such a jump is technical. Briefly put, the CBO assumes that other mandatory spending returns to its historical average, *including* Medicare's offsetting receipts (premiums and other Medicare collections that offset spending). These offsetting receipts grow with the Medicare program and are best thought of in the context of Medicare spending. By putting them in the "other mandatory" bucket (and projecting that this bucket returns to historical spending levels), the CBO is essentially assuming that "other mandatory" programs enjoy a major expansion to take advantage of the room created by higher Medicare offsetting receipts.

Given that neither the president's budget nor the House budget resolution includes such an expansion of these programs (and, in fact, the House budget resolution has very large other mandatory cuts), I assume that a minimum deficit reduction package would simply hold other mandatory spending at its current policy level. That reduces the long-term deficit by about 0.6 percent of GDP relative to the CBO's alternative fiscal scenario.

E. Revenues Equal to About 19 Percent of GDP

Given the heated ongoing debate over taxes, many may find it surprising that the leading conservative and progressive budgets are not in fact dramatically different on the amount of revenue proposed. Over the next decade, the president's budget and the House budget resolution differ by about 1 percentage point of GDP in the amount of

revenue being raised — or roughly a difference of about 5 percent of total revenues. By 2022, the president's budget proposes revenue equal to about 19.8 percent of GDP,³⁹ and the House budget resolution has revenues at about 18.7 percent of GDP.⁴⁰ Of course, a 5 percent difference is not insignificant. However, frequently these battles over taxes are framed as dramatic philosophical differences about the size of the tax system, with profound effects for the economy. That rhetoric does not align with the numbers themselves.

In the long term, both the president's budget and the House budget resolution assume modest growth in revenue. In its long-run projection, the president's budget assumes growth of about 1 percentage point through the end of the 75-year projection window after 2022,⁴¹ and the House budget resolution assumes growth of about 0.3 percentage points of GDP (up to 19 percent of GDP by 2025).⁴² Importantly (and as discussed later in this report), this growth in revenue under both budgets is considerably below the automatic increases in revenue that would occur in the absence of Congress enacting new tax cuts.

In short, the House budget resolution represents a minimum consensus on the level of revenue, which is lower than, but not dramatically different from, the level of revenues in the president's budget. Note that this level is somewhat higher than the historical average of the last 20 years, of about 18 percent of GDP, and even higher compared with the average of the 2000s, when revenues averaged just fewer than 17.5 percent of GDP.

This minimum consensus level of revenue is also somewhat higher than that in the CBO's alternative fiscal scenario. In that scenario, the CBO assumes the extension of all temporary tax cuts now in place (including stimulus provisions like bonus depreciation for investments made this year), with the exception of this year's payroll tax cut. And while

³⁹OMB, *supra* note 20, at 205, tbl. S-1.

⁴⁰House Committee on the Budget, *supra* note 20, at 88, tbl. S-1. Documents accompanying the House Budget Resolution say that it encompasses significant tax rate cuts beyond current policy. The Urban-Brookings Tax Policy Center has estimated that these additional tax cuts would reduce revenues by \$4.6 trillion over the 2013-2022 decade relative to current policy. Urban-Brookings Tax Policy Center, 2013 House Republic Budget Proposal (Excluding Unspecified Base Broadeners): Impact on Tax Revenue, 2012-2022, *Doc 2012-5882*, 2012 *TNT* 56-24. These additional revenue losses would reach about 2.3 percent of GDP by 2022. However, the House budget resolution assumes unspecified reductions in "tax expenditures" that offset these revenue losses. This analysis takes the revenue figures in the House budget resolution at face value.

⁴¹OMB, *supra* note 35, at 59, tbl. S-1.

⁴²CBO, *supra* note 36, at 3.

³⁷Current policy assumes continuation of all refundable tax credits now scheduled to expire and also assumes that the automatic sequester scheduled for the end of the year does not occur. These are the two adjustments made relative to current law.

³⁸The figures used here for other mandatory spending do not include Medicare "offsetting receipts" — premiums and other payments that offset spending. These offsetting receipts are instead included in the Medicare program.

	Fiscal Adjustment Needed to Stabilize Debt Over Given Periods (Percentage of GDP)				
	75-Year Fiscal Gap (2012-2087)	2012-2022	2023-2037	2038-2062	2063-2087
Total adjustment still needed under “consensus”	4.5%	1.6%	3%	4.9%	6.9%
Primary (non-interest) outlays	23.1%	20.4%	21.5%	23.5%	25.5%
Revenues	18.9%	18.1%	19%	19%	19%
If adjustment were split equally:					
Percentage of outlays	9.8%	4%	7.0%	10.4%	13.5%
Percentage of revenues	11.9%	4.5%	7.9%	12.9%	18.1%

Source: Author’s calculations.

	Fiscal Adjustment Needed to Stabilize Debt Over Given Periods (Percentage of GDP)				
	75-Year Fiscal Gap (2012-2087)	2012-2022	2023-2037	2038-2062	2063-2087
Total adjustment still needed under “consensus”	4.5%	1.6%	3%	4.9%	6.9%
Additional steps:					
1. Additional medium-term deficit reduction	-1.6%	-1.6%	-1.6%	-1.6%	-1.6%
2. Restore Social Security solvency (plausible policy path)	-1%	0%	-0.9%	-1.3%	-1.5%
Remaining adjustment after additional steps	1.9%	0%	0.5%	2%	3.8%
Backstops:					
1. Total automatic increase in revenues (from “consensus” level)	-2.8%	0%	-0.3%	-2.6%	-5.7%
1A. Provisions other than PPACA	-1.3%	0%	-0.1%	-1.1%	-2.6%
1B. PPACA	-1.6%	0%	-0.2%	-1.6%	-3%
2A. Grow discretionary with baseline (inflation) after 2022	-1.6%	0%	-0.5%	-1.8%	-3.0%
2B. Grow discretionary with baseline (inflation) + population after 2022	-1%	0%	-0.3%	-1.1%	-2.1%

Source: Author’s calculations.

the House budget resolution’s revenue level essentially incorporates extension of the major tax cuts (including the AMT patch and the 2001 and 2003 tax cuts), it does not provide room for all of them, and it has average revenues that are 0.3 percentage points higher than in the CBO’s alternative fiscal scenario over the coming decade. Further, the CBO’s scenario assumes no growth in revenues as a share of the economy after 2022 — so the gap widens further between the CBO alternative fiscal scenario and the House budget resolution.

Following the House budget resolution’s path for revenue rather than that in the CBO’s alternative fiscal scenario reduces the 75-year deficit by about 0.5 percentage points.

IV. The Path Forward

A. The Bargaining Space

The consensus measures described in the prior section by no means eliminate the long-term deficit.

As noted, compared with the CBO’s alternative fiscal scenario, they cut the long-term deficit by half. The fiscal gap is reduced from nearly 9 percent under the CBO’s alternative fiscal scenario to about 4.5 percent under the consensus deficit reduction measures.

This consensus projection of the budget not only shows the progress that policymakers are making but also helps define the bargaining space on the level of total spending and revenues. In simplistic terms, progressives would probably prefer closing the remaining fiscal gap more through revenues than through spending cuts, and conservatives would probably prefer the opposite. Table 2 shows the average primary spending (spending excluding interest) and revenue levels for each decade under this consensus, as well as the necessary adjustment in that decade to hold the debt constant as a share of the economy.

In the medium term, the bargaining space in fact may be relatively small compared with total spending and revenue levels. Beyond the current consensus, there is an additional adjustment of about 1.5 percent of GDP needed to stabilize the debt. That means spending must be lower or revenues must be higher than the current consensus by a combination totaling that amount. If split equally between spending and revenue, it is an adjustment of just under 5 percent of the total for both revenues and spending. From there, the necessary adjustment widens, to about 7 percent of GDP toward the end of the projection window — or in the range of 15 percent of currently projected spending and revenues (if that adjustment is again split equally between them).

B. Further Steps — and Backstops

No doubt there remains a significant fiscal adjustment, even with these consensus deficit reduction measures. However, it is not necessarily an overwhelming one, and, as this section explores, there is a plausible path forward. Two actions (to which both progressive and conservative leaders express general commitment) would close half of the remaining fiscal gap — namely, fully addressing medium-term deficits (so that the debt-to-GDP ratio at least stabilizes this decade) and closing the long-term Social Security shortfall. The path from there is less clear. However, there are at least two long-term backstops that can either aid in closing the remainder of the gap or put pressure on policymakers to do so: (1) The tax system will automatically ramp up revenue as a share of the economy over time, and (2) there could be significant pressure to grow discretionary spending more slowly than the economy over the long run.

1. Additional medium-term deficit reduction. Both Democratic and Republican political leaders express commitment to addressing the medium-term deficit, and at the end of this year policymakers face the much-discussed forcing event of “Taxmageddon” (cliffs that include the full expiration of the 2001 and 2003 tax cuts, expiration of the SGR patch, and sequestration of some discretionary and mandatory programs). This is not to say that medium-term deficit reduction will in any way be easy or automatic. The collapse of deficit reduction talks last summer vividly illustrates the pitfalls involved, even if that did result in modest deficit reduction in the form of the BCA.

The point of this exercise is not to assume away the deficit problem, but rather to ask how large long-term adjustments must be — assuming we meet medium-term deficit reduction goals. Meeting that goal of stabilizing debt as a share of the economy in this decade would result in additional deficit reduction of about 1.5 percent of GDP be-

yond the consensus measures described in the previous section — and closing nearly 40 percent of the remaining long-term fiscal gap if that deficit reduction is then carried forward.

2. Social Security. Neither the president’s budget nor the House budget resolution offer specific plans for Social Security. Both call for work on a bipartisan basis to restore long-term solvency to the system, but they go no further in terms of details.⁴³

Despite this lack of specifics on a Social Security plan, it seems likely that long-term deficit reduction will eventually include Social Security reform. However much policymakers may dislike the choices involved (some combination of lower benefits and higher payroll taxes), they will almost certainly have an even greater aversion to the prospect of a sudden reduction in benefits once the Social Security Trust Fund becomes insolvent. Moreover, there will be some pressure to take action on Social Security sufficiently in advance of the trust fund’s insolvency to allow changes to be phased in. That insolvency is now projected for 2033 by the Social Security trustees.⁴⁴

As budget experts have frequently emphasized, the expected growth in Social Security as a share of the economy, driven by the retirement of the baby boomers, pales in comparison with the growth in Medicare and Medicaid, driven by a combination of population aging *and* healthcare costs. Nonetheless, closing the long-term Social Security shortfall would generate a noticeable deficit reduction, especially over the long term. The 75-year Social Security shortfall now stands at about 1 percent of GDP according to the Social Security trustees,⁴⁵ meaning that we can expect any Social Security solution to involve an adjustment that reduces the long-term fiscal gap by about this amount — or nearly one-quarter of the remaining gap. Further, that deficit reduction would likely grow with time. For illustrative purposes, this report uses a plausible policy path that phases in changes after this decade and restores long-term solvency. That produces deficit reduction in the range of 1.5 percent of GDP by the end of the 75-year projection window.

⁴³See OMB, *supra* note 20, at 195 (“The President is committed to making sure that Social Security is solvent and viable for the American people, now and in the future . . . and looks forward to working on a bipartisan basis to preserve it for future generations”); House Committee on the Budget, *supra* note 20, at 56 (“In a shared call for leadership, this budget calls for action on Social Security by requiring both the President and the Congress to put forward specific ideas and legislation to ensure the sustainable solvency of this critical program”).

⁴⁴“The 2012 Annual Report of the Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds,” at 4 (2012).

⁴⁵*Id.* at 64-65.

3. Two ‘backstops’: revenue and discretionary spending. With those two further sets of policies assumed — achieving medium-term fiscal sustainability and restoring long-term solvency to Social Security — the long-term fiscal gap would stand at only about 2 percent of GDP over the next 75 years. By the end of the 75-year projection period, the necessary fiscal adjustment to achieve debt stability would be about 4 percent of GDP. A challenge would remain, but if this alone were the remaining adjustment needed in the distant future, it would be difficult to describe it as a crisis.

Importantly, there are two backstops to promote further deficit reduction. That is, in the event of a failure to come to agreement on additional deficit reduction measures, these could be allowed to phase in. That is not to say that it would be desirable for these policies to phase in relative to other forms of deficit reduction. Rather, it is to say that these backstops serve as a form of insurance policy.

The strongest of these backstops is the automatic growth in revenue over time as a share of the economy, absent enactment of new tax cuts. From a starting point of the minimum consensus revenue level of 18.7 percent of GDP as of 2022 (that under the House budget resolution), this would increase revenues to roughly 25 percent of GDP by the end of the 75-year projection period, based on previous CBO projections. (This assumes that the 2001 and 2003 tax cuts are extended and that the AMT system is fixed with its limits indexed to inflation; otherwise, growth would be faster.)

This increase in revenues comes about equally from long-standing structural elements of the individual income tax system and new revenue-raising elements enacted in the PPACA. As to the long-standing structural elements, the individual income tax system brackets are indexed to inflation, but income is expected to grow faster than that. Over time, that will push taxpayers into higher brackets. Also, the retirement of the baby boomers is expected to push revenues higher as tax-deferred savings accounts are cashed out and subjected to tax. As to the PPACA, several of its revenue-raising elements are expected to grow rapidly as a share of the economy over time. The most important of these is the excise tax on high premium health insurance plans, the threshold for which is indexed to inflation rather than to healthcare cost growth.⁴⁶

⁴⁶I calculate the long-term effects of these two factors — the long-standing structural elements of the income tax code and new provisions in the PPACA — based on earlier CBO projections, combined with the CBO’s current 10-year revenue outlook. For the preexisting structural elements in the income tax

(Footnote continued in next column.)

Altogether, this revenue backstop, if not offset through additional tax cuts, would reduce the long-term fiscal gap by roughly 3 percent of GDP over the 75-year period and by roughly 6 percent of GDP toward the end of the 75-year projection window. Again, note that this increase is split about equally between long-standing characteristics of the tax system (the tax brackets being indexed to inflation rather than real income growth) and new provisions enacted under the PPACA.

The weaker of the two backstops is slower growth in discretionary spending than already assumed here. The CBO standard 10-year “current services” baseline for discretionary spending — against which increases or decreases in discretionary spending generally get measured in budget discussions — grows with inflation (a combination of the GDP price index and the employment cost index) rather than GDP growth.⁴⁷ Thus, after the BCA caps end in 2021, congressional policies will be judged relative to a baseline that shrinks as a share of the economy. Simply holding discretionary spending constant as a share of the economy after that (which was assumed in the current consensus) would show up as a discretionary spending *increase* of more than \$500 billion over the decade thereafter relative to the official baseline. Especially in the face of deficits, this may tend to put downward pressure on discretionary spending, above and beyond the levels already assumed here.

This discretionary backstop may not be as strong as the revenue one. Unlike the revenue increases, it is not automatic. Congress must act annually on appropriations. However, the downward pressure on appropriations would certainly be much stronger than on mandatory programs, which do not require annual congressional action and for which policy changes are judged relative to a baseline that generally grows faster than inflation. Further, unlike for a program like Medicare, Congress may be able to maintain the same level of government

code, I use the CBO’s June 2009 alternative fiscal scenario, which projected long-term revenue growth assuming extension of an AMT patch and the 2001 and 2003 tax cuts (and without the effects of the PPACA, which had not yet been enacted). See CBO, “The Long-Term Budget Outlook,” at 52 (2009) (detailing revenue assumptions for the 2009 report’s alternative fiscal scenario). For the PPACA’s revenue elements, I use the CBO’s detailed description of their growth over time in its June 2010 extended baseline scenario (note that the CBO does not have as detailed a description in its two more recent reports). See CBO, “The Long-Term Budget Outlook,” 59-60 (2010) (describing the long-term revenue effects of the then just-enacted PPACA).

⁴⁷See, e.g., letter from Douglas W. Elmendorf to John A. Boehner and Harry Reid (Aug. 1, 2011) (measuring the effect of the BCA on the deficit by comparing the discretionary caps to a discretionary baseline that grows with inflation).

services (growing funding with inflation) even as funding shrinks as a share of the economy.

To give a sense for magnitude, if discretionary funding grew with the official baseline after the end of the BCA caps (which is still roughly three times as fast as the growth over this decade under the caps), this would reduce the long-term fiscal gap by 1.6 percent of GDP over the next 75 years and 3 percent of GDP toward the end of the 75-year projection window. Somewhat faster growth equal to inflation plus population (but still lower than GDP growth) would generate about two-thirds as much savings.

V. Conclusion

Statements about the long-term budget outlook should be made with a large dose of humility. The projection is subject to considerable economic uncertainty. Moreover, there is deep uncertainty about what pressures policymakers will face in the future. What will medical care look like 75 years from now, and how much money will Americans want to devote to that? Will America be involved with significant conflicts abroad? How much will Americans want to spend on roads and railways, and how relevant will those modes of transportation be? The questions, which are difficult for anyone to answer, could go on. And the answers have profound effects on the long-term outlook and the desirable policies to close the long-term shortfall.

Subject to that dose of humility, this report has taken issue with the broad consensus that the federal government is on a radically unsustainable course and that the current policies being advocated by our political leaders are simply unequal to the task. In fact, as this report has shown, if the minimum consensus policies being put forward by Obama and House Republicans were followed, the long-term fiscal deficit would be half what the CBO projected in its latest long-term projection of current policy. A gap remains, but there is a plausible path for shrinking it further — with important revenue and spending backstops to potentially close much, if not all, of the remaining shortfall as time goes on.

Does this mean that we can expect to see the long-term problem go away in the coming years? I would be very surprised if 10 or 20 years from now analysts and policymakers had declared the long-term shortfall solved. We will not know for some

time how some of the most important reforms play out, especially when it comes to healthcare cost growth. It is inevitable that the growth will slow; it is only a question of how. Progressives and conservatives have put forward plausible plans to transition to slower growth in Medicare in particular (and, in fact, many of the elements of the progressive plan have already been enacted). Whether those plans are successful — or unsustainable as some analysts suspect — will not be answered for many years to come.

Further, policymakers can responsibly defer decisions on some parts of the long-term fiscal gap. Or, in other words, some areas should have priority over others. With policymakers having limited bandwidth when it comes to policy decisions, policymakers should focus now on the long-term measures that will take time to phase in. The leading contenders are healthcare (for which policymakers already have relatively detailed plans) and Social Security (for which they do not yet). Deciding the exact level of revenue or discretionary spending 30 or 40 years from now is decidedly less urgent; these are policies that can be adjusted relatively quickly and certainly will see much additional policymaking between now and the distant future.

Perhaps most urgently, policymakers can act to establish credibility. Especially in the medium term, the bargaining space for deficit reduction is smaller than many might think. Showing that they can successfully close that gap — and do so in a bipartisan fashion — can establish credibility for the future, when new adjustments will be needed.

But even as policymakers have a responsibility, commentators and analysts do too. That responsibility is to recognize progress when it is being made. The measures now on the table close a significant portion of the long-term fiscal gap, and there is a path forward. It may not be an easy path, and policymakers may not manage to fulfill the promise of the existing consensus. However, denying the possible progress distorts the policymaking process and does not reward tough choices when they are made — while also justifying ever more radical solutions.

(Appendix appears on the following page.)

Appendix: CBO's Alternative Fiscal Scenario Versus Minimum 'Consensus' Deficit Reduction

Appendix Table 1. Alternative Fiscal Scenario vs. Minimum 'Consensus' Deficit Reduction		
	CBO's Alternative Fiscal Scenario	Minimum 'Consensus' Deficit Reduction
BCA sequester (applies to a variety of programs)	<ul style="list-style-type: none"> • Turned off for all programs 	<ul style="list-style-type: none"> • Turned off for all programs
Discretionary	<ul style="list-style-type: none"> • Through 2022, follows BCA caps (no sequester) and does not ramp down wars (discretionary equals 6 percent of GDP in 2022) • After 2022, discretionary ramps up to 7.5 percent of GDP by 2027 and is held constant thereafter 	<ul style="list-style-type: none"> • Through 2022, follows BCA caps (no sequester) and ramps down war funding to \$45 billion per year from 2014 on (discretionary equals 5.5 percent of GDP in 2022) • After 2022, discretionary held constant as a share of GDP (5.5 percent of GDP)
Medicare	<ul style="list-style-type: none"> • SGR: Freeze in payment levels (SGR cut turned off) • Otherwise, through 2022, follows current law • After 2022, excess cost growth of 1.5 percent, ramping down to 1 percent (adjusted for population age) 	<ul style="list-style-type: none"> • SGR: Freeze in payment levels (SGR cut turned off) • \$275 billion in Medicare savings through 2022 (Obama budget level; House budget resolution has an even lower Medicare topline) • After 2022, excess cost growth of 0.5 percent (adjusted for population age)
Other health (Medicaid, health exchanges)	<ul style="list-style-type: none"> • Assumes excess cost growth ramping down from just over 1.5 percent in 2011 to zero excess cost growth after 75 years (adjusted for population age) 	<ul style="list-style-type: none"> • Same as alternative fiscal scenario
Social Security	<ul style="list-style-type: none"> • Current law 	<ul style="list-style-type: none"> • Same as alternative fiscal scenario (current law)
Other mandatory (excluding Medicare offsetting receipts)	<ul style="list-style-type: none"> • Current policy through 2022 (2.5 percent of GDP in 2022) • After 2022, ramps up to about 3.3 percent of GDP by 2027 and held constant as a share of GDP thereafter 	<ul style="list-style-type: none"> • Current policy through 2022 (2.5 percent of GDP in 2022) • After 2022, held constant as a share of GDP (2.5 percent of GDP)
Revenue	<ul style="list-style-type: none"> • Assumes continuation of all present tax cuts (including stimulus measures such as expanded expensing), with the exception of the payroll tax cut (revenue equals 18.5 percent of GDP in 2022) • Revenues held constant after 2022 (18.5 percent of GDP) 	<ul style="list-style-type: none"> • Follows revenue path in 2013 House budget resolution • Revenues equal to 18.7 percent of GDP in 2022 • After 2022, revenues ramp up to 19 percent of GDP by 2025 and held constant thereafter