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

Keith Hall, Director

June 16, 2015

Honorable Ron Johnson
Chairman
Committee on Homeland Security and Governmental Affairs
United States Senate
Washington, DC 20510

Re: Communicating the Nation's Fiscal Status

Dear Mr. Chairman:

Thank you for your letter of June 9, 2015, regarding the Congressional Budget Office's analyses of the nation's long-term budget outlook and the agency's work on policy options that would address long-term fiscal imbalances. I am pleased that you find CBO's work on those subjects to be helpful. Effectively communicating the meaning and significance of the nation's long-term fiscal outlook is a challenge, so we appreciate your input on additional ways to do so.

Your letter addressed several topics:

- The reporting requirements specified in the 2016 budget resolution,
- Alternative presentations of long-term fiscal challenges,
- Thirty-year projections in CBO's annual *Budget and Economic Outlook*,
- Options for Social Security and Medicare, and
- Macroeconomic feedback from changes to Social Security or Medicare.

Reporting Requirements Specified in the Budget Resolution

You noted the provision in the 2016 budget resolution that directs CBO, whenever it "releases projections of Federal deficits over any term of years," to publish a one-page summary of federal outlays, receipts, surpluses, and deficits spanning those years—divided into specified categories.[1] Released by CBO this morning, *The 2015 Long-Term Budget Outlook* includes such a one-page statement.[2] (See Summary Table 1 on page 3; a copy is attached.)

Alternative Presentations of Long-Term Fiscal Challenges

In your letter, you requested that CBO include a one-page income statement and accompanying bar chart by decade in *The 2015 Long-Term Budget Outlook*. In the agency's judgment, however, alternative

[1] Section 3111 of the concurrent resolution on the budget for fiscal year 2016, S. Con. Res. 11, 114th Cong. (2015) (adopted).

[2] Congressional Budget Office, *The 2015 Long-Term Budget Outlook* (June 2015), www.cbo.gov/publication/50250.

presentations in the report convey the magnitude of the nation's long-term fiscal challenge more clearly and meaningfully—in particular, the summary table mentioned above and a new summary figure.

Summary Table 1 displays budgetary totals in different years and expresses those amounts as percentages of gross domestic product (GDP), which has some advantages. Expressing debt, for example, as a percentage of GDP gives some indication of the ability of the United States to reduce or eliminate that debt in the future. Although there are other ways of putting the amount of debt in perspective, expressing debt as a percentage of GDP accounts for changes in price levels, population, output, and income over time—all of which are important in assessing the sustainability of the budget. Just as a household's income and assets are a measure of how much debt it can reasonably bear, GDP broadly conveys the means available to finance debt held by the public.

Another useful way to assess the budgetary outlook is to estimate the magnitude of the policy changes that would be necessary to put the federal budget on a sustainable path for the long term. To do that, lawmakers would have to make significant changes to tax or spending policies by reducing spending for large benefit programs below the projected amounts, by letting revenues rise more than they would under current law, or by adopting some combination of those approaches. The size of such changes depends on the amount of federal debt that lawmakers consider appropriate.

Summary Figure 1 (on page 7 of the report) includes several measures aimed at communicating, in dollar terms, the size of potential policy changes that would be needed to meet two goals in 25 years: keeping debt at its current level and reducing debt to its average level over the past half-century. The measures include the total dollar value of the changes in taxes or spending next year that would put the budget on a path toward attaining either of those goals; that dollar value per person in the United States; the dollar value of the additional taxes that would have to be paid next year by a middle-income household if increases of equal percentage were enacted each year for all types of revenues; and the dollar value of changes next year in initial Social Security benefits for a middle-income retiree if cuts of equal percentage were enacted each year for all types of spending. A copy of that figure is attached.

I will be testifying on the report before the Senate Budget Committee tomorrow, and I look forward to hearing your views about the presentations of the outlook then or at any other time you would like to discuss them.

Thirty-Year Projections in CBO's Annual *Budget and Economic Outlook*

You noted the provision in the resolution (section 3108) that calls on CBO to provide projections of federal revenues, outlays, and deficits for the 30-year period beginning with the budget year as part of its annual *Budget and Economic Outlook*. CBO plans to produce such projections in conjunction with that report when it is issued next winter.

Options for Social Security and Medicare

You asked if CBO could produce a menu of policy options for Social Security with cost estimates covering 30 years. CBO has produced numerous reports about the Social Security program, many of which include a range of policy options and estimates of the effects of those options on the budget in the short term and the longer term. For example, CBO published a report entitled *Policy Options for the Social Security Disability Insurance Program*, which presented estimates of the budgetary effects of a variety of potential modifications to that program.[3] CBO recently answered several questions from

[3] See Congressional Budget Office, *Policy Options for the Social Security Disability Insurance Program* (July 2012), www.cbo.gov/publication/43421.

Senator Hatch about the implications of altering the Social Security payroll tax rates as well as the maximum amount of earnings on which those payroll taxes are imposed.[4] CBO has also presented a variety of options for changing the Social Security system and analyzed how they would affect the program's finances and how they would alter the benefits paid to people in various earnings categories and people born in various decades.[5] CBO is working on an update to that report, which will be released later this year.

In addition, you asked about options for Medicare. CBO has prepared numerous reports discussing the potential effects of changes to Medicare, most recently in *Options for Reducing the Deficit: 2015 to 2024*. Specific options have included the following: changing the cost-sharing rules for Medicare and restricting medigap insurance, increasing premiums for Parts B and D of Medicare, limiting medical malpractice torts, requiring manufacturers to pay a minimum rebate on drugs covered under Part D of Medicare for low-income beneficiaries, bundling Medicare's payments to health care providers, increasing the payroll tax rate for Medicare Hospital Insurance, raising the age of eligibility for Medicare to 67, and introducing a premium support system for Medicare.[6] Those reports provide estimates of annual budgetary effects that focus on the next 10 years but also include information on longer-term effects when possible and when that information is supported by available evidence. Longer-term estimates for Medicare and other health care programs are subject to considerable uncertainty, so providing reliable information on budgetary effects beyond the first decade is particularly challenging.

CBO will continue to consult with the Chairmen and Ranking Members of the budget committees and the committees of jurisdiction about priorities for future analysis of policy options affecting those programs.

Macroeconomic Feedback From Changes to Social Security or Medicare

Finally, you asked about estimates of the budgetary effects of macroeconomic feedback that might result from changes to revenues for Social Security or Medicare. CBO has devoted significant effort to developing analytical tools that enable it to assess the macroeconomic effects of fiscal policies.[7] In selected reports, the agency has provided estimates of the effects that significant changes in federal spending and tax policies would have on the economy. Some of those analyses have also examined how

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[4] See Congressional Budget Office, *Answers to Questions From Senator Hatch About Various Options for Payroll Taxes and Social Security* (July 2014), www.cbo.gov/publication/45519.

[5] See Congressional Budget Office, *Social Security Policy Options* (July 2010), www.cbo.gov/publication/21547.

[6] See Congressional Budget Office, *Options for Reducing the Deficit: 2015 to 2024* (November 2014), www.cbo.gov/budget-options/2014, *Health-Related Options for Reducing the Deficit: 2014 to 2023* (December 2013), www.cbo.gov/publication/44906, *Raising the Age of Eligibility for Medicare to 67: An Updated Estimate of the Budgetary Effects* (October 2013), www.cbo.gov/publication/44661, and *A Premium Support System for Medicare: Analysis of Illustrative Options* (September 2013), www.cbo.gov/publication/44581.

[7] See Congressional Budget Office, *How CBO Analyzes the Effects of Changes in Federal Fiscal Policies on the Economy* (November 2014), www.cbo.gov/publication/49494; Congressional Budget Office, *How Does CBO Model the Response of Labor Supply to Changes in Tax and Spending Policies?* (October 2012), www.cbo.gov/publication/43680; Robert McClelland and Shannon Mok, *A Review of Recent Research on Labor Supply Elasticities*, Working Paper 2012-12 (Congressional Budget Office, October 2012), www.cbo.gov/publication/43675; Felix Reichling and Charles Whalen, *Review of Estimates of the Frisch Elasticity of Labor Supply*, Working Paper 2012-13 (Congressional Budget Office, October 2012), www.cbo.gov/publication/43676; Jonathan Huntley, *The Long-Run Effects of Federal Budget Deficits on National Saving and Private Domestic Investment*, Working Paper 2014-02 (Congressional Budget Office, February 2014), www.cbo.gov/publication/45140; and Charles J. Whalen and Felix Reichling, *The Fiscal Multiplier and Economic Policy Analysis in the United States*, Working Paper 2015-02 (Congressional Budget Office, February 2015), www.cbo.gov/publication/49925.

the projected changes in the economy would affect the federal budget.[8] Such analyses are complex and time-consuming and could be undertaken only for selected issues.

As you know, the 2016 budget resolution requires CBO, to the greatest extent practicable, to incorporate budgetary effects of macroeconomic feedback in cost estimates for major legislation—which could affect revenues, spending, or both. The agency is prepared to produce such estimates when the legislative process allows sufficient time for the analysis that would be necessary. In addition, the agency can sometimes analyze macroeconomic feedback from proposals not covered by the requirement—such as ones at earlier stages of the legislative process—depending upon the details of the proposals and the availability of resources. I should note that, in general, conventional and dynamic estimates for policy proposals that affect only revenues are prepared by the staff of the Joint Committee on Taxation.

I look forward to working with you and your committee on these and other matters, and I welcome your input on ways that CBO can more effectively communicate with lawmakers and the public on these critical issues. I am available to discuss these matters with you at any time.

Sincerely,

Keith Hall
Director

Enclosure

cc: Honorable Tom Carper
Ranking Member
Committee on Homeland Security and Governmental Affairs

Honorable Mike Enzi
Chairman
Committee on the Budget

Honorable Bernie Sanders
Ranking Member
Committee on the Budget

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[8] See, for example, Congressional Budget Office, *The 2015 Long-Term Budget Outlook* (June 2015), Chapter 6, www.cbo.gov/publication/50250, *Budgetary and Economic Outcomes Under Paths for Federal Revenues and Noninterest Spending Specified in the Conference Report on the 2016 Budget Resolution* (April 2015), www.cbo.gov/publication/50115, *The Economic Effects of the President's 2015 Budget* (July 2014), www.cbo.gov/publication/45540, and *The Economic Impact of S. 744, the Border Security, Economic Opportunity, and Immigration Modernization Act* (June 2013), www.cbo.gov/publication/44346.

Summary Table 1.

Key Projections Under CBO's Extended Baseline

Percentage of Gross Domestic Product

	2015	2025	2040
		Without Macroeconomic Feedback[a]	
Revenues			
Individual income taxes	8.4	9.5	10.4
Payroll taxes	5.9	5.7	5.7
Corporate income taxes	1.8	1.8	1.8
Other sources of revenues	1.7	1.2	1.5
Total Revenues	**17.7**	**18.3**	**19.4**
Spending			
Mandatory			
Social Security	4.9	5.7	6.2
Major health care programs[b]	5.2	6.1	8.0
Other mandatory programs	2.6	2.3	1.8
Subtotal	12.7	14.1	16.0
Discretionary	6.5	5.1	5.1
Net interest	1.3	3.0	4.3
Total Spending	**20.5**	**22.2**	**25.3**
Deficit	-2.7	-3.8	-5.9
Debt Held by the Public at the End of the Year	74	78	103
		With Macroeconomic Feedback	
Deficit	-2.7	-3.8	-6.6
Debt Held by the Public at the End of the Year	74	78	107
Memorandum:			
Social Security[a]			
Revenues[c]	4.4	4.3	4.3
Spending	4.9	5.7	6.2
Net increase (-) in deficit	-0.5	-1.4	-1.9
Medicare[a]			
Revenues[c]	1.5	1.6	1.7
Spending	3.5	4.4	6.3
Offsetting receipts	-0.5	-0.8	-1.2
Net increase (-) in deficit	-1.5	-2.0	-3.4
Tax Expenditures	8.1	n.a.	n.a.
Gross Domestic Product (Billions of dollars)[a]	18,016	27,456	50,800

Source: Congressional Budget Office.

Notes: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period.

n.a. = not available.

a. These projections do not reflect the macroeconomic feedback of the policies underlying the extended baseline after 2025. (For an analysis of those effects and their impact on debt, see Chapter 6.)

b. Net of offsetting receipts for Medicare.

c. Revenues include payroll taxes other than those paid by the federal government for federal employees, which are intragovernmental transactions. Revenues also include income taxes paid on Social Security benefits, which are credited to the trust funds.

Summary Figure 1.

The Size of Policy Changes Needed Over 25 Years to Make Federal Debt Meet Two Possible Goals in 2040

If Lawmakers Aimed for . . .

Debt in 2040 to Equal Its 50-Year Average of 38% of GDP . . .	Debt in 2040 to Equal Its Current Level of 74% of GDP . . .

How Much Would They Need to Increase Revenues or Reduce Noninterest Spending per Year?

38% goal	74% goal
2.6% of GDP, which is equal to a 14% Increase in Revenues or 13% Cut in Spending	1.1% of GDP, which is equal to a 6% Increase in Revenues or 5½% Cut in Spending

What Would That Increase in Revenues or Reduction in Noninterest Spending Amount to in 2016?

38% goal	74% goal
$480 billion, which is equal to $1,450 per person	$210 billion, which is equal to $650 per person

What If the Changes Were Increases (of Equal Percentage) in All Types of Revenues?

One effect in 2016 is that, on average, **taxes on households** would be higher than under current law.

38% goal	74% goal
+$1,700	+$750

Values are for households in the middle fifth of the income distribution. Those taxes are projected to be $12,300 under current law.

What If the Changes Were Cuts (of Equal Percentage) in All Types of Noninterest Spending?

One effect is that **initial Social Security benefits** would be lower than under current law.

38% goal	74% goal
-$2,400	-$1,050

Values are averages for people in the middle fifth of the lifetime earnings distribution who were born in the 1950s and who would claim benefits at age 65. Those benefits are projected to be $18,650 (in 2016 dollars) under current law.

Source: Congressional Budget Office.

Notes: The values shown in this figure are relative to CBO's extended baseline. The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period. The sizes of the policy changes do not account for the macroeconomic feedback of the policies that might be used to achieve the goals or, in the case of the goal to reduce debt to 38 percent of GDP, of the reduction in debt.

GDP = gross domestic product.