The National Oceanic and Atmospheric Administration deems the drought here in Central Texas as exceptional, the most severe category. During the past 12 months we have received about 26 inches of rain, or 13 inches below the typical amount. So, when a line of storms moved through our area last week it was a cause for excitement and an opportunity to track the approaching storms’ progress using one of the many convenient web-based weather applications. Such software allows the user to watch a time-lapse series of radar images that track storms as they pass through a particular region of the state or country. However, when your area has had too little rain, too much rain, or severe weather you want to know if the future will bring relief. With the web-based applications it is easy to zoom out to a larger geographic area to see if more storms are approaching.

The recent focus on the long-term budget problems facing the federal government indicates that Americans are expanding their view of the forecast period. The Bowles-Simpson commission offered serious options to reduce federal spending and reform the tax code that have long-run consequences. Similarly, the House Budget Committee’s recommendations tackle long-run spending.

However, because the election cycle comes every other year for members of Congress, a constant tension exists in favor of short-run policy initiatives that seldom consider long-run consequences. During the last congress, the emphasis on the Affordable Care Act’s 10-year score indicates that the short-run carried the day. The same can be said about emphasis on the short-run evaluations of the prescription drug benefit when it was added to the Medicare program during the previous administration.

Figure 1 illustrates the conventional focus on the short-run. Federal receipts and outlays are presented beginning in 2000 to show a few years of history along with two alternative sets of forecasts for the years 2011 to 2021. The President’s 2012 Budget issued by the Office of Management and Budget (OMB) is indicated by the solid lines for outlays and receipts. The other forecast shows the evaluation of the President’s budget by the Congressional Budget Office (CBO).

The OMB’s forecast is the most optimistic and indicates that by 2021 the deficit will be 3.1
percent of Gross Domestic Product (GDP). Alternatively, the CBO estimates that the President’s budget will lead to a deficit of 4.9 percent of GDP in that year. The CBO also estimates that total federal spending will be 24.2 percent of GDP in 2021 or more than a fifth larger than the 50 year average.

The CBO’s projected 2021 deficit based on the President’s budget is equal to the entire output of the state of Illinois. Alternatively, it is equal to projected Social Security spending in that year with the exception of disability benefits and is more than Medicare spending in that year. If we raise taxes enough to close the projected 2021 deficit, we will have to devote an amount equal to the economy of Illinois. If the gap is closed by spending cuts we will have to cut the equivalent of the Medicare program or the bulk of the Social Security program from the budget.

The forecasts in Figure 1 only consider the next 10 years. If we zoom out, we can see the real storm bearing down. Figure 2 adds another 30 years to the forecast from the CBO’s baseline. We see that federal spending is projected to rise to almost 29 percent of the nation’s output or almost 50 percent higher than the historical average by 2040. The persistent deficits are alarming enough, but the CBO’s estimate of the President’s budget produces a larger deficit than does the baseline estimates depicted here. The current debt held by the public is equal to 62 percent of GDP, and the baseline estimates indicate it will rise to 76 percent by 2021, but the estimates based on the President’s budget indicate that the debt will be 88 percent of GDP in that year.

Another way to expand our view is to add state and local government spending to the picture. Figure 3 depicts the federal series and the combined series as percentages of GDP. The federal spending forecast follows the CBO’s baseline, and the state and local forecast assumes that it remains about a third of total government spending.

So, while federal spending is projected to rise to 29 percent of GDP in 2040, the total combined spending would rise to 42 percent of GDP in 2040 if the historical relationship persists. Expanding our view to include the long-run implications of current government policies and including all levels of government suggests that the brewing storm is larger than many imagine and will radically change the reach of government. To fund such spending will ultimately require commensurate tax collections.

In the case of federal spending, this brings us back to reconsidering the nature of the programs that drive the growth – Medicare and Social Security. These two programs are
central to the Bowles-Simpson proposals, and Medicare accounts for much of the projected spending reductions in the House Budget Committee’s plan. The encouraging aspect of both is that spending reductions are central to the deficit reduction plans. That is, tax increases are not the tools of choice to eliminate the deficits.

While the two plans both address Medicare, the means to constrain spending differ. The Bowles-Simpson proposals include a handful of reforms that produce modest savings in comparison to the size of the program.

In contrast, the Budget Committee’s proposal is a fundamental departure from the current way of paying for Medicare beneficiaries’ health care. In 2022 new retirees will receive risk-adjusted premium support that they can use to help buy health insurance. They can supplement the premium support from their own resources. Two potential premium support growth rates that immediately suggest themselves are per capita GDP growth, which makes the cost of the program similar to the growth projected in the 2011 Medicare Trustees Report, and price indexing which results in much slower growth.

The premium support proposal has been scored by the CBO using price indexing with the consumer price index. Ultimately, price indexing the premium support payments will result in a program that actually declines as a percent of GDP. The CBO scoring has caused some to question the proposal as it requires Medicare beneficiaries to bear almost the entire burden of the programs future projected shortfalls. This is unfortunate since changing the fundamental nature of Medicare from a top down government program to a bottom up program based on individual provider choice has great potential. Under a premium support regime the current system that relies on administrative controls to determine how health care is allocated would be replaced with a market system where users determine the health care allocation.

Importantly, allowing the premium support payments to grow at the same rate as per capita GDP has the potential to produce a program that in the long run is of approximately the same size as is forecast in the 2011 Medicare Trustees Report. In contrast to the Affordable Care Act’s provisions that require health care providers to bear the entire burden of the program’s future shortfalls and which underlie the Trustees Report’s forecasts, a program based on premium support will produce preferred outcomes for seniors who would be free to shop for health care.

The long run federal spending forecasts are in sharp contrast to the actual spending levels between 1980 and 2008 when the government spending as a share of the nation’s total output remained steady. People from across the political spectrum have started to recognize the inevitable storm that the future forecasts portend. Now the serious business of controlling this unprecedented non-military spending begins.