The Daily Dish

The Budget and Economic Outlook Redux

DOUGLAS HOLTZ-EAKIN | APRIL 10, 2018

Eakinomics: The Budget and Economic Outlook Redux

Yesterday the Congressional Budget Office (CBO) released the Budget and Economic Outlook: 2018 to 2028 ("Outlook"). AAF's Gordon Gray has a succinct summary here. Yesterday Eakinomics boldly predicted that there would be little news in some crucial aspects of the budgetary outlook. I hate being right. Specifically:

- *The federal deficit will widen steadily, both in absolute terms and as a fraction of gross domestic product (GDP)*. The deficit projection is $804 billion in 2018, rising to $1.5 trillion in 2028. It reaches $1 trillion in 2020, two years earlier than previously projected. Over the entire 10-year window, it averages 4.9 percent of GDP. None of this is good news.

- *Revenues will grow steadily at roughly the rate of growth of the economy*. The economy averages roughly 4.1 percent (in nominal terms), while revenues average 4.7 percent. Partly this is due to the sunsets in the tax law, but Gordon Gray points out that legislation lowered revenues by about $1.7 trillion, while better growth raised them by about $1 trillion.

- *Spending will grow much faster, fueled by ever-rising spending on Medicare, Medicaid, Social Security, Affordable Care Act (ACA) subsidies, and other entitlements*. Revenues grow at 4.7 percent per year, but spending grows at 5.3 percent per year. Social Security grows at 6.3 percent, Medicare at 7.3 percent, Medicaid at 5.2 percent, and the ACA at 6.0 percent. These programs are fundamentally unsustainable, which means the the federal social safety net is increasingly at risk. This is sadly ironic, as social insurance is supposed to reduce risk, not create it.

- *Borrowing costs will be an increasingly large fraction of those deficits*. Interest payments rise to $915 billion annually in 2028, which is roughly 60 percent of the deficit borrowing. Interest payments are increasingly important in the budget, as they exceed defense spending by 2025 and continue to rise.

- *The federal budget will enter an inexorable upward debt spiral*. Debt in the hands of the public roughly doubles over the 10 years, rising from 78.0 to 96.2 percent of GDP. Left unchecked, there is no question that there will be a debt crisis. The only question is when.

The Outlook did, however, shed some insight into how the CBO thinks about the changes in fiscal policy, notably the Tax Cuts and Jobs Act (TCJA) and the Consolidated Appropriations Act of 2018 ("omnibus"). The short version is that it views the combination as short-run good news, but a long-run non-event. CBO anticipates GDP will grow 3.3 in 2018 before growth tapers off to average 1.7 percent between 2023 and 2028. Similarly, unemployment is anticipated to drop to 3.3 percent before rising to 4.8 percent over the long term. Along with these developments will be higher near-term inflation, wage growth, interest rates, and trade deficits.

One way to think about this is that the economy responds to the incentives in the TCJA, but the individual and pass-thru business provisions sunset over the long term. While the corporate reforms remain, they are seemingly offset by the higher debt and borrowing. It is not a surprising economic bottom line.

The die is cast. Congress and the Administration have a couple of years of more robust growth during which to address a threat to seniors, low-income Americans, economic growth, and the next generation. Unfortunately, the tsunami of red ink is two years closer than before. It is time to act.