Past the Cliff, but Not Out of the Woods: Long-Term Analysis of the American Taxpayer Relief Act of 2012

Jan 29, 2013

EXECUTIVE SUMMARY

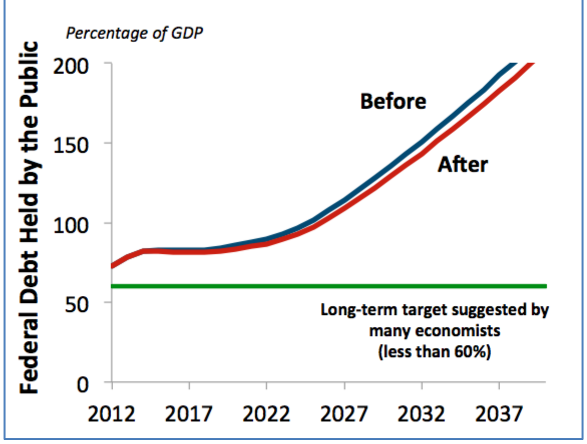
In the waning days of 2012 and early hours of 2013, U.S. policymakers struggled with how to address the "fiscal cliff"—a set of scheduled tax increases and spending cuts that, if allowed to take effect, could have pushed the economy into another recession. The outcome of their negotiations was the American Taxpayer Relief Act (ATRA).

What did the ATRA accomplish?

The ATRA did very little to improve our long-term budget outlook. While the ATRA prevented some economically damaging effects of the fiscal cliff, it did not make meaningful progress toward the primary goal of a sustainable fiscal policy—stabilizing debt as a share of the economy and putting it on a downward path. Before the enactment of the ATRA, federal debt was projected to climb to 200 percent of GDP in 26 years under current policies. After ATRA, debt is projected to climb to 200 percent of GDP in about 27 years. In short, the ATRA improved our long-term budget outlook by only about one year.

Our nation continues to face a serious long-term debt problem. Federal debt is currently projected to reach a staggering 200 percent of GDP by 2040, even after the enactment of the ATRA, the Budget Control Act (BCA) in 2011, and including the sequester and other automatic spending reductions under the BCA. The combined effect of all of the deficit reduction measures of the last two years has simply been a delay in the U.S. reaching these alarming levels of debt.

Effect of ATRA



SOURCE: PGPF projections based on data from the Congressional Budget Office, *The 2012 Long-Term Budget Outlook* (June 2012) and *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022 (August 2012)*; the revenue and cost estimates of the American Taxpayer Relief Act of 2012 from the Joint Committee on Taxation and the Congressional Budget Office; the Bureau of Economic Analysis; and the Department of the Treasury. PGPF's projections use the same definition of current policy that CBO used in its June 2012 long-term projection.

This unsustainable debt trajectory would be damaging to economic growth long before then, forcing policymakers to act much sooner to prevent a serious fiscal crisis and preserve national prosperity. Many economists suggest keeping debt at or below 60 percent of GDP—a target many countries have adopted—and empirical research indicates that economic growth slows for countries whose debt levels exceed 90 percent of GDP.

The reason why the debt picture has not materially improved is that spending on health care entitlements, Social Security, and interest costs are still projected to rise faster than revenues, leading to widening deficits and growth in federal debt. Until spending in those areas is reduced, tax revenues are increased, or we implement a combination of both, the United States will continue to have a severe long-term debt problem. It's simple math: the rapidly aging and longer living baby boomers represent very predictable and fast growing financial costs for the federal government, and existing fiscal policies are not sufficient to sustain these important programs.

Using data from the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT), an analysis by the Peterson Foundation finds that:

- <u>The ATRA improved our long-term budget outlook by only about one year</u>. Before the enactment of the ATRA, federal debt was projected to climb to 200 percent of GDP within 26 years under current policies. After ATRA, debt is projected to climb to 200 percent of GDP in about 27 years.

- <u>The sequestration under the BCA will also not improve the outlook significantly</u>. Even if the budget sequester (under the BCA) is fully implemented, projected federal debt would still reach 200 percent of GDP within about 28 years.

- Including the effects of all recent measures, the federal debt is currently projected to climb to about 200 percent of GDP by 2040. Taking into account the cumulative effect of the major deficit-reduction measures signed into law over the past 18 months (ATRA and the BCA—including full implementation of the sequester), debt is projected to reach these staggering levels just 5 years later than projected prior to all of these measures becoming law.

- In the near term, although the ATRA modestly improves the 10-year outlook for the budget, federal debt is still projected to rise from 72 percent of GDP in 2012 to 87 percent of GDP in 2022 if current policies continue.

The bottom line:

Lawmakers and the American people should not be under any false impression that our debt challenges are behind us. Much more work will be needed to put the federal debt on a sustainable long-term path. Failing to achieve that goal would put the prosperity and economy of the nation at risk.

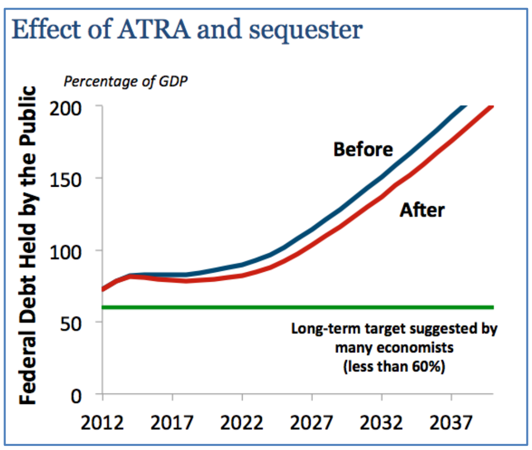
THE CURRENT LONG-TERM DEBT OUTLOOK

What are the long-term budgetary effects of the ATRA?

To answer that question, the Peterson Foundation developed a long-run model of the federal budget which includes the effects of the ATRA. The starting point for this analysis is a baseline projection that is based on CBO's August 2012 10-year budget outlook and uses CBO's definition of current policies. (See Technical Appendix for further information.)

This analysis clearly indicates that the ATRA does very little to change the long-run outlook. Before the ATRA, federal debt was projected to climb to 200 percent of GDP within 26 years (2038). After enactment of the ATRA, federal debt is projected to climb to 200 percent of GDP in about 27 years (2039). In other words, the ATRA improved our long-term debt outlook by only about a year.

In addition, the Foundation examined the 2013 sequester and other automatic reductions in spending authority—how would these additional measures improve the long-term debt outlook?



SOURCE: PGPF projections based on data from three reports from the Congressional Budget Office: *The 2011 Long-Term Budget Outlook (June 2011); The 2012 Long-Term Budget Outlook (June 2012)* and *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022 (August 2012);* the revenue and cost estimates of the American Taxpayer Relief Act of 2012 from the Joint Committee on Taxation and the Congressional Budget Office; the Bureau of Economic Analysis; and the Department of the Treasury. Both projections employ the same definition of current policy and the same long-run methodology that CBO uses in its June 2012 long-term projection. The "sequester" includes the automatic reductions in spending authority in current and future years as required under law from the failure of the Supercommittee process. See text for details.

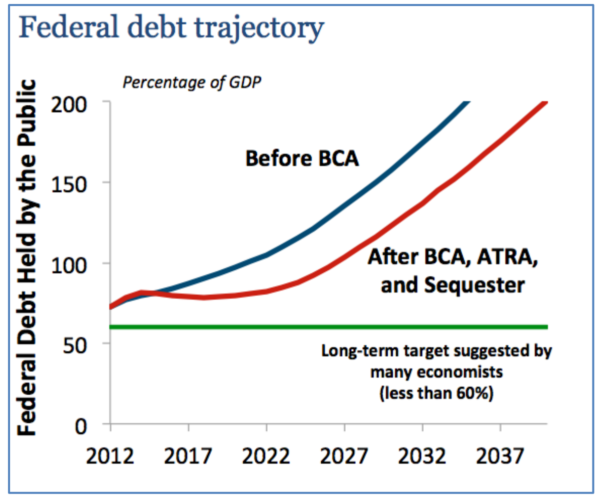
The sequester and automatic reductions in future spending authority required under current law also do very little to control our long-term debt. Even if those policies are fully implemented (along with the ATRA), projected federal debt would reach 200 percent of GDP within about 28 years (2040). Thus, the cumulative effect of both the ATRA and the sequester and other automatic reductions improves the long-term debt outlook by only about two years, a minor delay in the startling debt trajectory that would harm economic growth.

Cumulative effects of budget reforms since 2011

ATRA was policymakers' third step to reduce future deficits in the last two years. In 2011, the Budget Control Act was signed into law, which lowered spending levels by almost $900 billion over 10 years (according to CBO's estimates at the time). The BCA also established the "Supercommittee" process to achieve additional deficit reduction. When that process failed, it triggered the above mentioned sequestration and automatic spending reductions totaling nearly $1 trillion through 2021. However, as part of the ATRA, Congress and the President agreed to postpone implementation of the 2013 sequester for two months. Future implementation of these automatic spending reductions remains uncertain.

How have long-term projections changed in the aggregate since 2011? Before enactment of the BCA, we project that federal debt would have risen to 200 percent of GDP by 2035. Today, after enactment of the BCA and ATRA, and assuming full implementation of the sequester and the automatic spending reductions, we project that federal debt will reach about 200 percent of GDP by 2040.

Therefore, the combined effect of all of the deficit reduction measures of the last two years has simply been to delay when the U.S. reaches these alarming levels of debt. Many economists suggest keeping debt at or below 60 percent of GDP—a target many countries have adopted—and empirical research indicates that economic growth slows for countries whose debt levels exceed 90 percent of GDP. In addition, this modest improvement in the budget outlook is due only partially to the enactment of those laws—a meaningful portion of the improvement is due to changes in CBO's estimates since 2011 of the future economy that have reduced projected deficits.[1]



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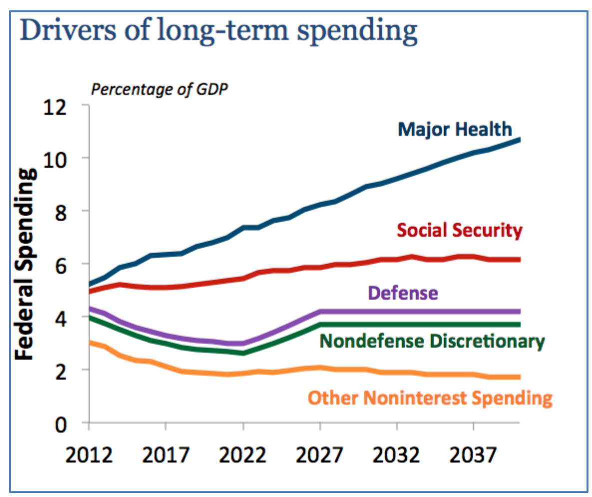
The drivers of long term U.S. debt

Recent deficit reduction measures have had such a small effect on our long-term debt outlook because they fail to address the most significant driver of long-term debt: rapidly rising health care costs. The rising costs of health care entitlements, Social Security, and interest on our debt are projected to account for <u>all</u> of the future growth in spending.

The BCA, including the sequester and automatic spending reductions, focuses almost exclusively on discretionary spending. This is a category of spending that was already expected to decline as a percentage of GDP over the next ten years, and is not a key driver of the country's fast growing long-term deficits and debt. The ATRA took a meaningful step in increasing projected revenue, but such revenue increases were not nearly sufficient to cover the projected rapid growth in spending.

Fortunately, there are many effective solutions to our nation's fiscal challenges. A wide range of reforms to Medicare and broader health care spending have been proposed and have the potential to reduce costs. Among these are measures to move away from traditional Medicare's fee-for-service payment system, impose hard growth caps on Medicare spending, raise the age of Medicare eligibility, and take steps to reduce wasteful health spending. In addition, relatively modest changes to Social Security—including progressive changes to the formula used to calculate benefits and increases in the level of income subject to the payroll tax–could yield significant improvements in long-run debt, while simultaneously strengthening protections for those who can't work longer and improving benefits for the most vulnerable. In addition, increasing projected revenue levels, through for example the elimination or reduction of tax expenditures, could serve to help reduce the level of projected deficits.



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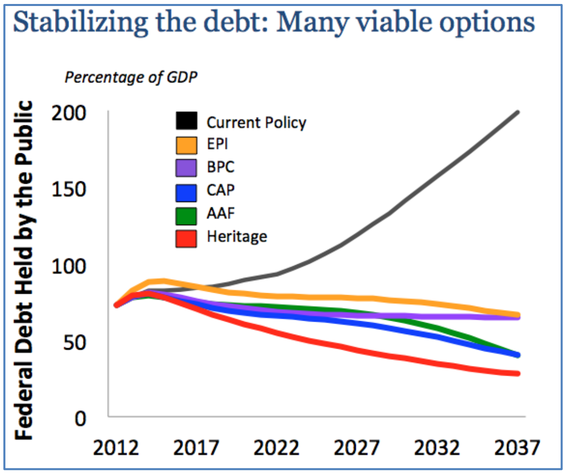
Over the last two years, the Foundation has sponsored its Solutions Initiative, in which diverse policy organizations from across the ideological spectrum produced comprehensive long-term fiscal plans. It is worth noting that all of the participating organizations produced comprehensive fiscal plans that would reduce projected debt levels far below current projections. In fact, most of the plans resulted in debt-to-GDP of less than 60 percent in about 25 years. The chart at left shows these much more sustainable fiscal paths proposed by these organizations.

[1] About one-third of the reduction in CBO's current-law deficits since March 2011 has been due to changes in economic assumptions. Legislative changes account for the remainder.



SOURCE: Peter G. Peterson Foundation, The Fiscal Cliff and Beyond, The Solutions Initiative II, November, 2012. "Current Policy" is CBO's alternative fiscal scenario (June 2012). "EPI" = Economic Policy Institute; "BPC" = Bipartisan Policy Center; "CAP" = Center of American Progress; "AAF" = American Action Forum; and "Heritage" = Heritage Foundation

However policymakers choose to confront the long-term imbalance between revenue and spending, it will be important to put a plan in place soon. Most Medicare and Social Security reform plans exempt Americans within 10 years of retirement in order to ensure that retirees and near-retirees do not experience sudden changes in the rules under which they've planned for retirement. Such a delay makes it all the more urgent to agree on changes now. Reforms should be implemented gradually, and fiscal improvements must be achieved before our debt level and interest payments are so high that sudden or more draconian reforms are required to avert a fiscal crisis.

ATRA'S EFFECT ON THE 10-YEAR BUDGET OUTLOOK

Although the ATRA averted the economic damage that would have come from going over the fiscal cliff in its entirety, it does not come close to solving longer-run structural deficits, nor does it yield significant improvements to our 10-year budget outlook.

Using CBO's definition of current policy, the Peterson Foundation estimates that the ATRA reduced 10-year cumulative deficits from $9.975 trillion to $9.240 trillion. As a result, federal debt is now projected to climb from 72 percent of GDP in 2012 to 87 percent of GDP in 2022, which is only slightly less than the 90 percent of GDP that debt was projected to reach before ATRA was enacted.

Two policy assumptions account for the difference between the Foundation's and CBO's analyses versus other reports that suggest more progress has been made on reducing the debt trajectory over the next 10 years. The first relates to whether all the savings from the planned reduction in overseas military forces in places like Afghanistan will be entirely dedicated to debt reduction. The second relates to whether policymakers will allow a large number of tax provisions (e.g. the research and experimentation tax credit) to permanently expire or extend them again as they have regularly done in the past. On both of these questions, the Foundation's analysis follows CBO's current-policy approach, which implicitly assumes the "war savings" will be reallocated to other spending priorities and the expiring tax provisions will be extended again in the coming years (see Technical Appendix).

CONCLUSION

While some claim that recent deficit-reduction measures have sharply narrowed the nation's fiscal imbalances, the reality is that we have not nearly achieved a primary goal of fiscal policy—stabilizing the national debt and putting it on a downward path. Neither lawmakers nor the American people should be under the false impression that our debt concerns are behind us.

- Our nation continues to face a serious long-term debt problem. ***Today, after enactment of the BCA and ATRA, and assuming that the sequester (and future automatic reductions) are implemented, we project that federal debt will reach about 200 percent of GDP by 2040***.
- The combined effect of all of the deficit reduction measures of the last two years has simply been to delay when the U.S. reaches these alarming levels of debt. If debt remains on this trajectory, our economy would suffer serious damage long before it reaches that level.

Much more work is needed before the debt is put on a sustainable long-term path. True fiscal sustainability will only be achieved when policymakers address the structural drivers of long-term debt, including some combination of health care and other spending reforms and increased revenue. Agreement on these structural issues has been elusive and will no doubt continue to be politically difficult. But failing to achieve long-term fiscal sustainability would put our economy at serious risk. Policymakers have ample incentive to act—and to act soon.

TECHNICAL APPENDIX:

This technical appendix provides more detailed information regarding the analysis and projections presented in this paper.

What is the American Taxpayer Relief Act of 2012?

The American Taxpayer Relief Act (ATRA) made various fiscal reforms, primarily to revenue in the budget. Specifically, the new law:

Tax provisions

- Permanently extends nearly all of the tax cuts that were originally enacted in 2001 and 2003 for incomes of married taxpayers under $450,000 (or those of single taxpayers under $400,000). Those tax provisions had been scheduled to expire at the end of 2012 under prior law.

- Allows the top marginal income tax rate to revert to 39.6 percent, which was the top rate before 2001. That rate will be applied only to income above $450,000 for married taxpayers (or $400,000 for single taxpayers). So, even taxpayers with incomes above $450,000 will have some benefit from ATRA because all of their income below $450,000 will benefit from the lower tax rates that were permanently extended by the new law.

- Limits itemized deductions and personal exemptions for married taxpayers with incomes of $300,000 or more (or single taxpayers with income of $250,000 or more).

- Increases to 20 percent tax rates on capital gains and dividends for married (single) taxpayers with incomes of $450,000 ($400,000) or more. For families below those thresholds, tax rates will remain at the same levels as under prior law, which was 15 percent (or 0 percent for certain low-income families).[2]

- Permanently extends current estate and gift tax policy with its $5 million exemption level, but raises the tax rate to 40 percent (from 35 percent) on transfers above that exemption.

- Permanently indexes the Alternative Minimum Tax (AMT) for inflation. The AMT was introduced in 1969 as an effort to ensure that high-income taxpayers paid a minimum amount of tax. However, the AMT's income thresholds were never indexed for inflation, so as the years passed, more Americans became subject to it. In recent years, lawmakers have been increasing the income thresholds temporarily, reducing the number of middle-class families subject to the AMT. The ATRA increases the income thresholds and permanently indexes them for inflation.

- Temporarily extends for five years some of the tax cuts enacted in 2009. The provisions include the American Opportunity Tax Credit (for certain educational expenses), a reduced earnings threshold for claiming the child tax credit, and a provision that extends the income range for eligibility of the Earned Income Credit.

- Temporarily extends for one year a large number of—but not all— other tax provisions for businesses and individuals that had expired at the end of 2012 or earlier. Most of these provisions have been routinely extended in the past. More than 50 tax provisions were extended.[3]

- Allows taxpayers to transfer funds from certain retirement accounts (such as qualifying 401(k) accounts) to Roth accounts without incurring additional taxes. This provision generates revenue over the first 10 years, but it will lose revenue in subsequent years. People electing the Roth accounts have to pay additional tax when they put money into the accounts, but will have smaller tax bills when they take money out during retirement.

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[2] The ATRA leaves in place a provision of the Affordable Care Act that imposes an additional tax of 3.8 percent on the capital gains, dividends and interest of married couples (singles) earning $250,000 ($200,000) or more. So the total top federal marginal rate on capital gains and dividend income will be 23.8 percent. The 3.8 percent tax on investment income will be phased in for high-income families. It is imposed on the lesser of investment income or the excess of adjusted gross income above the $250,000 ($200,000) threshold for married (single) taxpayers.

[3] Among the items that were extended are the tax credit for research and experimentation, the deduction for state and local sales taxes, tax credits for renewable energy, an extension of the 50 percent bonus depreciation rules on capital investments, and certain exceptions for foreign corporations with U.S. shareholders (popularly known as exceptions to subpart F for active financing income). Provisions that were not extended by the ATRA include the income and excise tax credits for alcohol fuels and fuel mixtures, the expensing of brownfields remediation costs, the enhanced charitable contribution for corporate contributions of computers to schools, and the suspension of net income limitations on percentage depletion for marginal oil and gas wells.

Spending provisions

- Delays for two months the automatic cuts to spending—the so-called sequester of defense and nondefense budget authority—that were scheduled to begin in early January 2013 because of the failure of the Supercommittee process. The sequester is now scheduled to begin in March 2013 unless policymakers change the law.

- Extends for one year a set of expanded benefits for the long-term unemployed (people who have been seeking work for more than 26 weeks).

- Updates Medicare's reimbursement rates for physician payments, which prevented a scheduled 27 percent drop in payment rates on January 1, 2013. However, this "doc fix" delays the drop in reimbursement rates for only one year. So lawmakers will face the same issue that, absent further action, physician reimbursement rates will decline sharply at the beginning of 2014.

- Makes a number of changes to federal health programs that cost about the same amount as the one-year "doc fix." Some of the most significant changes affect Medicare's payments to hospitals.

Defining the baselines

Federal budget law[4] defines the baseline as a projection of the laws currently in place before the legislation is enacted. Given policymakers' past actions, a baseline that assumes current law remains unchanged is not particularly plausible. Among other things, it assumes that lawmakers would allow popular tax cuts to expire, despite the fact that they have been routinely extended in the past. It also assumes that lawmakers would allow painful spending cuts to take place—such as sharp cuts to Medicare payments to physicians—when those cuts have been routinely delayed. Many budget observers doubt that lawmakers would allow these types of policy changes to be implemented.

To address the implausibility of the current-law baseline, budget analysts develop current-policy baselines that incorporate assumptions that policymakers will extend various expiring tax provisions and delay certain spending cuts. Current-policy baselines aim to provide more realistic projections about the future course of budget policy. Presently, a number of alternative current-policy baselines are employed.

In the analysis in this report, we use CBO's definition of current policy, which the agency labels the "alternative fiscal scenario" in its 2012 reports on the 10-year budget outlook. CBO also uses the same definition of current policy in its long-term projections of the budget. For our analysis, we use the most recent CBO budget baseline, which is from August 2012. CBO is expected to release a revised baseline in early February 2013.

Comparison between CBO's current law and current policy deficits before ATRA
in Billions of Dollars

10-Year Deficits Under CBO's Current Law (August 2012)	**-2,258**
Adjustments in the 10-Year Deficits	
Extend 2001/2003/2009 Tax Cuts and Index the AMT[1]	-4,532
Extend Other Expiring Tax Cuts	-890
Maintain Medicare's Reimbursement Rates	-245
Remove the Sequester and BCA's Automatic Enforcement Procedure	-972
Debt Service on Adjustments	-1,078
Total Adjustments	**-7,717**
10-Year Deficits Under CBO's Current Policy (August 2012)	**-9,975**

SOURCE: PGPF using data from CBO's *Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022* (August 2012).
Negative numbers indicate an increase in the deficit. 10-year deficits are measured from 2013 to 2022.

4 These laws include the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget and Impoundment Control Act of 1974.

ATRA= American Taxpayer Relief Act of 2012. BCA= Budget Control Act of 2011.
[1]Includes outlays from refundable tax credits.

As indicated in the table above, in August 2012, CBO projected that cumulative budget deficits under current law (before ATRA) would total $2.3 trillion from 2013 to 2022. However, those projections assumed that the 2001, 2003, and 2009 tax cuts would all expire, the AMT would not be indexed for inflation (which would have pushed 30 million additional taxpayers onto the AMT in tax year 2012), Medicare's reimbursement rates for physicians would drop by 27 percent, and the sequester and automatic spending reductions would take effect. If those changes did not occur, CBO estimated that the cumulative deficits would be $10 trillion over the 2013-2022 period—or $7.7 trillion higher than they would be under current law.

Consistent with these significant differences in assumptions there was a large gap in CBO's projections of current-law and current-policy debt. Under current law (before ATRA), federal debt was projected to decline to under 60 percent of GDP in 2022. However, under the more plausible current-policy baseline (before ATRA), debt was projected to soar to 90 percent of GDP by 2022. Based on the recent events, the current-policy assumptions have proven more accurate—the ATRA extended or made permanent all but about 10 percent of the provisions that had been scheduled to expire on or before December 31, 2012 (as measured by their costs).

Preparing estimates of 10 year current policy deficits

Using CBO's definition of current policy, we estimate that the ATRA reduced 10-year current-policy deficits by a total of $735 billion, from $9.975 trillion to $9.240 trillion. As a result, we project that federal debt will now climb from 72 percent of GDP in 2012 to 87 percent of GDP in 2022, which is only slightly less than the 90 percent of GDP that debt was projected to reach before enactment of ATRA.

Most of the deficit reduction stems from tax increases on high-income households, which amount to $564 billion over 10 years.[5] Another $70 billion was saved because the ATRA did not extend certain expiring tax provisions. Because the current-policy baseline before ATRA had assumed that all of those tax provisions would be extended, allowing some of them to expire generates savings relative to the baseline. Spending reductions in certain health programs saves another $23 billion, while additional spending on unemployment benefits costs $30 billion. The reduction in the discretionary caps in 2013 and 2014 reduce outlays by about $10 billion. Together, the provisions of the ATRA generate $98 billion of interest savings over 10 years, according to our estimates.

A number of provisions of the ATRA do not generate savings (or costs) versus CBO's current-policy baseline because they were already part of the assumptions of that baseline. For example, the baseline had already assumed that tax cuts would be extended for all families, so there are no additional costs of extending them for incomes below $450,000 (including the costs of the refundable tax credits for families with no tax liabilities). The current-policy baseline also assumed that there would be a "doc fix," and that the automatic spending reductions would not take effect, and that the payroll tax cut (which had reduced payroll tax rates by 2 percentage points) would expire.

In our analysis, we excluded the revenue from allowing taxpayers to convert certain retirement accounts into Roth accounts. This provision is viewed as a budget "gimmick" by many independent analysts. Although it generates $12 billion of additional revenue during the first 10 years, it results in revenue losses in subsequent years. Moreover, because taxpayers would not utilize the benefit unless it reduced their lifetime tax liabilities, the provision should be viewed as a net cost to the budget in present value—not as a net gain. In any case, the gains over the first 10 years are small, and their exclusion does not materially affect our long-term analysis.

[5] The budget savings of increasing taxes on high-income families cannot be measured as the simple difference between the cost of extending all of the tax cuts and the cost of the ATRA. The reason is that some of the tax cuts in the ATRA expire in 2017 for taxpayers with incomes below $450,000 for joint filers and $400,000 for single filers. To estimate the current-policy savings of the ATRA, we need to include the cost of extending the tax cuts from 2018 to 2022 for those groups.

Effect of ATRA on current law and current policy deficits
in Billions of Dollars

	Current Law	Current Policy
10-year Deficits Before ATRA	**-2,258**	**-9,975**
Revenues		
2001/2003/2009 Tax Cuts	-3,575	564
Other Expiring Tax Provisions	-76	70
Roth Conversions	12	0
Total Changes in Revenue	**-3,639**	**633**
Outlays		
Refundable Tax Credits	277	0
Unemployment Benefits	30	30
Medicare		
Doc Fix	25	0
Other Health Changes	-23	-23
Sequester Delay	24	0
Lowered Discretionary Caps	-10	-10
Total Changes in Outlays	**322**	**-3**
Net Change in Primary Deficits	-3,961	637
Debt Service	-647	98
Total Change in Deficits	**-4,608**	**735**
10-Year Deficits After ATRA	**-6,866**	**-9,240**

SOURCE: PGPF estimates using data from CBO and JCT.
ATRA=American Taxpayer Relief Act of 2012; CBO=Congressional Budget Office; JCT=Joint Committee on Taxation.
The estimates use CBO's definition of current policy from August 2012. See text for details.
10-year deficits are measured from 2013 to 2022.

Effect of ATRA on current policy budget projections

In Billions of Dollars												
	Actual 2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total 2013-2022
Before ATRA												
Revenues	2,449	2,583	2,825	3,111	3,361	3,596	3,808	3,996	4,196	4,399	4,608	36,483
Outlays	3,538	3,621	3,748	3,921	4,193	4,430	4,678	4,999	5,298	5,599	5,970	46,457
Deficit	-1,089	-1,037	-924	-810	-832	-833	-870	-1,003	-1,102	-1,200	-1,362	-9,975
Debt	11,270	12,460	13,478	14,391	15,321	16,258	17,215	18,298	19,477	20,749	22,181	
After ATRA												
Revenues	2,449	2,633	2,848	3,162	3,417	3,659	3,876	4,068	4,273	4,483	4,697	37,116
Outlays	3,538	3,644	3,749	3,914	4,185	4,420	4,668	4,985	5,279	5,575	5,936	46,356
Deficit	-1,089	-1,011	-901	-752	-768	-761	-793	-917	-1,005	-1,093	-1,239	-9,240
Debt	11,270	12,434	13,429	14,284	15,150	16,014	16,893	17,890	18,972	20,137	21,446	

In Percent of GDP												
	Actual 2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total 2013-2022
Before ATRA												
Revenues	15.8	16.3	17.2	17.8	18.1	18.3	18.3	18.4	18.5	18.5	18.6	18.1
Outlays	22.8	22.8	22.9	22.5	22.6	22.5	22.5	23.0	23.3	23.6	24.1	23.0
Deficit	-7.0	-6.5	-5.6	-4.6	-4.5	-4.2	-4.2	-4.6	-4.8	-5.1	-5.5	-4.9
Debt	72	79	82	83	83	83	83	84	86	87	90	
After ATRA												
Revenues	15.8	16.6	17.4	18.1	18.4	18.6	18.7	18.7	18.8	18.9	19.0	18.4
Outlays	22.8	23.0	22.9	22.4	22.5	22.4	22.5	22.9	23.2	23.5	24.0	23.0
Deficit	-7.0	-6.4	-5.5	-4.3	-4.1	-3.9	-3.8	-4.2	-4.4	-4.6	-5.0	-4.6
Debt	72	78	82	82	82	81	81	82	83	85	87	

SOURCE: PGPF estimates using data from CBO and JCT. The 2012 numbers are calculated from data from the Department of the Treasury and the Bureau of Economic Analysis.
ATRA=American Taxpayer Relief Act of 2012; CBO=Congressional Budget Office; JCT=Joint Committee on Taxation; Debt=Debt held by the public. The analysis uses CBO's definition of current policy. See text for details. The "Before-ATRA" scenario is based on the Alternative Fiscal Scenario published in CBO's *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022* (August 2012). The "After-ATRA" scenario is based on the revenue estimates from JCT and the cost estimates from CBO of H.R. 8, the American Taxpayer Relief Act of 2012.

After ATRA, the remaining differences between current-law and current-policy baselines are attributable to the sequester (and automatic reductions in future spending), the expiration of certain tax cuts, future "doc fixes," and the associated change in debt service.

Alternative definitions of current policy

Some other analysts produce 10-year projections that are more optimistic than what CBO projects and what we have presented in this paper. This is because they are using more optimistic assumptions. Those assumptions differ primarily with respect to two areas: war savings and expiring tax provisions.[6]

[6] When we use those alternative assumptions, we match the results that others have found.

First, some analysts assume that the planned reduction in overseas military forces as the U.S. engagement in Afghanistan winds down will be dedicated entirely to deficit reduction. And the budgetary savings of reducing the number of overseas troops to 45,000 by 2015 is large—it could save $852 billion (not including debt service) over 10 years, according to the latest estimates.

However, neither CBO nor the Office of Management and Budget (OMB) assume in their current-policy projections that the "war savings" would be dedicated to debt reduction. Instead, they assume that those savings would be reallocated to other priorities, as we have done in our analysis. That assumption seems reasonable, especially in light of tight agency budgets in coming years. For example, if all of the war savings were devoted to deficit reduction, total spending on all discretionary programs would fall to only 5.5 percent of GDP by 2022—significantly below its historical average of 9.4 percent of GDP since 1962 and lower than it has been in any single year for the last 50 years.

Second, some analysts assume that policymakers would allow a large number of tax provisions to permanently expire as scheduled under current law. Many of these provisions were only extended for one year by ATRA and will expire at the end of 2013. (There are also a number of provisions that will expire on various schedules in future years.) Allowing all of those provisions to expire on schedule could generate a significant amount of revenue–an additional $744 billion (before debt service) over the next 10 years.

However, neither CBO nor we assume that these provisions would be allowed to expire as scheduled (though OMB does make that assumption). Many of these expiring provisions are popular–such as the tax credit for research and experimentation–and policymakers have routinely extended many of them in the past. About $376 billion of the cost of extending those provisions comes from items that have been on the list of expiring provisions for 5 years or more. Indeed, the ATRA itself extended nearly all of the tax provisions that had expired on or before December 31, 2012. Moreover, because many of the remaining $369 billion of provisions were aimed at stimulating the economy, it seems improbable that they will be terminated at the end of 2013—or any time soon thereafter. CBO has projected that the economy will not be back to full employment until 2018, so these more "recent" expiring provisions could well be extended for several years or more.

Long-run budget model and baseline

In our model, revenue and spending paths from 2012 to 2022 are based on CBO's August 2012 10-year current-policy baseline, and we updated those revenue and spending paths to reflect changes in law, such as the ATRA. After the first 10 years, we assume that revenues and non-interest spending grow at the same rate that CBO uses for its long-term projections of current policy. Interest costs are determined within the model, and the implied interest rates in our model closely match CBO's.

For our pre-BCA baseline, we did not use CBO's long-term projections from 2011 because the agency has since changed its long-term methodology. (If we had used CBO's 2011 long-term projections, the analysis would have understated the improvement since the BCA). Instead, our pre-BCA baseline uses the 10-year CBO budget projections from just prior to the BCA and extrapolates them beyond 10 years using the revised assumptions that CBO now uses in its long-term projections.