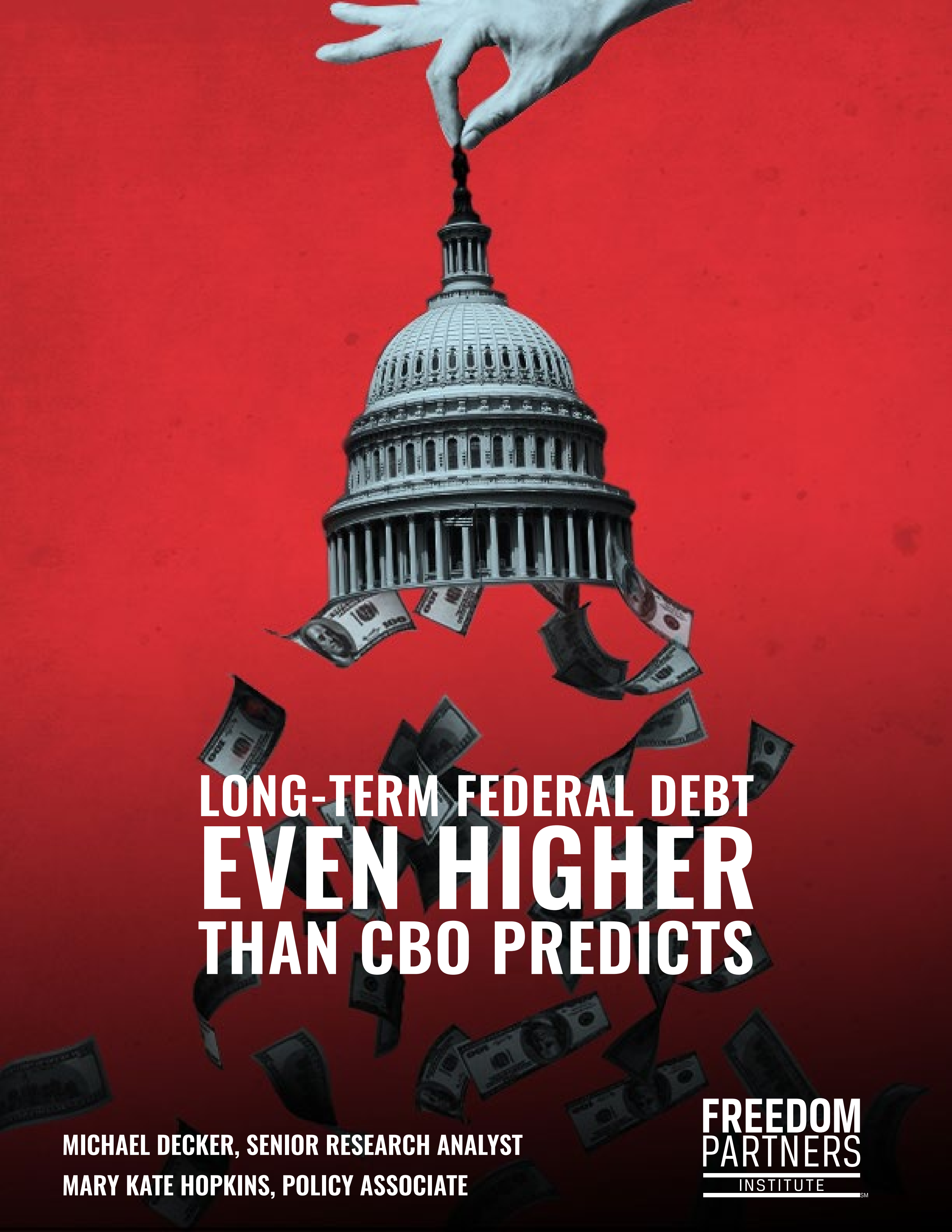

# LONG-TERM FEDERAL DEBT EVEN HIGHER THAN CBO PREDICTS

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## KEY FINDINGS

**CBO debt predictions fail to take the complete economic forecast into account.**

**According to Freedom Partners' analysis, debt will be 23.5 percent higher than CBO predicts in 2040.**

**Debt will nearly double by 2030, reaching 116 percent of GDP.**

**History has shown that governments can only withstand so much debt before wide-scale economic decline sets in.**

### LONG-TERM FEDERAL DEBT IS WORSE THAN CBO PROJECTS

The Congressional Budget Office (CBO) has released its 2016 Long-Term Budget Outlook,[1] the annual report that analyzes our nation's long-term economic health. Not surprisingly, the report paints a bleak economic outlook, saying, "*…federal debt as a share of GDP would reach unprecedented levels if current laws generally remain unchanged. Such high and rising debt would have serious consequences for the nation's budget and economy.*"

While these new projections are already dire, our analysis shows that CBO's outlook seriously underestimates the growth of federal debt during the coming decades. This is because CBO debt calculations completely overlook the intragovernmental debt that is earmarked to pay for Social Security and Medicare. By ignoring these enormous government spending programs and their debt, CBO underestimates the rapid rate at which our nation is heading toward a debt crisis.

The problem is that CBO excludes projections for "gross debt" in the long-term report, even though that data is available in CBO's 10-year budget projections.[2] The debt CBO does calculate over the long-term, known as "public debt," paints a rosier picture of our economic outlook than the more realistic measure of gross debt. This is important because a more accurate assessment of our nation's fiscal outlook would inform both citizens and lawmakers about the need for swift action to reduce spending.

Using the economic data available from CBO's long-term report and historical spending and debt information, Freedom Partners has developed a more realistic projection of our growing federal debt. Based on more accurate estimating techniques, we've determined that the gross federal debt will nearly double by 2030 (from $19.3 trillion to $37.8 trillion), reaching 116 percent of GDP.[3] This projection is 23.5 percent higher than CBO predicts.

### PUBLIC DEBT VS. GROSS DEBT: WHAT'S THE DIFFERENCE?

When CBO talks about the growing federal debt in its long-term outlook, it is only referring to what is called public debt. But it is important to understand that public debt doesn't tell the whole story about our country's fiscal outlook. Gross debt provides a much more realistic view of our future financial obligations that will ultimately fuel rapid and unsustainable growth of federal debt.

Here are the key differences between public debt and gross debt:

*Public debt*, currently hovering just below $14 trillion, is the measure of all federal securities sold to the "public," i.e. any investors outside the federal government. This ignores what's known as intragovernmental debt, or debt the government owes to itself for certain programs. Intragovernmental debt includes money owed to programs like Social Security and Medicare trust funds, both of which are likely to be insolvent within the next 15 years.[4] Ignoring these trust funds suggests that Congress could simply refuse to pay back these accounts and their beneficiaries, which is highly unrealistic.

*Gross debt* takes into account these programs and all other intragovernmental debt—the $5.3 trillion in debt we will eventually have to pay ourselves—and therefore gives a more accurate depiction of our country's long-term economic outlook. Gross debt has already exceeded $19 trillion, and constitutes 104 percent of GDP.

Gross debt is a much better indicator of the financial problems our country will face in the future, but CBO does not calculate gross debt projections beyond 10 years. Freedom Partners used CBO's existing data to estimate a projection of long-term gross debt accumulation. Our calculations reveal that America is headed for bankruptcy much more quickly than CBO projects in its 2016 outlook. And when we reach that point, America will no longer be able to afford to pay our liabilities without significant spending reductions, debt restructuring, or tax increases—bringing with them devastating economic effects.

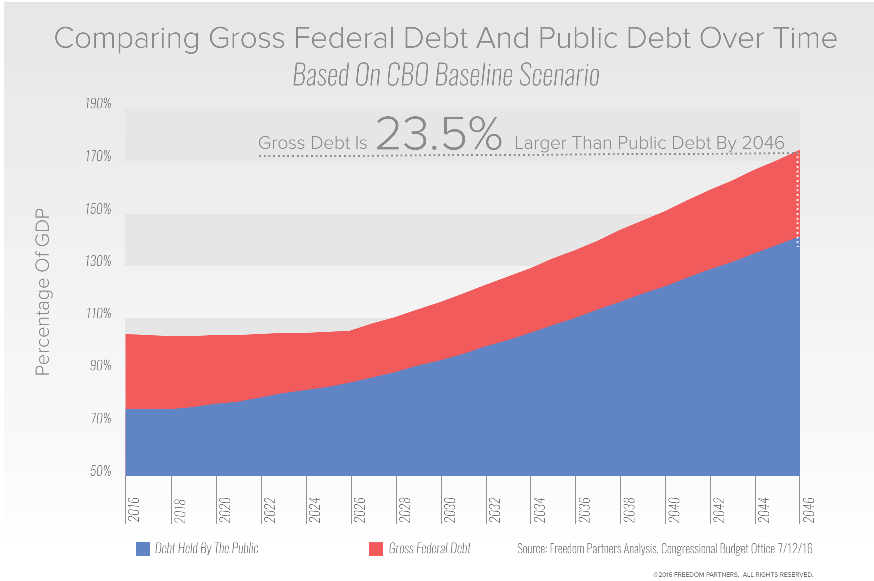
### OUR METHODOLOGY

Data from both CBO's long-term outlook and 10-year budget projections can be used to apply a more realistic set of assumptions regarding the country's true level of debt. Based on CBO's projections we estimate that within 15 years, the federal gross debt will nearly double—from $19.3 trillion this year to an overwhelming $37.8 trillion.

Let's explain in a little more detail why CBO's projections don't tell the whole story. As noted, when CBO publishes long-term spending and debt projections, it only provides information on debt held by the public. But it ignores intragovernmental debt, which is debt the government owes itself for things like the Social Security Trust Fund. Currently, intragovernmental debt accounts for almost 28 percent of all U.S. debt. So, looking only at public debt in the long-term ignores almost one-third of our existing debt.[5]

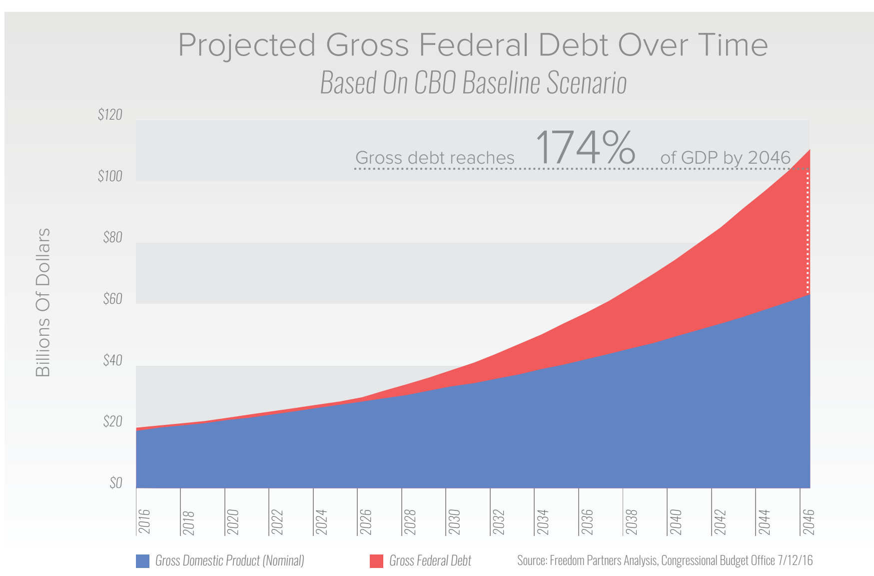
First, we concede that intragovernmental debt may continue to shrink as entitlement trust funds are depleted. Unfortunately, CBO does not provide a long-term estimate of the expected rate of decline of intragovernmental debt. As such, our analysis relies on holding constant the most forward-looking estimates available, which is 2026. The fact that we cannot make a better determination highlights another reason why CBO should provide long-term estimates of intragovernmental debt.

In order to estimate long-term gross debt, we looked at other CBO reports to assess trends in intergovernmental debt. CBO regularly publishes 10-year estimates for gross debt and debt held






> **THESE DEBT PROJECTIONS SHOW THAT WE ARE ON THE PATH TO BANKRUPTCY—WITH AN ECONOMIC FATE SIMILAR TO DEBT-DEVASTATED COUNTRIES LIKE GREECE AND ARGENTINA.**



by the public. We used these projections to calculate the ratio of debt held by the public to gross debt for each year from 2016 to 2026. We find CBO assumes the ratio of debt held by the public to gross debt gets larger for these 11 years, rising to 81 percent in 2026 as the share of intragovernmental debt slowly declines.

To avoid making assumptions regarding how lawmakers might attempt to solve depleting retirement and healthcare trust funds, and thus how these changes might impact intragovernmental debt, we assume the ratio between debt held by the public and intragovernmental debt remains constant for every year past 2026. This method uses CBO's most forward-looking dollar estimates and creates a benchmark which allows for a consistent analysis and paints the true dangers of a growing debt.

From there, we took the dollar amount of debt held by the public and divided it by the 81 percent to get the corresponding gross federal debt in that year.

The next step was to determine the dollar amount of debt held by the public. In order to do so, we took CBO's long-term debt held by the public projections (given as a percent of GDP) and converted that into dollars by applying that percentage to CBO's nominal GDP (given in dollars) projections. From there we estimated long-term debt held by the public in dollars.

Using projections for long-term debt held by the public, by year and in dollars, we then divided this by 81 percent for each corresponding year to determine gross debt over time.

So, looking at gross debt, the fiscal outlook is much worse that CBO projects. Under CBO's baseline scale scenario, public debt will reach 94 percent of GDP by 2030 and 122 percent of GDP by 2040. By ignoring the money owed to both Social Security and Medicare, CBO projects that debt levels will be high, but not catastrophic, for the next 15-25 years. However, based on our gross debt calculations, the realistic amount of federal debt will far exceed CBO's public debt projections: By 2030 gross debt will reach 116 percent of GDP, and by 2040 it will balloon to 151 percent.

> **"ARGENTINA'S DEBT CRISIS DETERIORATED THE ECONOMY AND, AS A RESULT, THE PROPORTION OF ARGENTINES LIVING BELOW THE POVERTY LINE MORE THAN DOUBLED IN JUST FOUR YEARS"**

These debt projections show that we are on the path to bankruptcy—with an economic fate similar to debt-devastated countries like Greece and Argentina, and most recently, our own territory of Puerto

## THE IMPACT OF HIGHER DEBT WILL BE ECONOMICALLY DEVASTATING

Argentina, Greece, and Puerto Rico serve as a few recent examples of what large amounts of government debt can do to the economy. Each has faced severe debt crises since 2000 and each witnessed similar economic deterioration as a result.

***Currency Devaluation and Inflation:***
When Argentina experienced a debt crisis in the early 2000s, its debt-to-GDP level hit 166 percent.[6] During the period of high debt, the Argentine currency devalued quickly,[7] from 1:1 exchange with the U.S. dollar (USD) to 4:1. In 2002, at the height of the debt crisis, inflation was 41 percent[8] (it had been low or negative since the early 1990s).

When Greece experienced its own debt crisis in the aftermath of the 2008 global financial crisis, government debt soared, rising to 179 percent of GDP[9] in 2014. Crisis ensued and the currency devaluation that followed hurt the entire European Union, bringing the value of the euro to a 12-year low[10] compared to the USD in 2015.

***High Unemployment:***
Argentina's economy collapsed in the lead-up to its debt default, and unemployment skyrocketed as a result—over 21 percent.[11] Greece saw a similar situation just a few years later: In 2010, unemployment was at 12 percent. As debt continued to grow so did the proportion of unemployed Greeks—up to 26.3 percent in 2014.[12] To put this in perspective, even during the height of the American Great Depression of the 1930s, national unemployment never exceeded 25 percent.[13]

Puerto Rico is well on its way to a similar situation. With debt growing since

2008, employment has fallen. The island's labor force participation rate, the share of the population that has a job or is looking for one, has fallen 9 percentage points since 2007, and is currently at an abysmal 40.6 percent (it is 62.7 percent[15] in the United States).

***Tax Increases:***
Last year, despite nearly a decade of anemic economic growth, the Greek government increased its sales tax from 13 percent to 23 percent[16] —an average cost of $1,635 per person annually. The sales tax hike even included essentials like meat, sugar, and bread—causing the price of goods to rise 9 percent automatically.

In Argentina, as the government grew desperate for revenue in a shrinking economy, taxes increased from 1999-2002. By the peak of the crisis, the value-added tax (VAT) was 21 percent, Social Security and medical care taxes were 31.9 percent, and the top income tax rate (on all persons making over $50,000 USD in 2002) was 35 percent.[17] At that point, the "tax wedge"—the difference between gross income and take-home pay—was 42 percent.

***Automatic Cuts to Mandatory Government Programs:***
In Greece, one of the huge drivers of debt has been the country's expensive and inefficient pension system for retirees. Since 2008, a series of "austerity cuts" has brought pension payments way down.[18] Pensions paying over 2,000 euros per month were cut by over 40 percent, and pensions paying less than 1,000 euros per month were cut by 14 percent. And, just this past May,[19] Prime Minister Alexis Tsipras announced further cuts—a package totaling 5.4 billion euros in cuts to the pension system and tax hikes.

Argentina similarly had to make cuts to retirement pensions. In 2001, public pensions over 500 pesos a month were cut 13 percent to reduce the government's deficit. (Argentina fully privatized Social Security in 2001, so the only retirement cuts were for public pensions.) More damaging for the economy, however, was the country's inability to make payments on its $95 billion[20] debt starting in 2001. This default has kept Argentina shut out of the bond market for the past 15 years. Only just this year did the country begin to try to sell enough bonds to make payments to creditors it has owed since 2001.[21]

***More People in Poverty and Less Opportunity:***
Argentina's debt crisis deteriorated the economy and, as a result, the proportion of Argentines living below the poverty line more than doubled[22] in just four years—from 25.9 percent in 1998 to 57.5 percent in 2002.

In Greece, an alarming trend took hold after 2008.[23] In 2012, the percentage of full-time workers living in "absolute poverty" was 19.7 percent. For part-time workers, that proportion was a whopping 52 percent. Even those who are employed are unable to make ends meet during this time of economic crisis. And the unemployed are not surprisingly much worse-off, with 65.5 percent living in "absolute poverty."

In Puerto Rico over 40 percent of the population is currently living below the poverty line. It's no surprise, then, that Puerto Ricans have been fleeing the island in record numbers[24] in search of better opportunities and a better life. In 2014, 84,000 people left for the U.S. mainland, a 38 percent increase from 2010.

> **“SINCE 2009, U.S. FEDERAL SPENDING HAS GROWN BY 23 PERCENT, WHILE FAMILY INCOMES HAVE FALLEN BY 2.3 PERCENT”**

## WE'RE ALREADY SEEING HOW DEBT HURTS PEOPLE

Higher government spending and record levels of debt in recent years have not helped hardworking Americans. The Obama administration has said time and time again[25] that increased government spending has spurred an "economic recovery," but average American families aren't seeing signs of improvement.

• The federal debt has ballooned from $5.8 trillion in 2000[26] to over $19 trillion today.[27]

• Since 2009, federal spending has grown by 23 percent,[28] while family incomes have fallen by 2.3 percent.[29]

• Since 2000, nominal spending[30] has increased 106 percent and nominal income increased 28 percent.[31]

## WITHOUT REFORMS WE ARE HEADING TO BANKRUPTCY

CBO's original projections for our long-term budget outlook are indeed grim—but as we've explained, they only tell part of the story. By ignoring the money owed to Social Security and Medicare, CBO vastly underestimates the rate at which our country will take on debt over the next few decades. Our calculations of long-term gross debt show the real impact our out-of-control spending policies are having on our economic future. Without serious budget and spending reform efforts by Congress, America will be headed for bankruptcy even faster than CBO is willing to admit.

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