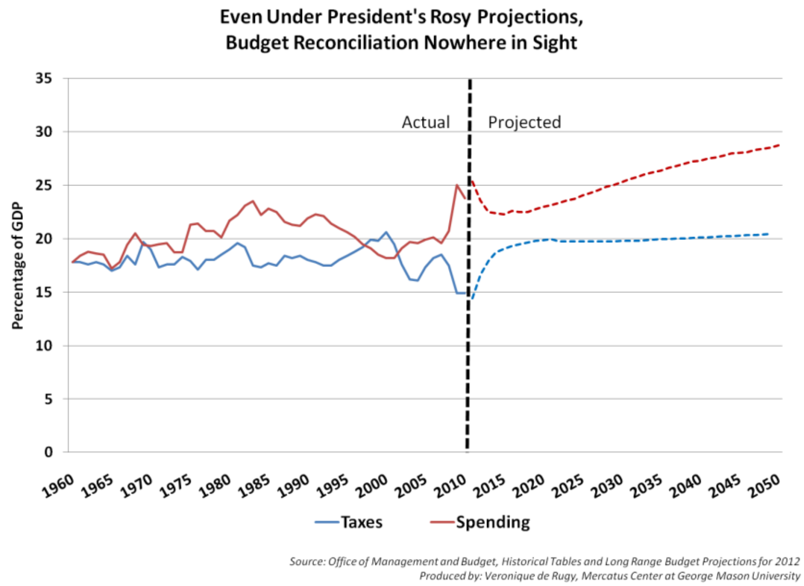

This week, Mercatus Center Senior Research Fellow Veronique de Rugy charts the Office of Management and Budget's (OMB's) long range projections of federal spending (in red) and tax revenues (in blue) as percentages of GDP. These projections incorporate both current law and 2012 presidential policy. Spending will far exceed taxes this year and every year in the foreseeable future – under these policies, deficits and increasing debt are certain.

Between 2011 and 2050, tax revenues as a percentage of GDP are projected to grow by 42% to a level higher than the historical rate of tax collection in the United States – to 20.4% of GDP. Despite this monumental increase in tax revenues, spending levels will remain even higher. In 2050, spending by the federal government is projected to consume 28.7% of the United States economy.

OMB's findings are consistent with projections from across government: federal spending growth is fueled by ballooning mandatory spending. Under OMB's current policy projections spending on the three largest mandatory spending programs, Medicare, Medicaid and Social Security, is projected to grow as a share of federal spending from 42% in 2011 to 63% of federal spending by 2050.

With a growing gap between spending and revenues, persistent deficits are projected to continue into the future; the 2012 presidential policy reflected in these projections has not yet bent the spending curve. In practical terms this means growing debt, slowing economic growth, and decreased resources available for meeting the America's legitimate needs.

Maybe more importantly, these projections do not take under considerations any impact that such level of spending, debt and deficits could have on economic growth. However, even in the absence of a crisis or a downgrade, the effects of persistent deficits remain substantial. As the government borrows, some people will delay spending and investment in anticipation of future increased taxes. Others will not invest in the economy or start new businesses as government borrowing consumes a greater portion of the available capital. All of these activities hurt the economy. Economists use the term "crowding out" to refer to this contraction in economic activity that follows from deficit-financed spending.

Recently, the CBO looked into the effects that crowding out may have on GDP per capita and contrasted it with its commonly used projections. The data from a presentation to the Fiscal Commission in June 2010 shows per capita GDP growth simply collapsing around year 2022 due to crowding out. Before 2022, GDP per capita grows at a slower rate than currently projected. A revised projection shows the economy collapsing in 2034 with a rate of growth significantly smaller starting today than currently projected. The contrast with the data generally referenced by scholars and government officials is striking.

In other words, it is very likely that the people of the United States will feel the negative impacts of high debt and deficits driven by overspending long before the United States reaches a milestone debt ratio. When that happens, our country will be caught in a downward, potentially unmanageable spiral.

Veronique de Rugy testifies before the House Committee on Ways and Means on debt and deficits.