Insight

We Have Not Yet Begun to Fight

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According to the Congressional Budget Office (CBO), over the next decade federal debt held by the public will surpass 96 percent of the U.S. economy, and by 2048 the debt will be 152 percent of gross domestic product (GDP). The last time the debt approached these levels was during and immediately after World War II – in 1946 the federal debt was the highest it's ever been on record, at 106 percent of GDP. By contrast, CBO does not assume a third global war in its future budget projections. Rather, CBO simply analyzed the budgetary trajectory of current U.S. laws, which will result in average deficits over the next decade of about $1.2 trillion.

Many observers are aware of the large and growing U.S. debt load and the fact that at some point policymakers will need to reverse this trend. What many don't appreciate is that this effort will require an unprecedented fiscal consolidation to avoid a fiscal crisis.

Unlike after the second World War, our deficits cannot be erased by the transition from a war-footing to a peacetime economy. Rather, the United States will need to make fundamental changes to major health, retirement, and other spending programs as well as the tax code. To reduce the debt by 2048 to its 50-year historical average of 41 percent of GDP, the CBO recently calculated, policymakers would need to enact a fiscal consolidation of 3 percent of GDP each and every year compared to current budget projections. And this consolidation is only the *primary* deficit reduction required to achieve the debt target. CBO assumes, and its calculation relies upon, additional debt reduction from reduced interest costs and stronger economic growth.

A somewhat less ambitious debt target of 78 percent of GDP (the current level) in 2048 would require sustained, primary deficit reduction of 1.9 percent of GDP every year. Either approach would be unprecedented.

For perspective, consider the revenue effects of the major tax bills passed since 1940. Not a single tax bill since then ever put in place, on a sustained basis, the sort of deficit reduction required to reduce or stabilize the current U.S. debt going forward.

Table 1: Revenue Effects of Major Tax Bills (1940-1966)

Tax Act	Revenue Effects (% of GDP)
Revenue Act of 1940	0.91
Second Revenue Act of 1940	0.71
Revenue Act of 1941	2.2
Revenue Act of 1942	5.04
Current Tax Payment Act of 1943	1.16
Revenue Act of 1943	0.46
Individual Income Tax Act of 1944	-0.27
Revenue Act of 1945	-2.67
Revenue Act of 1948	-1.87
Revenue Act of 1950	1.33
Excess Profits Tax of 1950	0.97
Revenue Act of 1951	1.52
Excise Tax Reduction Act of 1954	-0.24
Internal Revenue Code of 1954	-0.04
Revenue Act of 1962	-0.03
Revenue Act of 1964	-1.6
Tax Adjustment Act of 1966	0.6

Source: Tempalski, Jerry. "Revenue Effects of Major Tax Bills Updated Tables for all 2012 bills." U.S. Treasury Department, Office of Tax Analysis (February. 2013). https://www.treasury.gov/resource-center/tax-policy/Pages/tax_analysis_paper.aspx

Table 2: Revenue Effects of Major Tax Bills (1967-2013)

Tax Act	Revenue Effects (% of GDP) 2-Yr Avg.	4-Year Avg.
Revenue and Expenditure Control Act of 1968	1.09	N/A
Tax Reform Act of 1969	0.3	N/A
Revenue Act of 1971	-0.44	N/A
Tax Reduction Act of 1975	-0.28	N/A
Tax Reform Act of 1976	-0.69	N/A
Tax Reduction and Simplification Act of 1977	-0.72	N/A
Revenue Act of 1978	-0.69	-0.83
Crude Oil Windfall Profit Tax Act of 1980	0.5	0.5
Economic Recovery Tax Act of 1981	-1.91	-2.89
Tax Equity and Fiscal Responsibility Act of 1982	0.8	0.98
Social Security Amendments of 1983	0.2	0.21
Deficit Reduction Act of 1984	0.3	0.39
Tax Reform Act of 1986	0.22	0.01
Omnibus Budget Reconciliation Act of 1987	0.24	0.26
Omnibus Budget Reconciliation Act of 1990	0.49	0.5
Omnibus Budget Reconciliation Act of 1993	0.5	0.63
Tax Relief Act of 1997	-0.08	-0.14
Economic Growth and Tax Relief Reconciliation Act of 2001	-0.53	-0.68
Job Creation and Worker Assistance Act of 2002	-0.42	-0.26
Jobs and Growth Tax Relief Reconciliation Act of 2003	-0.83	-0.59
Working Familes Tax Relief Act of 2004	-0.26	-0.2
Tax Increase Prevention and Reconciliation Act of 2005 (enacted in 2006)	-0.17	-0.16
Economic Stimulus Act of 2008	-0.55	-0.24
Emergency Economic Stabilization Act of 2008	-0.36	-0.19
American Recovery and Reinvestment Tax Act of 2009	-0.94	-0.52
Patient Protection and Affordable Health Care Act of 2010	0.06	0.18
Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010	-2.4	-1.31
American Taxpayer Relief Act of 2012 (enacted in 2013)	-1.8	-1.78

Source: Tempalski, Jerry. "Revenue Effects of Major Tax Bills Updated Tables for all 2012 bills." U.S. Treasury Department, Office of Tax Analysis (February. 2013). https://www.treasury.gov/resource-center/tax-policy/Pages/tax_analysis_paper.aspx

Only one tax bill, the Revenue Act of 1942, had a deficit effect in a single year that met or exceeded what was needed to meet the 41 percent debt target. It was a temporary measure that the post-World War II tax cuts effectively undid.

For all the gnashing of teeth and rending of garments, the Tax Cuts and Jobs Act (TCJA) will reduce revenues by an average of 1.1 percent of GDP over the next four years. Multiply the political rancor over that bill by 3 and assume it applies to Medicare and Social Security, too – that's the magnitude of the federal debt challenge. Far worse, however, would be to continue on the present course, where policymakers either ignore or continue to add to the problem, forestalling an inevitable but far more difficult policy course.