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## SOCIAL SECURITY AND THE FEDERAL BUDGET

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### Why the sudden concern about the budget deficit?

As has been widely noted, the 2009 budget deficit was the largest since World War II relative to the size of the economy. This is not surprising given that the current recession is also the worst since the Great Depression, and a large deficit is normal in this situation. But the recession is only half the story. Tax cuts, wars, and other legacies of the Bush administration contributed almost as much to the 2009 deficit, and cumulatively have had a greater effect on the debt since the federal budget went from surplus to deficit in 2002.

Though President Obama may have inherited the problem, it is still his—and Congress’—job to fix it. The first task facing the president and Congress is to promote job creation and economic growth. After the recession is past, they must put the federal budget on a sustainable path. First and foremost, this means getting health care costs under control. Second, policy makers should reverse the Bush tax cuts<sup>1</sup> for the wealthy and the buildup in defense spending. Finally, tax revenues will need to increase *modestly* and *gradually* over coming decades to pay for costs associated with the Baby Boomer retirement and rising life expectancies.

This primer is intended as a resource for those who worry that the sudden concern about deficits may be a ploy to cut Social Security and other key social insurance programs. Are we really on a collision course with an entitlements iceberg, or is it just a question of fixing our health care system and ensuring that high-income taxpayers pay their share?<sup>2</sup>

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## How does Social Security affect the federal budget?

Social Security is funded through dedicated payroll and benefit taxes as well as interest earned on previous surpluses. Hence, its finances are separate from the rest of the federal budget.<sup>3</sup> Similarly, Medicare is primarily funded through dedicated payroll taxes and user premiums, though general revenue sources now constitute a significant source of funds.

Social Security is currently in surplus, and the Congressional Budget Office (CBO) projects that the trust fund will continue to grow through 2020 to help pay for the Baby Boomer retirement (CBO 2010b). At some point in the following decade, outlays will start to exceed revenues, though the trust fund will ensure that full benefits can be paid for three decades or so. Thereafter, if modest changes are not made, benefits would have to be cut by roughly a fifth (or payroll taxes will have to be raised by a similar amount), as current revenues will not be sufficient to cover full benefits after the trust fund is exhausted.<sup>4</sup>

Though such an abrupt cut in benefits should certainly be avoided, it is important to note that the inflation-adjusted value of these benefits would still be larger than current benefits due to economic growth, though lower relative to pre-retirement earnings. Furthermore, since the Social Security Administration does not have the legal authority to pay full benefits in the event of a shortfall, this does not constitute a multi-trillion dollar liability for taxpayers as is often claimed.

This also assumes nothing is done to close the gap between projected revenues and outlays, which is quite modest—in the range of 0.5–0.7% of GDP over a 75-year horizon. Balance could be achieved by raising employer and employee payroll taxes by 1 percentage point or less (CBO 2009d; Social Security Trustees 2009). A more progressive alternative would be to raise or eliminate the cap on taxable earnings (Irons 2009a).

Why all the commotion, if the Social Security shortfall is so modest? The fact that programs like Social Security and Medicare have long-term, dedicated funding sources means that they are more likely to be criticized for not being in balance, even when the projected shortfall

is modest and distant, as in the case of Social Security. Perversely, policies like the Bush tax cuts that were never paid for with offsetting tax increases or spending cuts receive less scrutiny because no federal agency is required by law to estimate their impact on the federal budget 75 years into the future.<sup>5</sup>

## What are the repercussions of running a deficit?

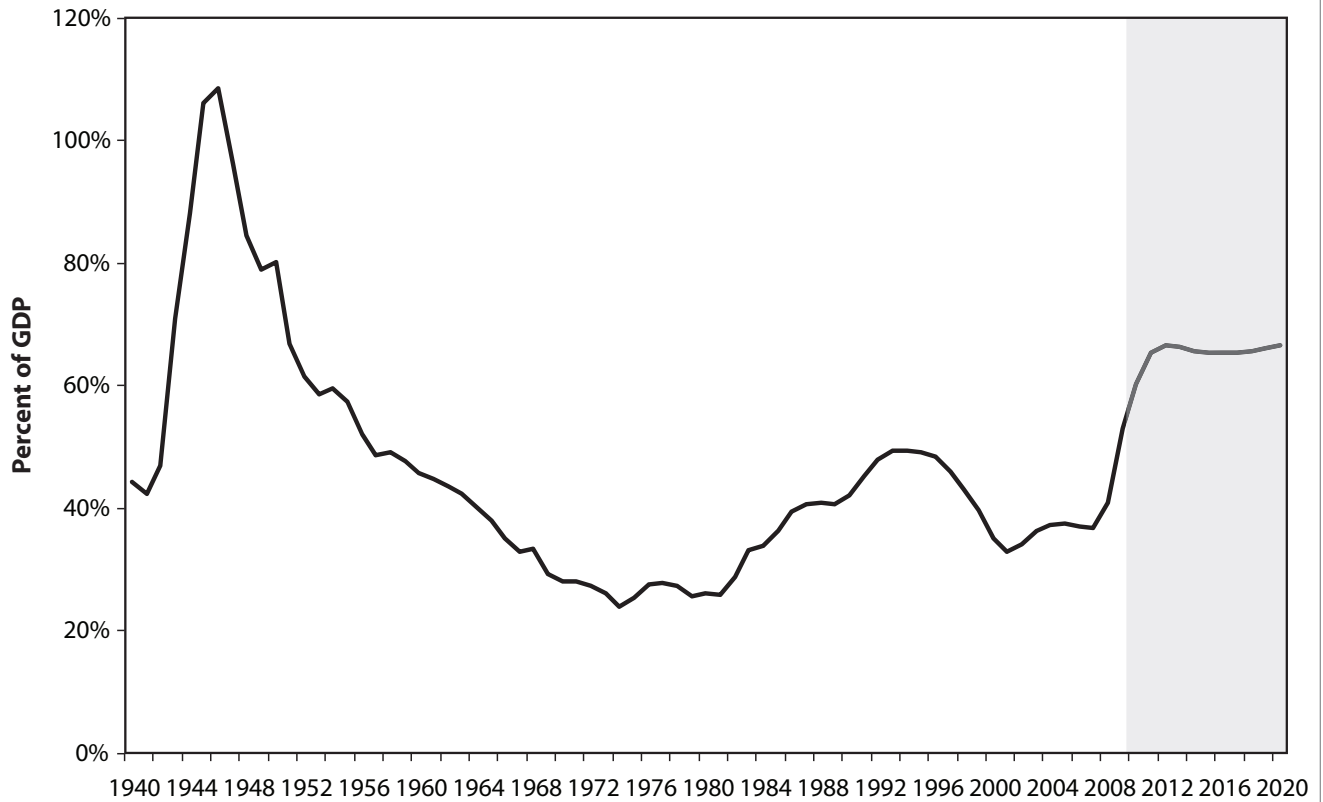
Budget hawks offer two main arguments for balancing the federal budget: first, that we are saddling our children and grandchildren with debt; and second, that budget deficits raise interest rates, crowd out private investment, and fuel inflation. In addition, some argue that reducing the deficit in expansions will give us room to maneuver in future recessions (Ettlinger and Linden 2009).

These arguments are addressed in more detail in Bivens (2010), but the most important point to remember is that the United States and other advanced economies have generally relied on economic growth rather than budget surpluses to reduce the debt relative to the size of the economy (gross domestic product, or GDP). The debt-to-GDP ratio has fluctuated significantly since World War II—typically rising during wars and recessions and declining during peacetime expansions—despite the fact that deficits have been the rule rather than the exception. In fact, since 1970, the only time the budget has been in surplus was from 1998 to 2001.

Thus, the goal is not necessarily to eliminate the deficit but rather to bring it down to a sustainable level after the economy fully recovers. This process should not be rushed, however, because the risk of stalling the recovery with premature fiscal retrenchment is more serious than the risk of dragging it down with debt. Though the debt-to-GDP ratio is likely to grow from around 40% before the recession to 70% or higher<sup>6</sup> by the end of the decade (see **Figure A**), this is not likely to pose a serious problem as long as interest rates remain relatively low, as the CBO projects (CBO 2010a). The 1949–53 expansion, for example, was robust despite the very high debt burden left over from World War II. In contrast, the 2001–07 expansion was notably weak despite the sharp drop in the debt that preceded it.

FIGURE A

Federal debt held by the public as a share of GDP



NOTE: Shaded area indicates projection.

SOURCE: Office of Management and Budget (historical); CBO (baseline projection).

In theory, interest rates are influenced by the federal budget deficit. But the link is weak, in part because there is a global market for U.S. securities. Though the U.S. Treasury borrows more during recessions, this tends to be offset by the fact that investors flock to U.S. government bonds and other relatively safe assets during global downturns. Furthermore, because investment is also driven by economic growth, government spending will tend to “crowd in” rather than “crowd out” private investment spending in a slack economy (Bivens 2010). For similar reasons, concerns about inflation are ill-timed at a time when the economy is likely to be operating below capacity for several years and deflation remains a more serious concern (Bivens 2010).

### How quickly should we reduce the deficit?

While many economists and policy makers accept the need for deficit spending during a recession, some assume the economy is on a secure path to recovery and are calling for reducing the deficit to a sustainable level by the end of the decade (Ettlinger and Linden 2009; NRC and NAPA 2010; Peterson-Pew Commission 2009; Ruffing et al. 2010).

This is premature. Unemployment is extremely high and will remain so for several years even under optimistic scenarios. Shierholz (2010) has estimated that the economy would need to generate 415,000 jobs a month to return to pre-recession unemployment rate within three years. Instead, the economy is still shedding jobs.

Those calling for rapid deficit reduction usually assume the economy will return to full employment by 2014, but they do not explain how this can happen in the context of rapid deficit reduction. Mishel (2010) estimates that \$150-250 billion in additional spending targeted for job creation will be required to prevent the employment situation from *worsening*.

More generally, it is a mistake to make too sharp a distinction between recessions and expansions. We also need to worry about periods of slow growth, like the anemic expansion of the last decade that saw historically low job growth and stagnant median family incomes (Bivens and Irons 2008). Prominent economists from across the political spectrum are warning that we could be in for another sluggish recovery as real estate and other depressed sectors remain a drag on the economy, while households try to pay down debt and rebuild their balance sheets (Matthews and Homan 2010).

## What is a sustainable deficit?

Paul Krugman has estimated that after the economy recovers, a deficit equal to roughly 3% of GDP would stabilize the debt-to-GDP ratio. Anything smaller, such as a deficit equal to 2% of GDP, would tend to shrink the debt ratio (Krugman 2009a; Krugman 2009b). He derived this estimate by multiplying projected GDP growth (4.5%) by the projected debt share after the recession is over (70% of GDP).

Admittedly, this simple definition of a sustainable deficit—a deficit small enough that the debt is stable or shrinking relative to the size of the economy—can describe a highly indebted country devoting a large share of government revenues to debt service. A stricter definition of a sustainable deficit is one where the debt-to-GDP ratio eventually stabilizes at or below a target level. To meet this stricter definition of sustainability, the rule of thumb is that the primary deficit share (the gap between government revenues and spending on government programs as a share of GDP, excluding interest payments) must be less than or equal to the difference between the growth rate of GDP and the interest rate on the federal debt, multiplied by the target debt-to-GDP ratio.<sup>7</sup>

This raises the question of what the appropriate fiscal target is and how fast we should aim to get there.

While prominent voices have suggested stabilizing the debt at 60-70% of GDP within 10 years (NRC and NAPA 2010; Peterson-Pew Commission 2009; Ruffing et al. 2010), a cross-country comparison by economists Carmen Reinhart of the University of Maryland and Kenneth Rogoff of Harvard University found no evidence that debt-to-GDP ratios below 90% had any impact on economic growth (Reinhart and Rogoff 2010). Even if a lower target is chosen, a rush to achieve the target could require drastic budget cuts that would slow or even derail the recovery. Rather, the goal should simply be to return to a sustainable deficit of around 3% after the economy has fully recovered.

It is also important to keep in mind that economic projections vary widely and tend to be based on somewhat conservative assumptions, such as a 4.5% GDP growth rate (the CBO assumes an even lower GDP growth rate than Krugman—4.2%). Historically, GDP growth has averaged around 6% over the past quarter century and 7% over the past half century. If we resume these higher growth rates, then deficits on the order of 3-5% could be sustainable, as they have been in the past.

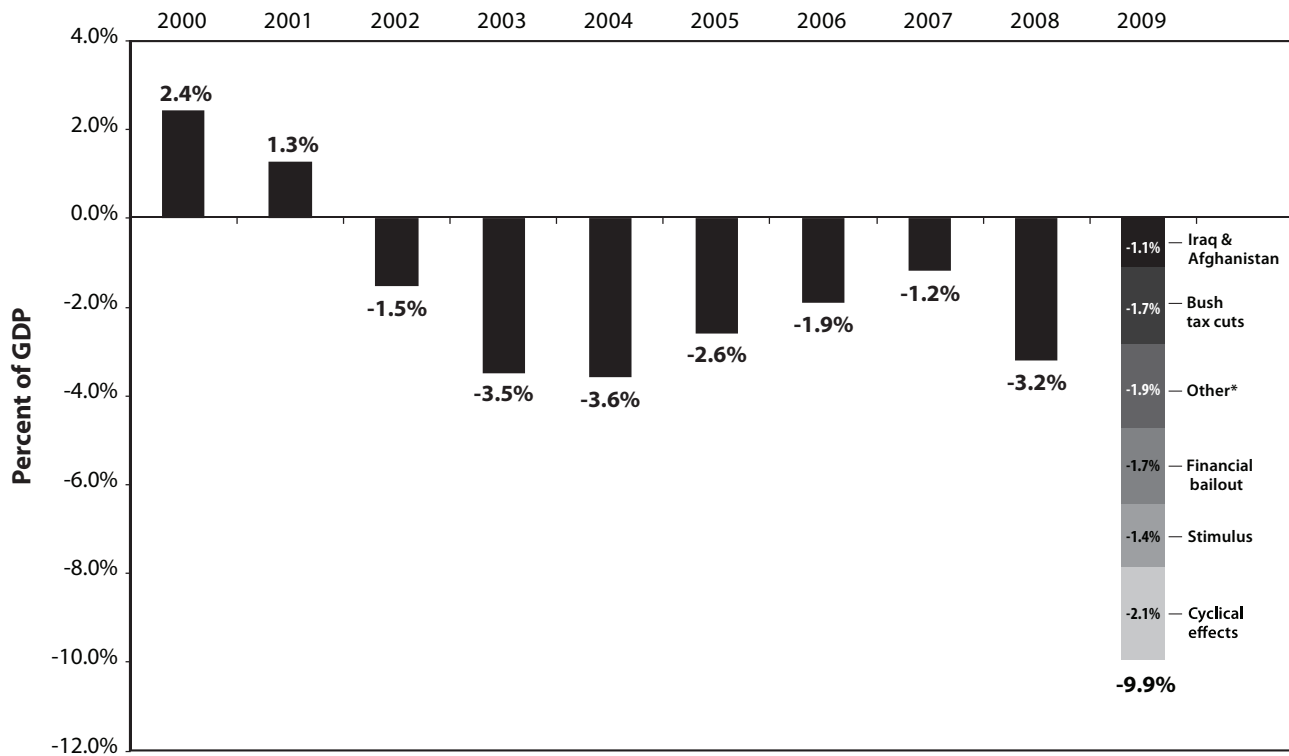
These calculations also assume that the economy is at full employment. As long as the economy is operating below capacity, the GDP growth rate is not fixed but is itself a function of the federal deficit. And not all deficits are created equal: spending or tax cuts targeted to low- and moderate-income households will tend to have a larger stimulus effect than those that benefit wealthy households, who usually save a share of their incomes.

In addition, public investment in infrastructure, education, and the like increases economic capacity, so policies that increase the debt share of future generations may nevertheless improve their standard of living. Similarly, stimulus and antipoverty measures, while increasing the debt share, also help youth. If this spending is curtailed because of deficit concerns, the next generation of workers will face wage losses and other long-term repercussions of lower educational attainment, poor nutrition, and the like (Irons 2009b).

In general, the greater the need for stimulus and the greater the share of government spending on productive investments, the more justification there is for allowing the debt-to-GDP ratio to rise, or at least for using a looser

**FIGURE B**

**Deficit as share of GDP, 2000-09**



\* "Other" includes increased defense spending (aside from the wars in Iraq and Afghanistan) and the new Medicare D Prescription drug plan, among other policies implemented since the budget was in surplus in 2001.

SOURCE: CBO and Citizens for Tax Justice.

definition of “sustainable.” Since this is a once-in-a-lifetime economic downturn and we are still far from debt levels that could threaten future growth, the most prudent strategy for the time being is to err on the side of deficit spending, not deficit reduction.

**How large was the 2009 deficit, and how much was due to the recession?**

The CBO reported that the 2009 deficit was 9.9% of GDP. More than half of that (5.3% of GDP) is due to the recession (see **Figure B**). This includes decreases in tax revenues and increases in spending on unemployment and other benefits that occur automatically as a result of a cyclical downturn (2.1% of GDP). The rest is the projected cost of the financial bailout (1.7% of GDP) and

the comparatively modest Recovery Act (1.4% of GDP) (CBO 2010a; CBO 2009f).

If the economy were at full employment, the deficit would be smaller and GDP would be higher, so the *structural* deficit (the deficit, minus cyclical effects and the cost of countercyclical policies, as a share of *potential* GDP) is around 4.5% (Auerbach and Gale 2009). This structural deficit—roughly 1.5 to 2 percentage points above a sustainable deficit—is what we will need to address once the recession is behind us.

**How did the policies of the Bush administration contribute to the deficit?**

Though the recession was the primary cause of the 2009 deficit, it is important to keep in mind that policies put in

place by the Bush administration before the recession have had a greater cumulative impact on the national debt than the recession and the countercyclical policies of the Bush and Obama administrations (Ruffing and Horney 2009). President Bush inherited a surplus of 2.4% of GDP and bequeathed his successor a deficit equal to 3.2% of GDP. The policies of his administration—including the 2001 and 2003 tax cuts (1.7% of GDP in 2009) and the wars in Iraq and Afghanistan (1.1% of GDP in 2009)—continue to add to the deficit today (Citizens for Tax Justice 2009a; CBO 2010a).

These measures understate the full impact of those policies because they do not include interest on the increased debt, and because the run-up in defense and security spending during the Bush administration exceeded the direct cost of the two wars. Researchers at the

Center on Budget and Policy Priorities have estimated that in 2009, the full cost of the Bush tax cuts was \$427 billion (3.0% of GDP), and the full cost of increases in defense and security spending was \$399 billion (2.8% of GDP) (figures include associated debt service) (Brunet and Kogan 2008).

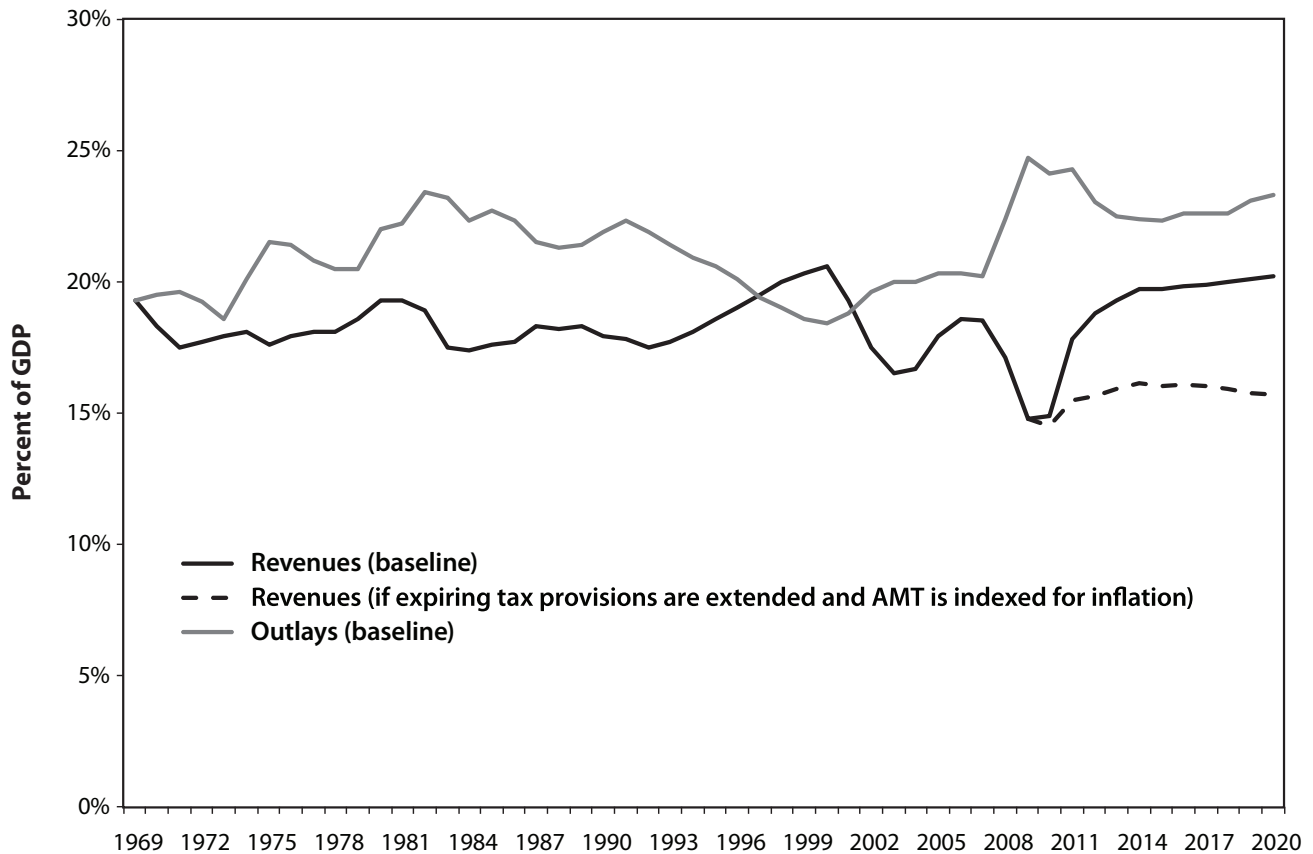
### What are the medium-term challenges?

Under the CBO’s baseline projection, the deficit will drop to around 3% by 2013 and remain around that level for the rest of the decade (CBO 2010a). However, this assumes the Bush tax cuts and other tax provisions are allowed to expire and that the Alternative Minimum Tax (AMT) is not indexed for inflation.

If the 2001 and 2003 tax cuts are extended, this would add to the annual deficit by an average of 1.5% of GDP

FIGURE C

#### Federal revenues and outlays as a share of GDP, 1969-2020



SOURCE: CBO.

over 2010-20 (author's calculations based on CBO 2010a, including debt service) (see **Figure C**). Extending other expiring tax provisions and indexing the AMT to inflation would add an additional 1.5% of GDP per year (1.9% including interactive effects). Thus, extending expiring tax provisions and indexing the AMT would more than double the deficit over this period, approaching 6-7% of GDP by the end of the decade.<sup>8</sup>

Most likely, the tax cuts will not be allowed to expire completely. The Obama administration has pledged not to raise taxes on single taxpayers with incomes under \$200,000 or married taxpayers with incomes under \$250,000. As a result, the administration would only recoup about a third of the revenues lost due to tax cuts if Congress went along with the administration's plans (author's calculations based on Auerbach and Gale 2009).

## What are the long-term challenges?

Whereas the biggest short-term challenge is tackling the recession, and the biggest medium-term challenge is recouping revenues lost to tax cuts, the biggest long-term challenge is stemming the rise in health care costs. Not only will we face mounting Medicare and Medicaid costs, but the problem will be compounded by rising interest on the debt.

The CBO projects that if health care costs continue to outpace economic growth, the deficit will grow to nearly 18% of GDP by 2080 (CBO 2009b). However, this assumes that Medicare and Medicaid spending will continue to outpace economic growth as it has since 1975. Since this would eventually cause consumption of other goods and services to decline, CBO assumes that health care cost inflation will eventually slow but that health care will then consume *every dollar* of economic growth.

It is simply not realistic to assume that health care spending will grow indefinitely as a share of the economy, especially since private health care costs would likely grow even faster. While the health care overhaul recently passed by Congress may not "bend the cost curve" sufficiently, in health policy jargon, it is a significant step forward. A more realistic concern is that delays in implementing additional cost-control measures, such as introducing competition through a public option, could cause us to cut or constrain other needed government programs.

Another long-term challenge is an aging population. The CBO estimates that if health care costs just keep pace with economic growth, spending on Social Security, Medicare, and Medicaid will rise by 3 percentage points of GDP over the next two decades as the baby boomers retire, and by an additional 1 percentage point over the following half century due to increase in life expectancy (CBO 2009b) (see **Figure D**).

Slightly more than half of the total increase in entitlement spending associated strictly with aging—2.4%—is due to increased Medicare and Medicaid spending (CBO 2009b), and the remainder—1.6%—is due to Social Security. However, Social Security has been running a surplus in anticipation of the Baby Boom retirement, and the CBO projects that the 75-year Social Security deficit represents just 0.5% of GDP even if rising health care costs continue to erode taxable payroll (CBO 2009d). Therefore, payroll and other tax revenues will have to increase by at most 3% of GDP (rather than 4% of GDP) over the next 75 years to cover costs associated with aging in these entitlement programs. However, the federal government will have to raise general tax revenues or cut spending by 1% of GDP to make up for the fact that the Social Security surplus currently reduces the size of the unified budget deficit.

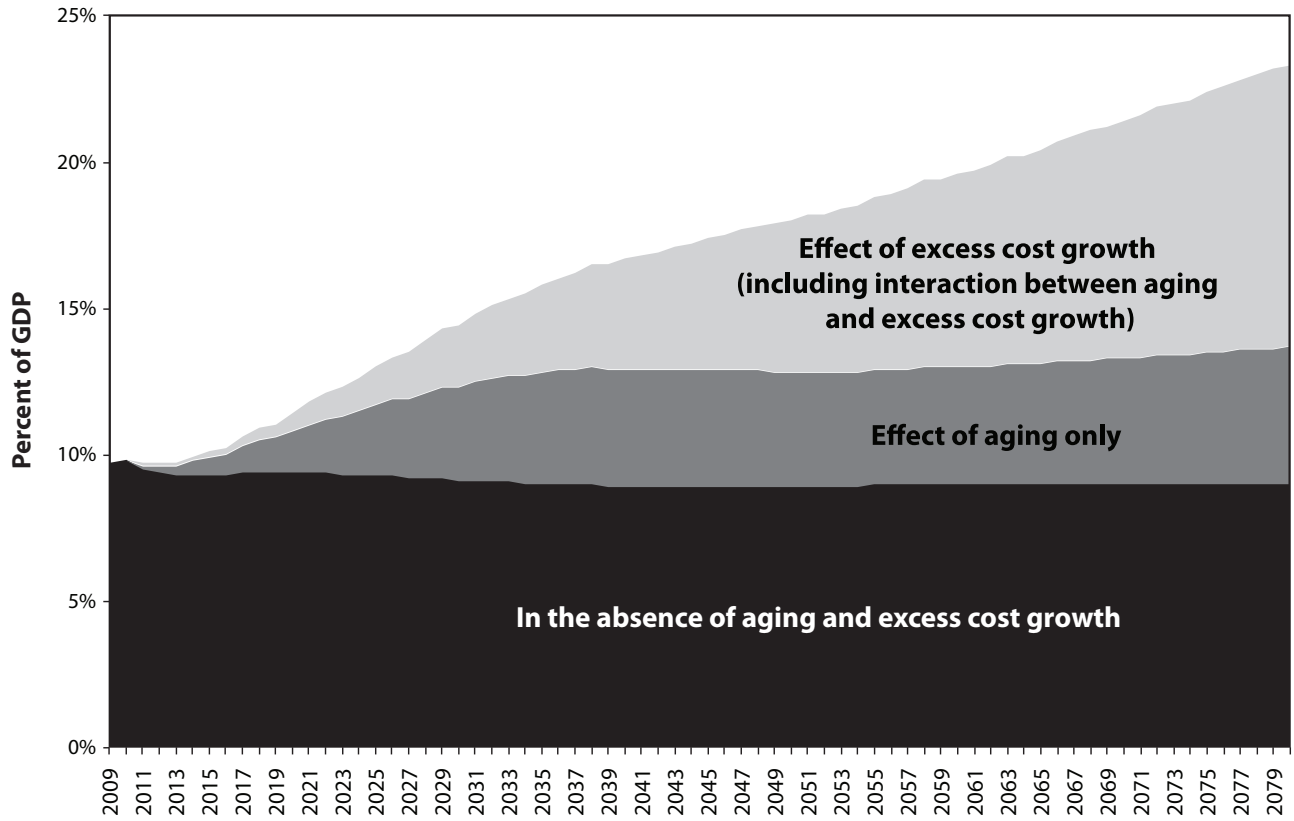
## Should we focus on taxes or spending?

The U.S. tax share—federal, state, and local taxes as a share of GDP—is the lowest among advanced economies (28%, compared to an Organization for Economic Cooperation and Development average of 36% in 2007) (OECD 2009). Even if the Bush tax cuts for the wealthy are allowed to expire and the costs associated with aging are paid for by raising taxes, the U.S. tax share will still be low compared to other advanced economies.

Meanwhile, the need for safety net programs and public investment is greater than ever. Poverty rates were trending upward even before the recession hit (U.S. Census Bureau 2008), and even middle-class Americans face growing economic insecurity as fewer jobs come with adequate health and retirement benefits (Hacker 2006; Schmitt 2005). There is also a dire need for investment in infrastructure, early childhood education, alternative energy, and many other areas.

FIGURE D

**Projected spending on Social Security, Medicare, and Medicaid as a share of GDP**



SOURCE: CBO.

**Is there room to cut spending?**

When President Bush took office in 2000, federal spending as a share of GDP was fairly low by post-war standards. During the Bush administration, spending grew by roughly 2 percentage points of GDP even before the recession hit, largely due to increases in defense spending and, to a lesser extent, the passage of the Medicare D prescription drug benefit. Even so, the federal share in 2007 was moderate by historical standards, below the shares in 1980 and 1990. Only in 2008 and 2009, after the recession hit, did federal spending exceed post-war norms.

There is not much fat to trim in the domestic discretionary budget, which shrank from 3.1% of GDP to 2.8% of GDP between 2001 and 2008 (Kogan 2008). In contrast, defense and security appropriations increased from 3.6% to 5.6% of GDP over this period, not all of this

due to the wars in Iraq and Afghanistan (Kogan 2008). The run-up in defense spending included cost overruns for weapons systems totaling some \$300-400 billion over this period (Korb et al. 2008),<sup>9</sup> or up to 0.5% of GDP.

Social insurance programs represent a growing share of federal spending, but this does not mean benefits are too generous and should be cut. Social Security replacement rates (benefits as a share of pre-retirement earnings) are already shrinking due to a gradual increase in the normal retirement age. These benefits are more critical than ever, as fewer and fewer workers have secure employer pensions, and many have seen their retirement savings plummet during the current downturn. As a result, the Center for Retirement Research estimates that over half of American workers are now at risk of being unable to maintain their standard of living in retirement (Munnell et al. 2009).

Similarly, Medicaid, the State Children's Health Insurance Program (SCHIP), and other government programs are picking up the slack as employer-sponsored insurance covers a shrinking share of Americans (Gould 2009). As mentioned earlier, an aging population is another factor in the growth in entitlement spending, especially Medicare. However, the biggest challenge is cost inflation. Since this is, if anything, an even bigger problem for the private sector, taking additional steps to slow the growth of health care costs is not just the key to putting the federal budget on a sustainable path, but also to our overall well-being.

## How can we generate federal revenues?

In recent years, tax policy has tended to favor the wealthy, exacerbating what was already a growing gap between the rich and poor. This argues for more progressive tax policies going forward. Meanwhile, tax policies may be an effective way to address problems ranging from climate change to financial market instability.

As mentioned earlier, a good place to start would be allowing the Bush tax cuts for the wealthy to expire. These tax cuts, which will have cost more than \$2 trillion over 10 years, are very regressive, with over two-thirds of the tax cuts going to households in the top 20% of the population (those making \$115,000 or more) (Leiserson and Rohaly 2008). As mentioned earlier, these tax cuts, if extended, will increase the deficit by around 1.5% of GDP, so not extending the tax cuts for these wealthy households would shrink the deficit by about 1% of GDP.

Cap-and-trade legislation aimed at reducing greenhouse gas emissions would also create revenue opportunities. The CBO estimates that such legislation could generate \$50-300 billion per year from the sale of emission permits (Dinan 2009), though half or more of these revenues could be needed to compensate low- and moderate-income consumers and companies for their losses. Thus, such legislation could eventually help reduce the deficit by 1% of GDP.

The cap-and-trade bills now being discussed in Congress would generate much more modest revenues. For example, the American Clean Energy and Security

Act (H.R. 2998) would reduce the deficit by \$9 billion over a decade because most emissions permits would be given away rather than auctioned (CBO 2009c). Ideally, cap-and-trade revenues could be used to fund green jobs programs while unemployment remains high, with a gradual shift toward deficit reduction as economic conditions improve.

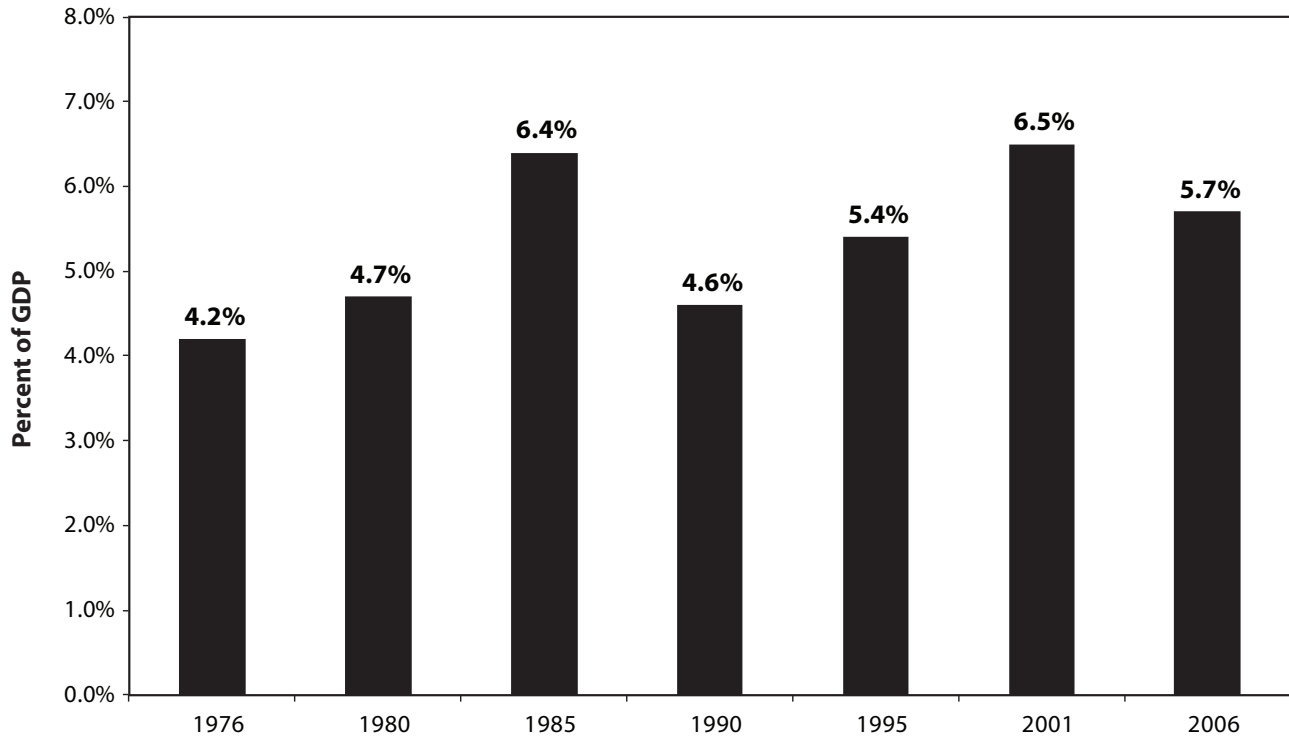
Another potential source of revenue comes from a financial transactions tax, which has the potential to stabilize financial markets by penalizing high-volume trades. A 0.5% tax spread over a variety of financial assets could raise anything from 0.8% to 1.6% of GDP annually, with most of the burden falling on upper-income households (EPI 2009). A similar tax already exists in the United Kingdom.

## What about tax expenditures?

Tax expenditures (a.k.a. tax breaks, incentives, loopholes, or shelters) are revenue losses resulting from tax provisions designed to encourage certain kinds of behavior or aid taxpayers in special circumstances (Gravelle 1999). Examples of tax expenditures include the home mortgage interest deduction and lower tax rates for capital gains and dividends.

As the name implies, tax expenditures are equivalent to spending programs channeled through the tax system. Theoretically, it should not matter whether the purchase of energy-efficient appliances, for example, is subsidized through mail-in rebates or tax rebates since the impact on the deficit is the same. Politically, however, the two types of policies are treated very differently. Unlike most spending programs, tax expenditures do not have to be renewed by Congress each year and amounts are not limited, so they have a tendency to grow unchecked.

Tax expenditures declined as a result of the Tax Reform Act of 1986; however, by 2001 they had exceeded their pre-reform level as a share of GDP (**Figure E**) (Burman et al. 2008). Despite dropping off somewhat after 2001 due to lower marginal tax rates, they continue to have a big impact on the federal budget, and the cost of tax expenditures now exceeds domestic discretionary spending (Hungerford 2008; Huang and Shaw 2009).

**FIGURE E****Non-business tax expenditures as share of GDP, 1976-2006**

SOURCE: Burman, Toder, and Geissler (2008).

Observers have noted that tax expenditures find common ground between Republicans who want to cut taxes and Democrats who want to achieve social goals like expanding education or home ownership (Reischauer 2009). However, tax subsidies tend to be poorly targeted and are often more successful at lowering taxes for the wealthy than achieving their ostensible purpose. Though a few tax expenditures are targeted to low-income households, most are more valuable to high-income taxpayers. The value of the mortgage interest deduction, for example, depends on the home owner's tax bracket as well as the size of the loan. It subsidizes home loans as large as a million dollars, including those for second homes, while providing no help to home owners who do not itemize (Pelletier 2009). As a result, roughly two-thirds of the largest tax expenditures, including the mortgage interest deduction, go to taxpayers in the top income quintile (Gist 2007; Burman et al. 2008; Hungerford 2008; Toder et al. 2009).

Simply reducing tax expenditures to their 1990 share of GDP (4.6%) would go more than half way toward shrinking the structural deficit to a sustainable level. Going further—for example, restructuring the tax system so that the top 20% of taxpayers receive the same share of tax breaks as the bottom 80%—would put us on a sustainable path for years to come if health care costs are also brought under control.

### **What to do, in a nutshell?**

The federal budget was in surplus as recently as 2001, and CBO projected surpluses through the coming decade (CBO 2001). However, President Bush's policies, especially the 2001 and 2003 tax cuts and the run-up in defense spending, put the budget in deficit even before the recession hit. Reversing these policies, in whole or in part, would be the obvious way to return to a sustainable deficit equal to 3% of GDP. The structural deficit is currently around 4.5% of GDP. Allowing Bush tax cuts for the

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wealthy to expire would reduce this to around 3.5% of GDP, and trimming the defense budget by eliminating pork could yield another 0.5% or more.

To stay on a sustainable path, we will also need to take additional steps to restrain health care cost inflation as well as a gradual increase in revenues to pay for costs associated with an aging population. Total federal revenues will have to increase by roughly 3% of GDP over the next two decades to handle the Baby Boomer retirement (and more slowly thereafter, due to increases in life expectancy). Since Social Security has been running a surplus in anticipation of the Boomer retirement, payroll tax revenues would have to increase only modestly to keep the Social Security system in balance. However, additional revenue sources may need to be tapped to pay for an increase in Medicare and Medicaid beneficiaries. These revenues could come from cap-and-trade revenues, a financial transactions tax, or trimming tax breaks, each of which could yield revenues equal to 1% of GDP or more. Thus, a sustainable budget can be achieved by combining tax and health care reform with policies that help our environment and stabilize our economy—*without* cutting essential programs like Social Security.

## Endnotes

1. The Economic Growth Tax Relief Reconciliation Act (EGTRRA) of 2001 and the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003.
2. Many of the topics discussed here are covered in more depth in an EPI Briefing Paper, “Budgeting for Recovery,” by Josh Bivens (2010). Links to that paper and other sources are provided in this paper’s references.
3. Nevertheless, it is often useful to focus on a unified federal budget that includes all federal programs, including Social Security and Medicare, as we do here. This allows us to estimate how total federal revenues and outlays need to be adjusted to put the federal government on a sustainable path while still paying scheduled benefits in full.
4. For consistency, the paper will cite CBO projections except where otherwise noted.
5. The Bush tax cuts were set to expire after a few years as a budget gimmick. However, the obvious intent was to make them permanent, since the Bush administration even proposed a budget rule that would have required CBO to consider an extension of the tax cuts to have zero cost (Friedman and Shapiro 2004).
6. CBO projects that the debt will be around 67% of GDP in 2020 (CBO 2010a), but this assumes no change in tax laws. Under an alternative scenario which, among other things, assumes the 2001 and 2003 tax cuts are extended and the Alternative Minimum Tax is indexed to inflation, CBO projects the debt would reach 83% of GDP (CBO 2009b).
7. For example, if you assume GDP growth of 4.5%, a 3% interest rate, and a target debt-to-GDP ratio of 70%, then a primary deficit equal to 1.05% of GDP is sustainable (4.5% minus 3% and multiplied by 70%). This is equivalent to a total deficit, including debt service, of 3.15% of GDP because the interest on the debt will stabilize at 2.1% of GDP (3% multiplied by 70%).
8. Adjusting the CBO baseline projection to consider the impact of extending expiring tax provisions and indexing the Alternative Minimum Tax, the deficit would be 7.3% in 2019 (authors’ calculations based on CBO 2010a). Making these and other adjustments to the CBO baseline, the Center on Budget and Policy Priorities projects a 2019 deficit of 6.4% of GDP (Ruffing et al. 2010).
9. Winding down the wars would also reduce defense spending, but this is already assumed in CBO projections.

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