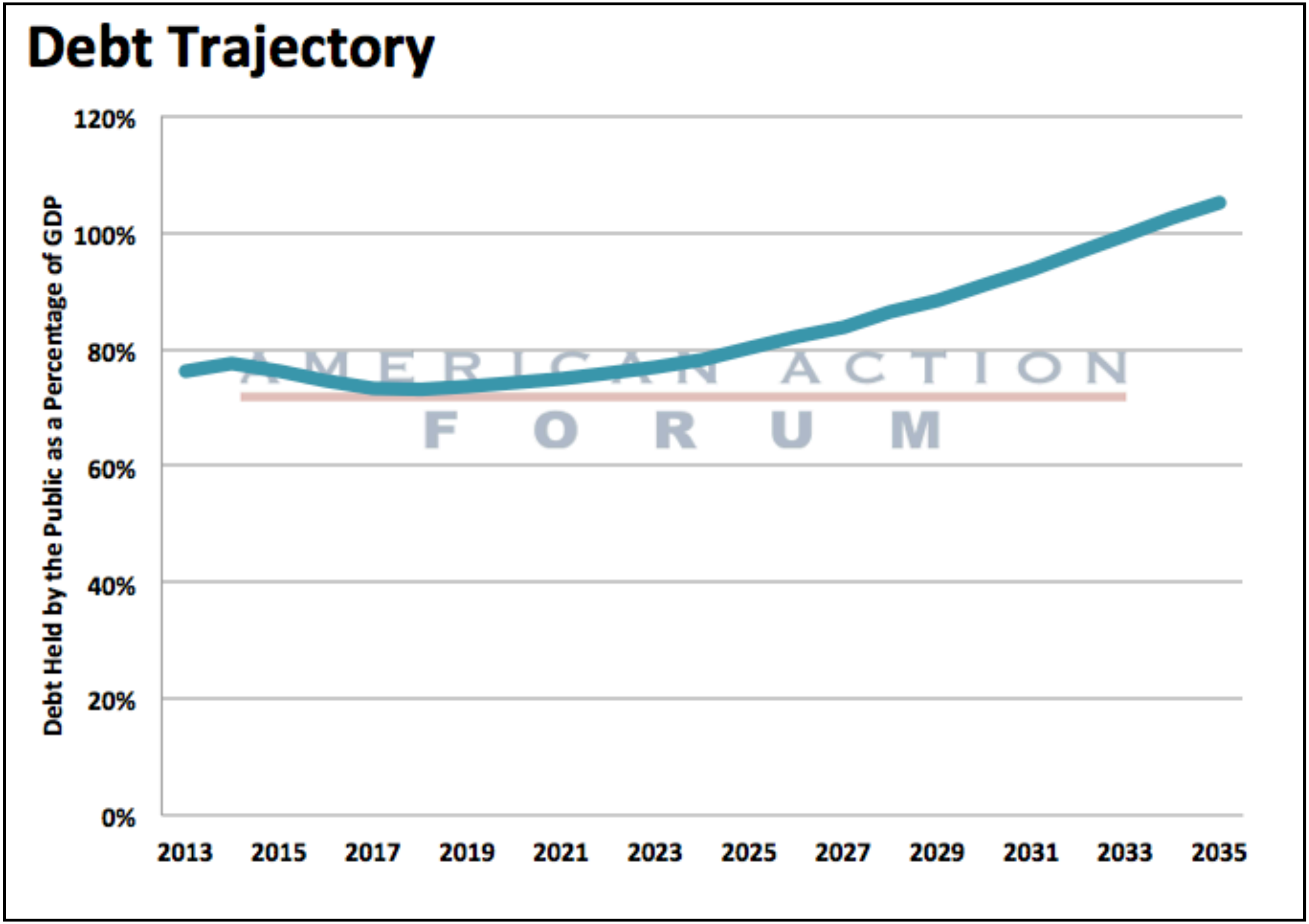
AMERICAN ACTION FORUM

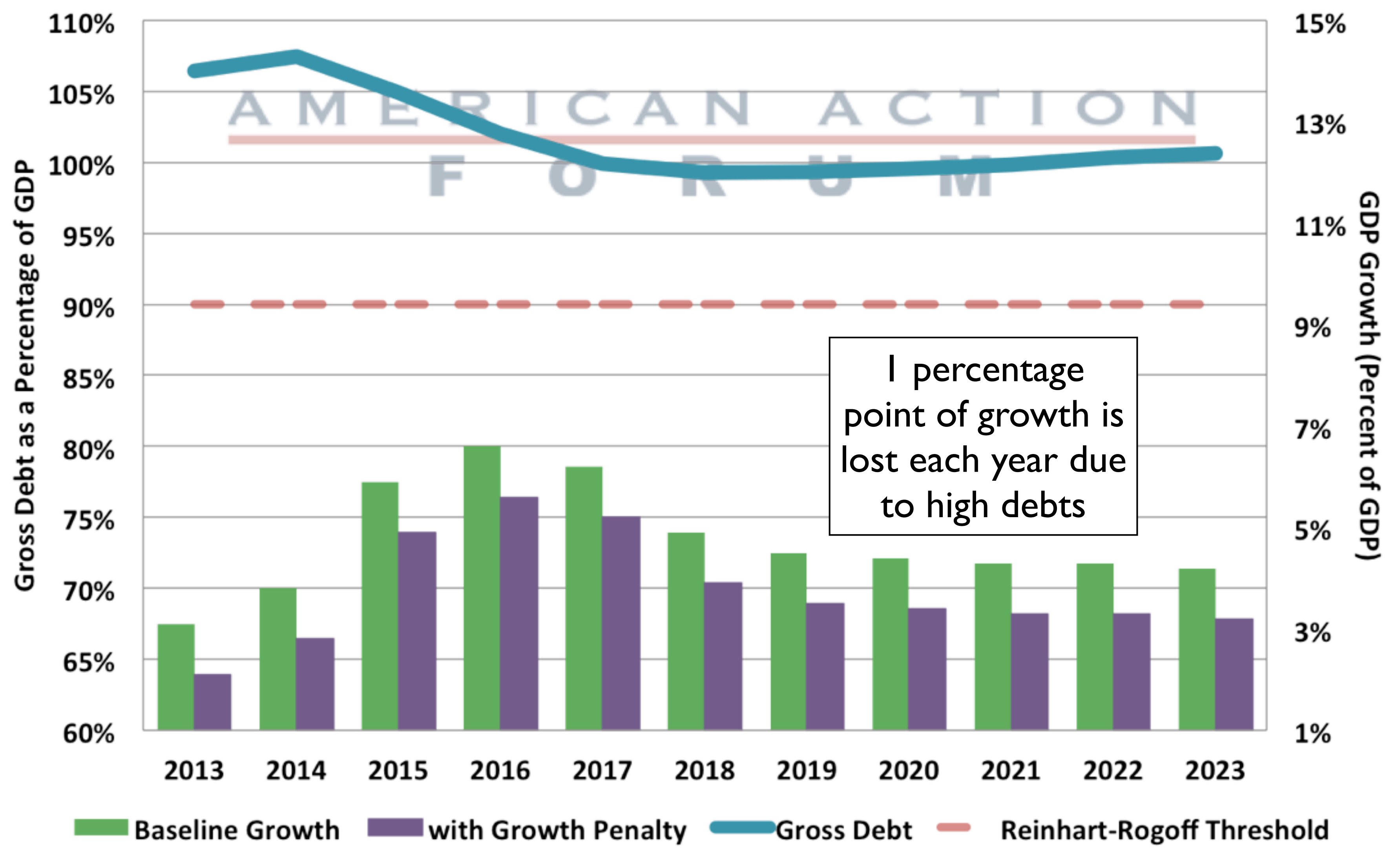
# Updated Baseline Confirms: Spending-Driven Debt Crisis Continues

February 5, 2013



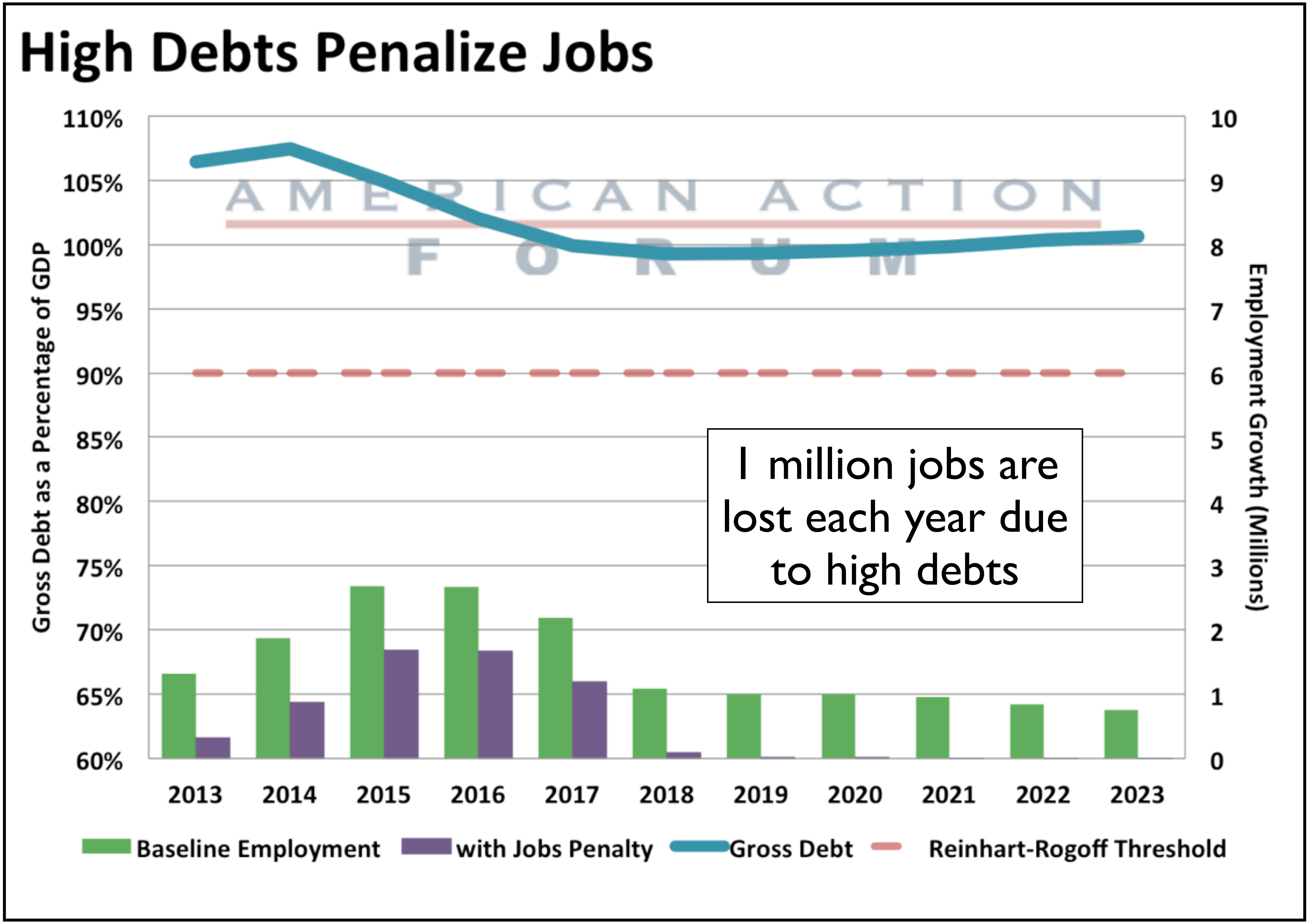

Under current law, debt held by the public will temporarily shrink over part of the ten-year budget window. Undoubtedly, some will suggest that the absence of immediate and severe debt accumulation in the near-term suggests the freedom to forgo near-term debt reduction. This ignores the fact that the debt-outlook is but a short-lived reprieve, as a conservative medium-term projection reveals. Inclusive of many unrealistic assumptions (SGR, sequester, etc) the debt held by the public will reach 105 percent of GDP by 2035.

# High Debts Penalize Growth

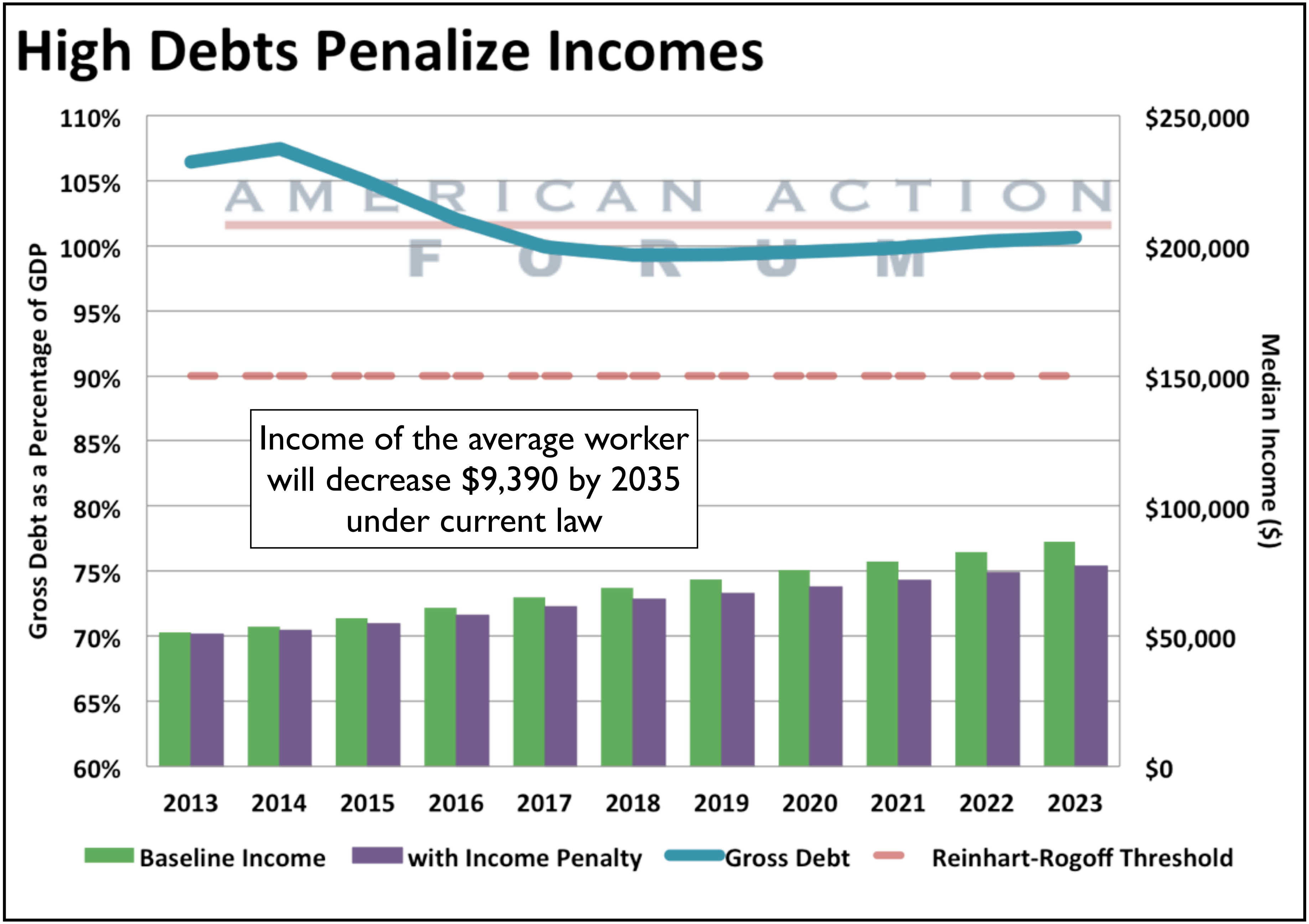



Economists Carmen Reinhart, of the University of Maryland, and Kenneth Rogoff, of Harvard University, have demonstrated that when debt as a percent of GDP exceeds 90 percent, median growth is roughly 1 percent lower than countries with lower debt burdens.

Under current law, gross debt will remain above 90 percent over 2013-2023, which suggests a persistent growth penalty of 1 percentage point per year. Accordingly, debt reduction is no mere arithmetic exercise – it is an economic imperative. High levels of indebtedness will penalize the overall economy, and therefore slow job creation and wage growth.

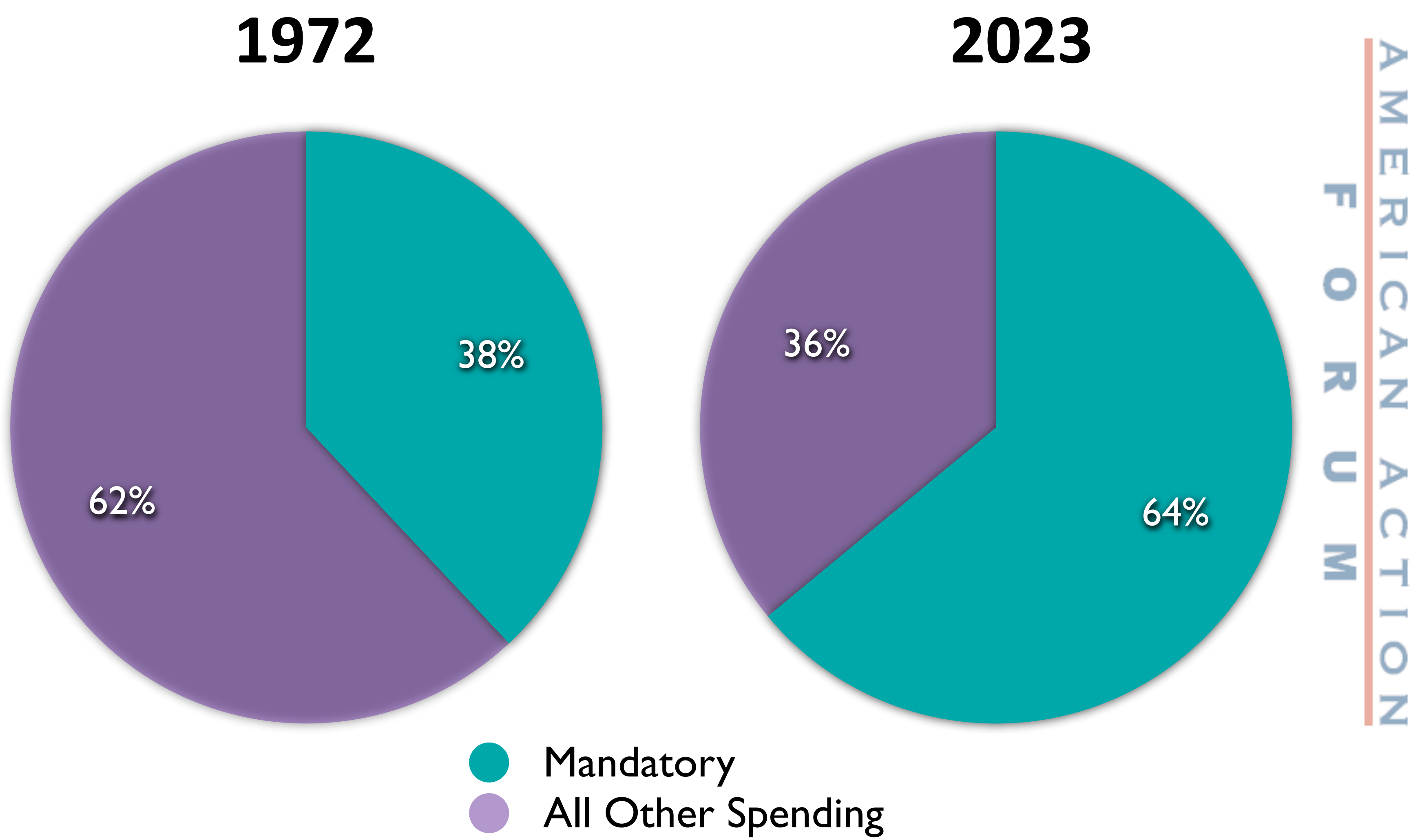



The administration has estimated that one percentage point in growth translates into approximately 1 million jobs created. Accordingly, over the period in the CBO baseline, a persistent 1 percentage point growth penalty should translate into an annual penalty of 1 million jobs forgone – or 11 million jobs over 2013-2023.




Over 2013-2023, CBO estimates growth of wages and salaries to average about 5 percent. Assuming a growth penalty of 1 percent, consistent with the Reinhart-Rogoff finding, income growth will also stagnate in a climate of high national indebtedness. Median household income was $50,054 in 2011. Under CBO's projections, this should exceed $86,000 by 2023. However, the income effects associated with higher debt will slow this income growth over time, such that a worker would see their income reduced by $9,390 by 2035 under current law.

## Mandatory Spending Crowds Out the Budget




At the heart of the nation's debt accumulation is mandatory spending – largely comprised of Medicare, Medicaid, and Social Security. In 1972, mandatory spending comprised 38 percent of the federal budget. By 2023 this share will increase to 64 percent – crowding out other federal priorities. Moreover, as the nation continues to borrow to finance growing mandatory spending, interest costs will further constrain federal resources and contribute to the economic challenge posed by debt accumulation