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Deficit forecast gloomy for years

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For the fourth year in a row, Washington faces a $1 trillion-plus deficit and just servicing the nation's debt will soon cost as much as paying for Medicaid, the federal-state health care program for the poor and disabled.

Those were two grim predictions in a 147-page report from the Congressional Budget Office, which Tuesday stepped into the 2012 campaign like some stern Aunt Cassandra — coming down from the attic to lecture the protagonists: "It's not just the economy stupid, it's also the debt."

Indeed the $1.079 trillion deficit now projected for the 2012 fiscal year ending Sept. 30 is wider than what the added CBO had predicted in August, and the picture won't substantially improve unless Congress comes to grip with changes needed in tax and spending policy.

"The CBO's latest alarm bell couldn't be more ominous," said House Budget Committee Chairman Paul Ryan (R-Wis.). "For years, politicians from both political parties have failed to be honest with the American people about the size and scope of the debt threat. The CBO's report today confirms that it is past time for serious leaders to put aside politics and start forging solutions."

To punch home its message, CBO outlines an especially grim scenario in which lawmakers not only extend all the current Bush-era tax cuts at the end of this year but also pull the plug on the $1.2 trillion in automatic cuts set in motion by the Budget Control Act last summer.

In this scenario — which can't be ruled out politically — deficits would stubbornly hover just under $1 trillion through 2017 adding another $4.7 trillion to the debt over five years.

Under the more prudent — many say unrealistic — scenario of ending all the tax breaks and implementing spending cuts, the cumulative deficits would be $1.72 trillion or $3 trillion less from 2013 to 2017. And it's that $3 trillion difference that essentially defines the battleground after the November elections if Washington again dithers through this year as it did much of 2011.

As the clock ticks, many costs are already baked into the cake.

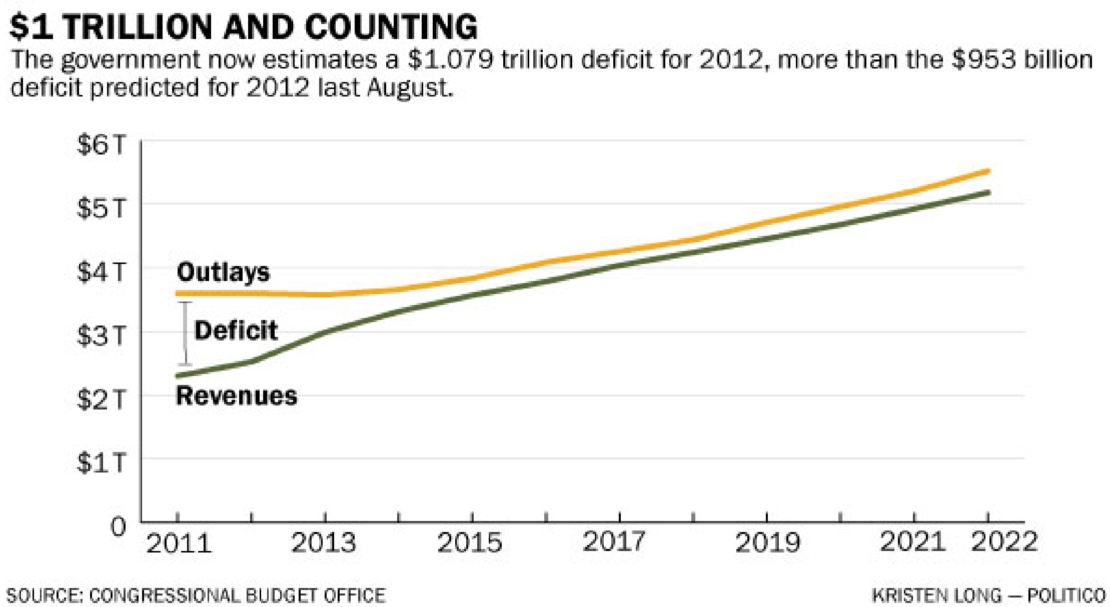
For example, even under the more prudent path outlined by CBO, net interest costs will grow dramatically to where they reach $624 billion by 2022 — 2.5 percent of GDP compared with 1.4 percent today.

To put this in some perspective, servicing the debt by 2017 will consume almost as many dollars as paying for Washington's Medicaid costs — even allowing for the greater health care spending under President Barack Obama's reforms. And before the end of the decade, debt costs will surpass Medicaid and begin to approach total federal outlays for all nondefense discretionary appropriations.

The same sort of dynamic can be seen in CBO's predictions for Medicare's own inexorable growth.

With baby boomers retiring, the caseload for the health care program for the elderly will grow annually at a 3 percent rate over the next decade. But CBO is assuming the growth in costs per patient from 2012 to 2022 will average close to 1 percent above inflation — far less than the 5 percent experienced from 1985 to 2007 and suggesting that it won't be a simple matter to cut benefits further.

A much smaller illustration — but one that could still be important to writing a farm bill this year — is the rising cost of crop insurance subsidies because of CBO's predictions of continued high commodity prices. The report indicates an uptick of about $1 billion annually in mandatory spending for agriculture, and much of this appears driven by higher subsidies to support premium payments to insure higher-priced crops.



Not to be forgotten too is the economy, whose continued weakness is a major reason for the higher deficit predicted now by CBO for this year.

Last August, the budget office had predicted a $953 billion shortfall for 2012, breaking the embarrassing string of trillion-plus deficits that began in 2009. And the $1.079 trillion estimate now results from lower-than-expected revenues after CBO downgraded its economic forecast.

In August, for example, the agency predicted 2.7 percent growth in real GDP for 2012, when measured fourth quarter to fourth quarter. Unemployment was expected to fall to 8.5 percent. The new forecast predicts 2 percent growth by comparison, and 8.9 percent unemployment.

CBO admits that's its alternative budget scenario — allowing for more tax cuts and no sequester next year — will yield higher growth in the short term and lower unemployment. But CBO Director Doug Elmendorf warns too that "over time, the resulting larger deficits would reduce private investment in productive capital and result in real GDP that would fall increasingly below the level in CBO's baseline projections."

Comments by Senate Budget Committee Chairman Kent Conrad in reacting to the report captured some of this dilemma.

The North Dakota Democrat warned "we will not solve this [deficit] problem unless both sides, Democrats and Republicans, are willing to move off their fixed positions and find common ground." But mindful of the slow recovery, Conrad argued that the CBO numbers should also spur more immediate action on extending jobless benefits and a payroll tax holiday, due to expire at the end of February.

"Although the economic recovery is strengthening, it is clear the economy remains fragile," Conrad said. "Failing to extend these critical measures would add further drag to the economy and jeopardize the gains we have already made."

Tuesday's release of the CBO forecast sets the stage for President Barack Obama's own 2013 budget to be rolled out on Feb. 13. But much as Ryan spoke of both parties needing to work together, there's little evidence the GOP is prepared to move from its anti-tax posture that so frustrated Obama last year.

Even among House Republicans, there is a reluctance to fully commit to corporate tax reform before the November elections, because of the painful economic choices that will be required. And much as Democrats have enjoyed all the focus on Republican Mitt Romney's wealth and low 15 percent tax rate, the discussion has also highlighted how much lower the relative tax rates have become for many middle-income families as well.

The Tax Institute at H&R Block illustrates this in a mockup tax return for a family of four — comparing filings after tax reform in the mid-1980s vs. 2011 after a decade of tax cuts and added child and education tax credits that have made the code more complicated.

In the first case, a family with adjusted gross income of $40,100 in 1987 ends up paying $4,297, or an effective rate close to Romney's 15 percent. In the second, the 2011 household with an income of $80,000 — about the same as $40,000 in real dollars — pays just $3,690 in income taxes — thanks to the credits — and enjoys an effective rate of 6.9 percent.

If real reform is coming, it will also have to address these tax expenditures — many of which are far more expensive. And all told, CBO estimates that through the 10-year budget window, major tax expenditures in the individual income Tax Code will total nearly $12 trillion over the 2013 to 2022 period, or 5.8 percent of GDP.