The coming financial crisis: Policy corrections needed

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ABSTRACT

The Congressional Budget Office has released its outlook for federal spending and tax revenue over the next ten years. This "Alternative Fiscal Scenario" shows an alarming increase in deficit spending and the national debt over the planning period. In addition current law calls for sharp tax increases and spending cuts to be effective January 1, 2013, often called the "fiscal cliff".

These policies seem to lead to unsustainable fiscal results. A recession in 2013 could be the near term result, and longer term it appears that the public debt could reach 94% of GDP. In addition the fiscal crisis in Europe and the slowdown in China could depress the US economy. It is imperative for US policy makers to reconcile fiscal policy soon.

Keywords: fiscal policy, national debt, tax reform, budget deficit, economic forecast

INTRODUCTION

The Congressional Budget Office (CBO) has published its annual fiscal policy forecast, commonly called the Baseline Budget Outlook (2012). This outlook over the next ten years is the official planning template for Congressional budget actions. This Baseline outlook, and the related scoring of proposed legislation by CBO, guides the legislative process, in which planned increases in spending must be offset by equal increases in tax revenues or cuts in other spending. The Omnibus Budget Reconciliation Act of 1990 established this "PAYGO" requirement.

As shown in Table 1 (Appendix), the CBO Baseline Outlook shows a 46% drop in the federal budget deficit in 2013, and an additional 41% drop in the deficit in 2014. Over the ten-year planning period of 2013-2022, the total federal deficit is set to reach \$3.1 trillion. The result would be a national debt held by the public of \$15.2 trillion, which would constitute 62% of GDP in 2022. See Congressional Budget Office, 2012b and 2011.

While alarming, these figures are optimistic and not likely to be achieved. The CBO has identified four policy changes that are expected to be in force over the next ten years. These policy changes, which are not built into the baseline forecast - some recently enacted into law, will affect federal deficits and debt. The CBO has estimated the effects of these four policy changes, and they produced an Alternative Fiscal Scenario to include them. The Alternative Scenario is considered to be the best estimate of future budget outcomes under current and expected policy. See Congressional Budget Office, 2012a.

THE ALTERNATIVE FISCAL SCENARIO

Due to political and economic realities, these four important policy changes are widely expected to be in force over the ten year planning horizon. First, Medicare payments to physicians were scheduled to be cut by 27% on March 1, 2012 due to the Affordable Care Act of 2010 (to make the bill look less costly). If implemented, that large cut would have caused many physicians to stop treating Medicare patients, which would be untenable in an election year. The recently enacted bill to extend unemployment benefits postponed this physician pay cut, and the cost has been added back into the Alternative Fiscal Scenario.

Secondly, after the recession of 2001, Congress passed major tax cuts in 2001 and 2003 (the "Bush" tax cuts"). Those tax cuts covered income, capital gains, dividends, and estates, and they were advocated to help spur the relatively slow recovery from recession. Although they originally were planned to expire on December 31, 2010, these tax cuts were extended until December 31, 2012 due to the weak economy. Considering the continued weak state of the US and world economy, the adverse effects of such a large tax increase at the end of this year seem to dictate a postponement. The CBO has assumed in the Alternative Fiscal Scenario that these tax increases will not occur.

Thirdly, the Alternative Minimum Tax (AMT) was first passed in 1969 to reduce the number of high-income taxpayers who paid reduced income tax due to certain exemptions and deductions, such as tax-exempt municipal bond interest. That tax was not adjusted for inflation, so since 1969 many more taxpayers have become subject to it. Congress has routinely acted to prevent the AMT from affecting large numbers of middle-income taxpayers. The Alternative Fiscal Scenario now assumes that the AMT will be indexed for inflation, and this change adds to future deficits.

Finally, the Budget Control Act of 2011 was enacted to promote a compromise of tax and spending changes to reduce budget deficits. It established a special bi-partisan committee that was chartered to reach an agreement to cut the deficit by $1.2 trillion over ten years. The committee failed to agree, and as a result automatic enforcement procedures (sequestration or spending cuts) are scheduled to affect both defense and non-defense discretionary spending starting in 2013. The Alternative Fiscal Scenario assumes that these cuts will be eliminated. See Congressional Budget Office, 2012a.

BUDGET DEFICIT TRENDS

Since World War II, the US federal budget has had only ten non-deficit spending years. The recession and financial crisis of 2007-2009 led to significant stimulus spending and expanded deficits, as shown by Figure 1. For the planning period of 2013-2022, Table 2 (Appendix) provides more detail on projected deficits under the Baseline Scenario. This projection shows an actual deficit of $1.1 trillion in 2011 and a projected deficit of $1.1 trillion in 2012, followed by considerable reductions in annual deficits in future years. Unfortunately these reductions are not expected to occur, because of the four expected policy changes mentioned above (physician pay, extension of tax cuts, AMT relief, and sequestration relief). The Alternative Fiscal Scenario provides the best estimate of the likely outcome, assuming these changes are made.

Table 3 (Appendix) compares the Baseline and the Alternative Scenarios. The dramatic impact of the revisions in the budget outlook is due to the four major policy changes discussed above. Specifically, the Baseline Outlook shows a cumulative (2013-2022) deficit of $3.1 trillion, while the Alternative Scenario shows $11 trillion. Under the Alternative Scenario, the federal debt held by the public will reach $23.2 trillion by 2022. This result would be 94.2% of GDP, compared to 72.2% in 2012. This outcome has important implications for interest rates and the US dollar, as discussed below. (Not included in this debt estimate are the unfunded liabilities of Medicare, Medicaid, Fannie Mae, Freddie Mac, and Pension Benefit Guaranty Corporation.)

FEDERAL DEBT HELD BY THE PUBLIC

The annual federal deficit adds to the national debt. A portion of the debt is held by the government in accounts for Social Security and other programs. The remaining debt is held by the public. The public includes individuals, corporations, central banks and governments in the US and around the world. Much analysis is focused on the public debt because it must be paid on schedule to avoid default. The debt held within the government is sometimes treated differently because Congress has taxing and other legislative powers to deal with this debt. Figure 2 (Appendix) shows recent trends for the deficits and the public debt. The top graph of Figure 2 shows the large difference between the deficit (as a percentage of GDP) under the Baseline Scenario and the Alternative Scenario. Under the Alternative Scenario, by the middle of the ten-year planning period the deficit is set to begin expanding. The bottom graph shows the public debt since World War II. One can see the recent sharp increase in public debt since 2009. Under the more likely Alternative Scenario the public debt will continue to rise. This outcome leaves no room for added spending for national emergencies, defense, or new programs.

ECONOMIC EFFECTS OF THE ALTERNATIVE FISCAL SCENARIO

The CBO outlook is not a dynamic forecast; it is a static projection assuming key relationships remain constant. Nevertheless we can gain insight by comparing the 2022 results of the Baseline Outlook with the Alternative Fiscal Scenario. One can speculate on how the results might be different based on a dynamic model. Table 4 (Appendix) shows the CBO projections of economic variables under the Alternative Fiscal Scenario. Short-term interest rates are important because a large part of federal debt is in short maturity instruments. By shifting from the Baseline to the Alternative, it can be seen that CBO short-term interest rate projections (three-month Treasury bills) rise from 3.8% to as much as 4.5%. Such an increase would add 18% to short term interest expense. For ten-year Treasury notes, the same shift would increase rates from 5% to as much as 5.7%, adding 14% to intermediate term interest expense. In fact, the significant increase in federal deficits and debt under the Alternative Scenario could lead to much larger increases in interest rates and interest expense.

The complete economic effects of projected federal deficits could be much worse. The remaining national debt (not held by the public) must be counted because it must be paid to meet legitimate legal and moral obligations to pensioners, veterans, and employees. In addition the Social Security System is not fully funded, and the Baby Boom generation is adding 10,000 retirees to the mix every day. Medicare and Medicaid have significant unfunded liabilities, and it is unclear how dramatically the recently enacted Affordable Care Act will affect the federal budget.

It is noteworthy that there are other potential liabilities. Aside from hurricanes and tornadoes, there are numerous potential events that may require federal funding over the ten-year planning period until 2022. Many cities and states have large unfunded liabilities for retiree pensions and healthcare. Many of these plans promise benefits assuming plan investment returns of 7-9% per year, and that is more than twice recent results. While some states are taking action to reconcile future revenues and expenses, many are not. In some cases there is strong political opposition at the local level. There could well be numerous other crises and pressure for federal assistance. See Social Security Administration (2010).

Many private multi-employer pension funds are underfunded. Traditionally these plans assumed investment earnings of 7-9%, however recent results have been lower. There is political pressure for a federal bailout, and the Pension Benefit Guarantee Corporation could be called upon to support some of these plans. The PBGC already is underfunded, and the potential for additional federal funding cannot be dismissed.

Some of the larger states, notably California, are having severe fiscal problems. Last year California issued vouchers in lieu of tax refunds. While some states have benefitted by cutting taxes and expenses, others, such as Illinois, have raised taxes and seen their fiscal situation worsen. We cannot rule out crises in additional states, which would be likely to result in calls for federal assistance.

Another complication to careful policy planning is that the US will reach the debt ceiling as soon as mid-November 2012, just after the November elections. (The debt ceiling may not be breeched until early 2013, depending on Treasury Department strategy.) Some policy makers argue for debt ceiling increases to equal deficit reductions, while others do not. It seems that both parties are likely to hold to their positions until the election results are in, setting the stage for another game of chicken, as was seen in 2011. See Bernanke, 2012.

THE WORST CASE SCENARIO

The US is seen as one of the strongest economies and a premier credit risk among nations. However, this can change as the debt continues to mount. Reinhart and Rogoff document the results of fiscal excess over the past few hundred years. They show that debt reaching 90% of GDP is a common danger signal of financial crisis. See Reinhart and Rogoff, 2009.

The US dollar serves as a world reserve currency. Even during the US financial crisis capital flowed into US bonds, rather than out of them, in a flight to safety. However, if federal debt continues to rise, there may come a day when the world seeks an alternative reserve currency. There has been talk of pricing commodities such as oil in Euros or a basket of currencies. Should this happen, the demand for and value of dollars would fall. It cannot be assumed that the US dollar is immune to market forces. See Gordon, 2011.

Interest expense is a major concern. Currently US interest rates are very low, due to Federal Reserve policy and low inflation. This policy is designed to encourage investment and economic growth. However, it has adverse effects on retirees living off investments, including 401k plans. The expectation that rates will remain low for an extended period encourages investors to wait before making investment decisions. When inflation does begin to rise, interest on the debt will rise quickly due to the short average maturity of government bills, notes, and bonds. A strategy of extending the maturity of government debt now would reduce this risk; however there seems to be no movement in that direction. In case of a financial crisis, it is possible that creditors would shun US paper, and US interest rates would have to rise sharply to fund current operations. This year the government is borrowing 40% of the budget. Spain is in a similar situation, as their debt as a percentage of GDP is up sharply. Since 2006 the spread on Spanish bonds compared to German bonds is up from near zero to 5%. If US interest expense does rise sharply, that will require either tax increases or spending cuts. In a fragile economy, those moves threaten renewed recession.

THE FISCAL CLIFF, POLITICS, AND THE NOVEMBER ELECTION

The Budget Control Act of 2011 set up a select committee that was charged with finding a compromise solution to the federal deficit over ten years. They failed to agree on a plan, and as a result the Act set in motion automatic spending cuts in defense and non-defense programs. In addition the 2001 and 2003 tax cuts are set to expire in December 31, 2012. They will reduce the federal deficits in FY 2013-2014 by $560 billion, or 3.7% of GDP (4.7% on a calendar year basis). See Taylor, 2012.

Together these fiscal policy changes have been called the “fiscal cliff”. The changes would be a huge shock to the economy, causing a recession in the first half of 2013. The assessment of the Congressional Budget Office states: “Growing debt also would increase the likelihood of a sudden fiscal crisis during which …the government would lose its ability to borrow at affordable rates.” (See Congressional Budget Office, 2012a, page 2.) The CBO estimates that if Congress reverses the “fiscal cliff” the real GDP would grow by 4.4% in 2013. The November elections will set the stage for resolving this policy dilemma.

CONCLUSIONS AND RECOMMENDATIONS

The recent financial crisis and the government reaction to it should be a warning sign. Congress seems to be evenly split on austerity vs. stimulus measures, and the very weak recovery from the recession of 2007-2009 has delayed policy actions. It may be that the lack of political consensus is causing a lack of investment and job creation. The current economic slowdown in China and the financial problems in Europe add more drag to the economic situation.

Failure to rein in the continuing deficits and growing federal debt threatens to create an unsustainable situation. As debt gets larger, it is more difficult to control. The interest expense becomes more burdensome, and passing the needed tax cuts and spending cuts become politically more difficult.

The 2010 Simpson Bowles compromise solution included both spending restraint and tax revenue increases. Although few policy makers have supported that plan, it may now be the best basis for an attainable compromise. See The White House, 2010.

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APPENDIX

Table 1
CBO's Baseline Budget Outlook

	Actual, 2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total 2013-2017	Total 2013-2022
							In Billions of Dollars							
Revenues	2,302	2,523	2,988	3,313	3,568	3,784	4,039	4,243	4,456	4,680	4,926	5,181	17,692	41,179
Outlays	3,598	3,601	3,573	3,658	3,836	4,086	4,259	4,439	4,714	4,960	5,205	5,520	19,413	44,251
Deficit (-) or Surplus	**-1,296**	**-1,079**	**-585**	**-345**	**-269**	**-302**	**-220**	**-196**	**-258**	**-280**	**-279**	**-339**	**-1,721**	**-3,072**
On-budget	-1,363	-1,130	-619	-363	-282	-318	-235	-206	-258	-265	-245	-283	-1,818	-3,074
Off-budget[a]	67	52	34	19	13	16	15	10	*	-16	-34	-55	97	2
Debt Held by the Public at the End of the Year	10,128	11,242	11,945	12,401	12,783	13,188	13,509	13,801	14,148	14,512	14,872	15,291	n.a.	n.a.
							As a Percentage of Gross Domestic Product							
Revenues	15.4	16.3	18.8	20.0	20.2	20.2	20.5	20.5	20.6	20.7	20.9	21.0	20.0	20.4
Outlays	24.1	23.2	22.5	22.1	21.8	21.8	21.6	21.5	21.8	21.9	22.0	22.4	21.9	21.9
Deficit	**-8.7**	**-7.0**	**-3.7**	**-2.1**	**-1.5**	**-1.6**	**-1.1**	**-0.9**	**-1.2**	**-1.2**	**-1.2**	**-1.4**	**-1.9**	**-1.5**
Debt Held by the Public at the End of the Year	67.7	72.5	75.1	74.8	72.6	70.5	68.5	66.8	65.5	64.2	63.0	62.0	n.a.	n.a.

Source: Congressional Budget Office.

Note: * = between -$500 million and zero; n.a. = not applicable.

a. Off-budget surpluses or deficits comprise surpluses or deficits in the Social Security trust funds and the net cash flow of the Postal Service.

Table 2

Federal Debt Projected in CBO's Baseline

(Billions of dollars)

	Actual, 2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Debt Held by the Public at the Beginning of the Year	9,019	10,128	11,242	11,945	12,401	12,783	13,188	13,509	13,801	14,148	14,512	14,872
Changes in Debt Held by the Public												
Deficit	1,296	1,079	585	345	269	302	220	196	258	280	279	339
Other means of financing	-187	36	118	111	113	103	101	96	89	84	81	80
Total	**1,109**	**1,115**	**703**	**456**	**382**	**406**	**321**	**291**	**347**	**364**	**360**	**419**
Debt Held by the Public at the End of the Year	10,128	11,242	11,945	12,401	12,783	13,188	13,509	13,801	14,148	14,512	14,872	15,291
Memorandum:												
Debt Held by the Public at the End of the Year (As a percentage of GDP)	67.7	72.5	75.1	74.8	72.6	70.5	68.5	66.8	65.5	64.2	63.0	62.0
Debt Held by the Public Excluding Financial Assets[a]												
In billions of dollars	9,275	10,337	10,916	11,257	11,516	11,813	12,028	12,214	12,459	12,726	12,991	13,315
As a percentage of GDP	62.0	66.7	68.6	67.9	65.4	63.2	61.0	59.1	57.6	56.3	55.0	54.0
Gross Federal Debt[b]	14,762	16,002	16,813	17,369	17,869	18,428	18,940	19,444	19,984	20,531	21,069	21,665
Debt Subject to Limit[c]	14,747	15,986	16,796	17,351	17,851	18,410	18,921	19,425	19,964	20,511	21,049	21,644

Source: Congressional Budget Office.

Note: GDP = gross domestic product.

a. Subtracts from debt held by the public the value of financial assets (such as preferred stock) purchased from institutions participating in the Troubled Asset Relief Program; holdings of preferred stock in Fannie Mae and Freddie Mac; and the Treasury's holdings of mortgage-backed securities, cash balances, and other financial instruments.

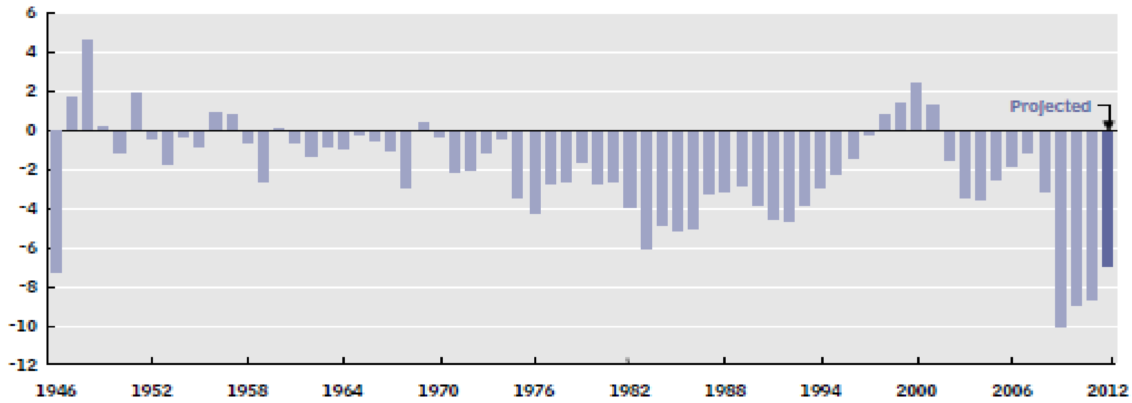
b. Comprises federal debt held by the public plus Treasury securities held by federal trust funds and other government accounts.

c. The amount of federal debt that is subject to the overall limit set in law. Debt subject to limit differs from gross federal debt because most debt issued by agencies other than the Treasury and the Federal Financing Bank is excluded from the debt limit, currently set at $16.4 trillion.

Figure 1

Deficits or Surpluses Since 1946

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Table 3

Deficits Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total 2013-2017	Total 2013-2022
In Billions of Dollars													
CBO's January 2012 Baseline													
Revenues	2,523	2,988	3,313	3,568	3,784	4,039	4,243	4,456	4,680	4,926	5,181	17,692	41,179
Outlays	3,601	3,573	3,658	3,836	4,086	4,259	4,439	4,714	4,960	5,205	5,520	19,413	44,251
Deficit	**-1,079**	**-585**	**-345**	**-269**	**-302**	**-220**	**-196**	**-258**	**-280**	**-279**	**-339**	**-1,721**	**-3,072**
Debt Held by the Public at the End of the Year	11,242	11,945	12,401	12,783	13,188	13,509	13,801	14,148	14,512	14,872	15,291	n.a.	n.a.
Alternative Fiscal Scenario													
Revenues	2,500	2,680	2,904	3,126	3,324	3,556	3,732	3,915	4,100	4,305	4,513	15,589	36,154
Outlays	3,611	3,661	3,820	4,024	4,305	4,516	4,738	5,059	5,353	5,649	6,008	20,328	47,136
Deficit	**-1,111**	**-981**	**-917**	**-899**	**-981**	**-960**	**-1,005**	**-1,144**	**-1,253**	**-1,344**	**-1,495**	**-4,739**	**-10,981**
Debt Held by the Public at the End of the Year	11,275	12,374	13,402	14,414	15,499	16,560	17,661	18,895	20,232	21,657	23,232	n.a.	n.a.
As a Percentage of Gross Domestic Product													
CBO's January 2012 Baseline													
Revenues	16.3	18.8	20.0	20.2	20.2	20.5	20.5	20.6	20.7	20.9	21.0	20.0	20.4
Outlays	23.2	22.5	22.1	21.8	21.8	21.6	21.5	21.8	21.9	22.0	22.4	21.9	21.9
Deficit	**-7.0**	**-3.7**	**-2.1**	**-1.5**	**-1.6**	**-1.1**	**-0.9**	**-1.2**	**-1.2**	**-1.2**	**-1.4**	**-1.9**	**-1.5**
Debt Held by the Public at the End of the Year	72.5	75.1	74.8	72.6	70.5	68.5	66.8	65.5	64.2	63.0	62.0	n.a.	n.a.
Alternative Fiscal Scenario													
Revenues	16.1	16.8	17.5	17.7	17.8	18.0	18.1	18.1	18.1	18.2	18.3	17.6	17.9
Outlays	23.3	23.0	23.0	22.8	23.0	22.9	22.9	23.4	23.7	23.9	24.4	23.0	23.4
Deficit	**-7.2**	**-6.2**	**-5.5**	**-5.1**	**-5.2**	**-4.9**	**-4.9**	**-5.3**	**-5.5**	**-5.7**	**-6.1**	**-5.4**	**-5.4**
Debt Held by the Public at the End of the Year	72.7	77.8	80.9	81.8	82.9	84.0	85.5	87.4	89.5	91.7	94.2	n.a.	n.a.
Memorandum:													
Deficit: Alternative Fiscal Scenario Minus CBO's January 2012 Baseline													
In billions of dollars	-33	-396	-572	-630	-679	-740	-810	-886	-973	-1,065	-1,156	-3,018	-7,909
As a percentage of GDP	-0.2	-2.5	-3.5	-3.6	-3.6	-3.8	-3.9	-4.1	-4.3	-4.5	-4.7	-3.4	-3.9
Policy Alternatives That Affect the Tax Code (Billions of dollars)													
Effect on revenues	-23	-309	-410	-442	-460	-483	-511	-541	-579	-621	-668	-2,104	-5,024
Effect on outlays	0	1	39	41	42	43	43	43	42	42	42	166	378
Effect on the deficit[a]	-23	-309	-449	-483	-502	-526	-554	-584	-622	-663	-710	-2,270	-5,403

Source: Congressional Budget Office.

Notes: The alternative fiscal scenario incorporates the assumptions that all expiring tax provisions (other than the payroll tax reduction), including those that expired at the end of December 2011, are instead extended; that the alternative minimum tax is indexed for inflation after 2011 (starting at the 2011 exemption amount); that Medicare's payment rates for physicians' services are held constant at their current level; and that the automatic enforcement procedures specified by the Budget Control Act of 2011 do not take effect. Outlays under the alternative fiscal scenario also include the incremental interest costs associated with projected additional borrowing.

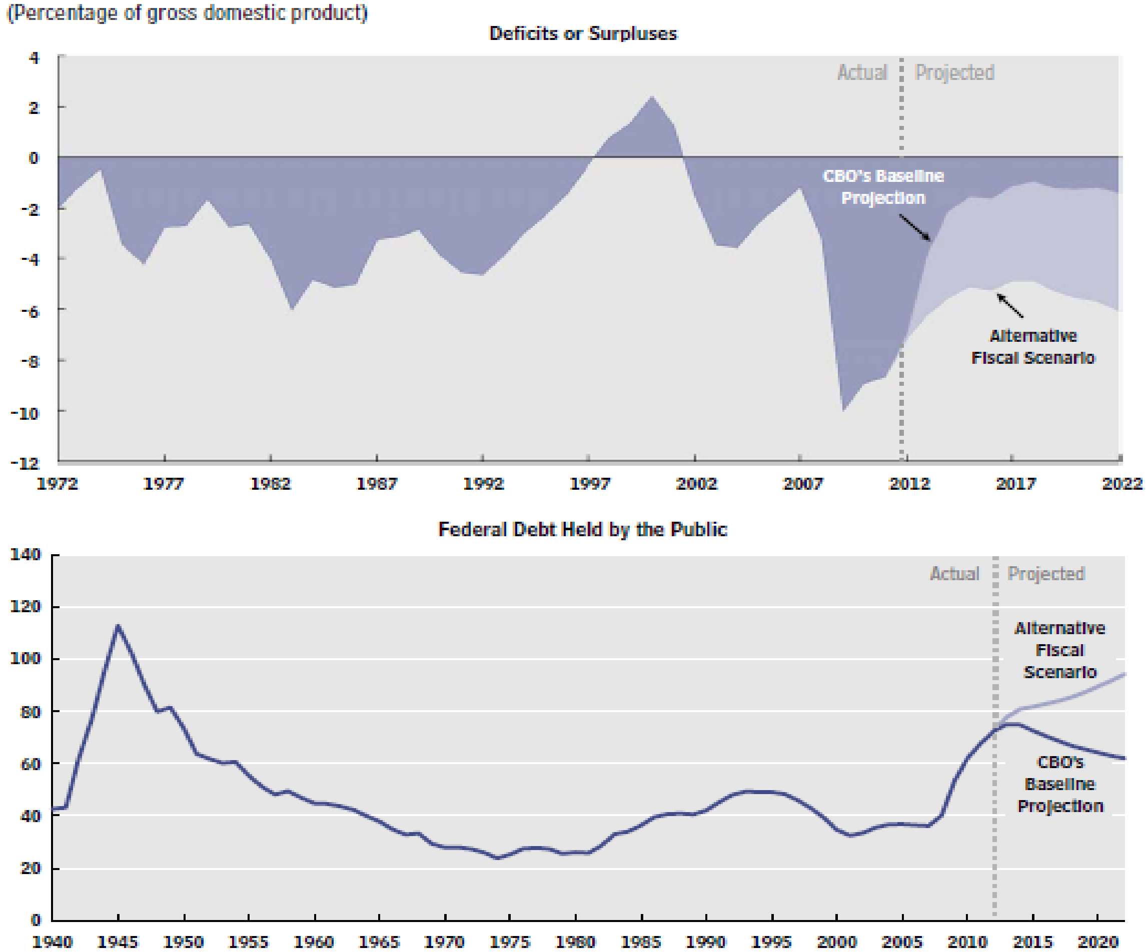
GDP = gross domestic product; n.a. = not applicable.

a. Negative numbers indicate an increase in the deficit.

Figure 2

Deficits or Surpluses and Federal Debt Held by the Public, Historically and As Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Note: The alternative fiscal scenario incorporates the assumptions that all expiring tax provisions (other than the payroll tax reduction), including those that expired at the end of December 2011, are instead extended; that the alternative minimum tax is indexed for inflation after 2011 (starting at the 2011 exemption amount); that Medicare's payment rates for physicians' services are held constant at their current level; and that the automatic spending reductions required by the Budget Control Act of 2011 do not take effect. The budgetary effects under the alternative fiscal scenario also include the incremental interest costs associated with projected additional borrowing.

Table 4

Economic Effects of Policies in CBO's Baseline and Under an Alternative Fiscal Scenario

	2012	2013	2022
	Difference Between Fourth-Quarter Level and Baseline (Percent)		
Real GDP (Percentage difference from baseline)	0.2 to 0.8	0.5 to 3.7	-2.1 to 0.2
	Fourth Quarter to Fourth Quarter (Percent)		
Growth in Real GDP			
CBO's January 2012 baseline	2.0	1.1	2.4
Alternative fiscal scenario	2.3 to 2.8	1.4 to 4.1	2.1 to 2.3
Difference (Percentage points)	0.2 to 0.8	0.3 to 2.9	-0.2 to -0.1
	Fourth-Quarter Level (Percent)		
Unemployment Rate (Fourth-quarter level, in percent)			
CBO's January 2012 baseline	8.9	9.2	5.3
Alternative fiscal scenario	8.7 to 8.8	7.4 to 8.9	5.3
Difference (Percentage points)	-0.2 to -0.1	-1.8 to -0.3	0
Interest Rate on Three-Month Treasury Bills			
CBO's January 2012 baseline	0.1	0.2	3.8
Alternative fiscal scenario	0.1 to 0.1	0.2 to 0.2	4.0 to 4.5
Difference (Percentage points)	0 to 0	0 to 0	0.3 to 0.7
Interest Rate on Ten-Year Treasury Notes			
CBO's January 2012 baseline	2.4	2.6	5.0
Alternative fiscal scenario	2.4 to 2.7	2.6 to 2.9	5.3 to 5.7
Difference (Percentage points)	0 to 0.3	0 to 0.3	0.3 to 0.7
Memorandum:			
Real GNP (Percentage difference between fourth-quarter level and baseline)[a]	0.2 to 0.7	0.5 to 3.5	-3.7 to -1.0

Source: Congressional Budget Office.

Notes: The alternative fiscal scenario incorporates the assumptions that all expiring tax provisions (other than the payroll tax reduction), including those that expired at the end of December 2011, are instead extended; that the alternative minimum tax is indexed for inflation after 2011 (starting at the 2011 exemption amount); that Medicare's payment rates for physicians' services are held constant at their current level; and that the automatic enforcement procedures specified by the Budget Control Act of 2011 do not take effect.

Ranges of estimated effects are shown for the alternative fiscal scenario to reflect the uncertainty that exists about many of the economic relationships that are important in the models used to calculate those effects.

GDP = gross domestic product; GNP = gross national product.

a. Changes in GNP exclude foreigners' earnings on investments in the domestic economy but include U.S. residents' earnings overseas and are therefore a better measure of the effects on U.S. residents' income than are changes in gross domestic product.