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The National Debt Is Worse Than You Think

Today's outlook for revenue growth is based on policy that's unlikely to pan out.

By William A. Galston
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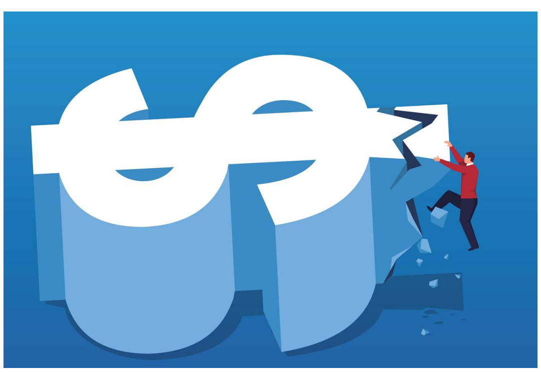
I know that worrying about the deficit and debt is hopelessly retro, but please indulge me for a few minutes.

Last week the Congressional Budget Office issued its outlook for the next 10 years. The news was not good. Over the next decade, the annual federal deficit averages $1.2 trillion. It rises from 3.5% of gross domestic product in 2017 to 5.1% in 2027. The national debt, which is driven by annual deficits, rises from $15.7 trillion to $28.7 trillion over the same period, and surges from 78.0% to 96.2% as a share of GDP—the highest mark since just after World War II.

These projections have worsened significantly since the CBO's report last June, and public-policy decisions are the culprit. The 2017 tax law reduced projected federal revenue by $1.7 trillion over the next decade, while the recent appropriations bill increased spending by $1 trillion.

And if this outlook weren't bad enough, the real story will probably be worse. The CBO is legally required to make its estimates on the basis of current law, but the federal government is likely to end up spending more and taxing less than the law specifies.

Here's why: To make the numbers add up, the tax law specifies that most individual tax breaks will disappear after 2025. But neither political party is likely to let this happen, at least for low- and middle-income taxpayers.



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In a similar vein, the appropriations bill assumes defense and domestic spending will decline after the current two-year agreement ends. But Republican defense hawks and Democratic defenders of social programs will work hard to prevent this from happening.

The CBO estimates that if current *policy* continues—rather than current law—the cumulative deficit will rise a further $2.6 trillion over the next decade, to a staggering $15 trillion. This would push the national debt to 105% of GDP, a level exceeded only once in our history.

Supply-siders may object that these estimates don't account for projected economic growth from the tax cuts. In fact, they do. The CBO projects that the tax law will increase real GDP by an average of 0.7% and employment by an average of 1.1 million jobs each year over the next decade. These economic gains will reduce the reform's net cost by 22% during this period, meaning the bill doesn't come close to paying for itself even with dynamic scoring.

The picture would be much brighter if the tax reform boosted growth to the Trump administration's target of 3%, but the CBO doesn't expect this to happen. In the short term, it estimates that growth will surge to 3.3% in 2018 and a respectable 2.4% in 2019. In 2020, however, growth is expected to subside to just 1.8% with no significant rise thereafter. Average growth in the coming decade is projected at a mere 1.9% per year.

The reason for the slowdown is straightforward. Economic growth reflects two key variables: the total number of hours worked and output per hour, known as productivity. Over the next decade the CBO expects annual productivity increases to average 1.4%, a dramatic improvement over the dismal 0.9% of the previous decade. But the labor force, which grew 2% annually as recently as the 1990s, is expected to increase by only 0.5% per year over the next decade. The aging of the population will exert steady downward pressure on labor-force participation during this period while increasing the pool of retirees by one-third.

Several measures could produce marginal improvements in labor-force participation. We could stem the flow of women leaving the U.S. workforce by investing in the type of pro-work and pro-family programs that European countries have implemented in the past decade. We could do much more to reintegrate felons into the workforce.

We could also make bigger gains if we were prepared to increase the number of working-age immigrants entering the U.S. This would require both reducing the number of slots dedicated to family reunification, which most Democrats oppose, and increasing the total number of immigrants, the reverse of the Trump administration's position.

Absent big changes in the labor force, advocates of 3% growth are left hoping for a productivity miracle. Economists aren't sure what makes productivity wax and wane, meaning a return to the 2% annual productivity gains of the 1990s can't be ruled out. But even this surge would leave us well short of the 3% target.

It would be more realistic to accept that in our aging society, the economy will expand more slowly while retirement spending expands more quickly. Congress should adopt a fiscal policy consistent with these realities. Academic economists can make improbable assumptions, but policy makers don't have that luxury.