STATE OF FISCAL

The United States is on an unsustainable and dangerous fiscal path. Our nation's debt is at historically high levels and projected to rise dramatically, posing a significant risk to our economy and to every American's future.

Our debt challenge isn't based on politics or partisanship – it's the simple math of spending more than we take in. America has 73 million baby boomers retiring and living longer, a highly inefficient healthcare system, and a tax code that fails to generate sufficient revenues. These factors combine to pose real threats to our future, from lower productivity and reduced public and private investment to a higher likelihood of fiscal crises, weakening of our safety net, and diminishing economic opportunities for Americans.

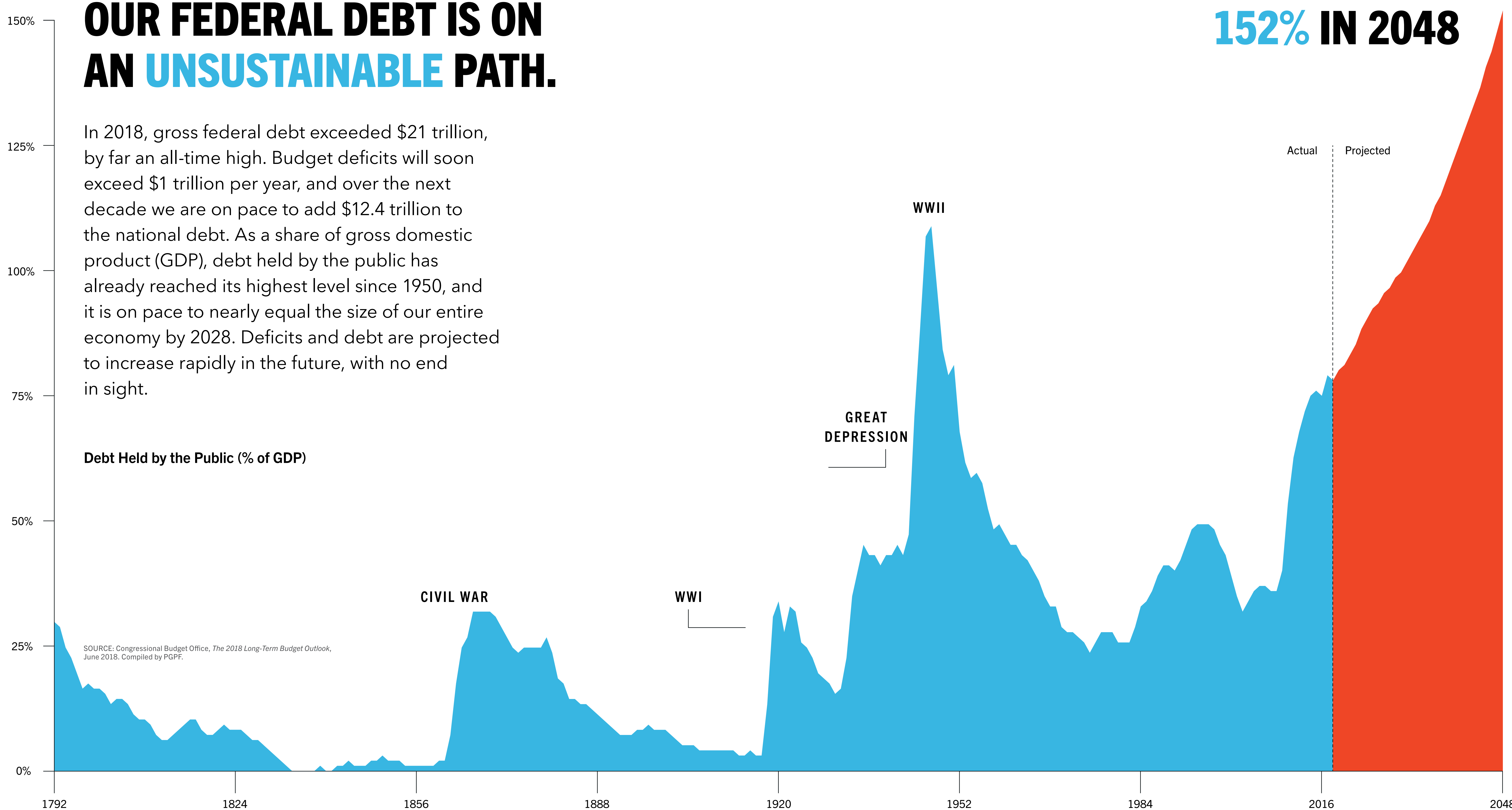
The vast majority of American voters recognize these dangers and believe that addressing our nation's debt should be a priority in Washington. Most elected officials say that they agree. Yet the problem remains unaddressed.

The good news is that viable solutions exist that can reverse our fiscal course and reduce the harm of our current trajectory. But the longer we wait to take action, the more difficult and painful it will be to tackle the problem. Now is the time to chart a better path and create the conditions for sustained economic growth and prosperity into the future.

OUR FEDERAL DEBT IS ON AN UNSUSTAINABLE PATH.

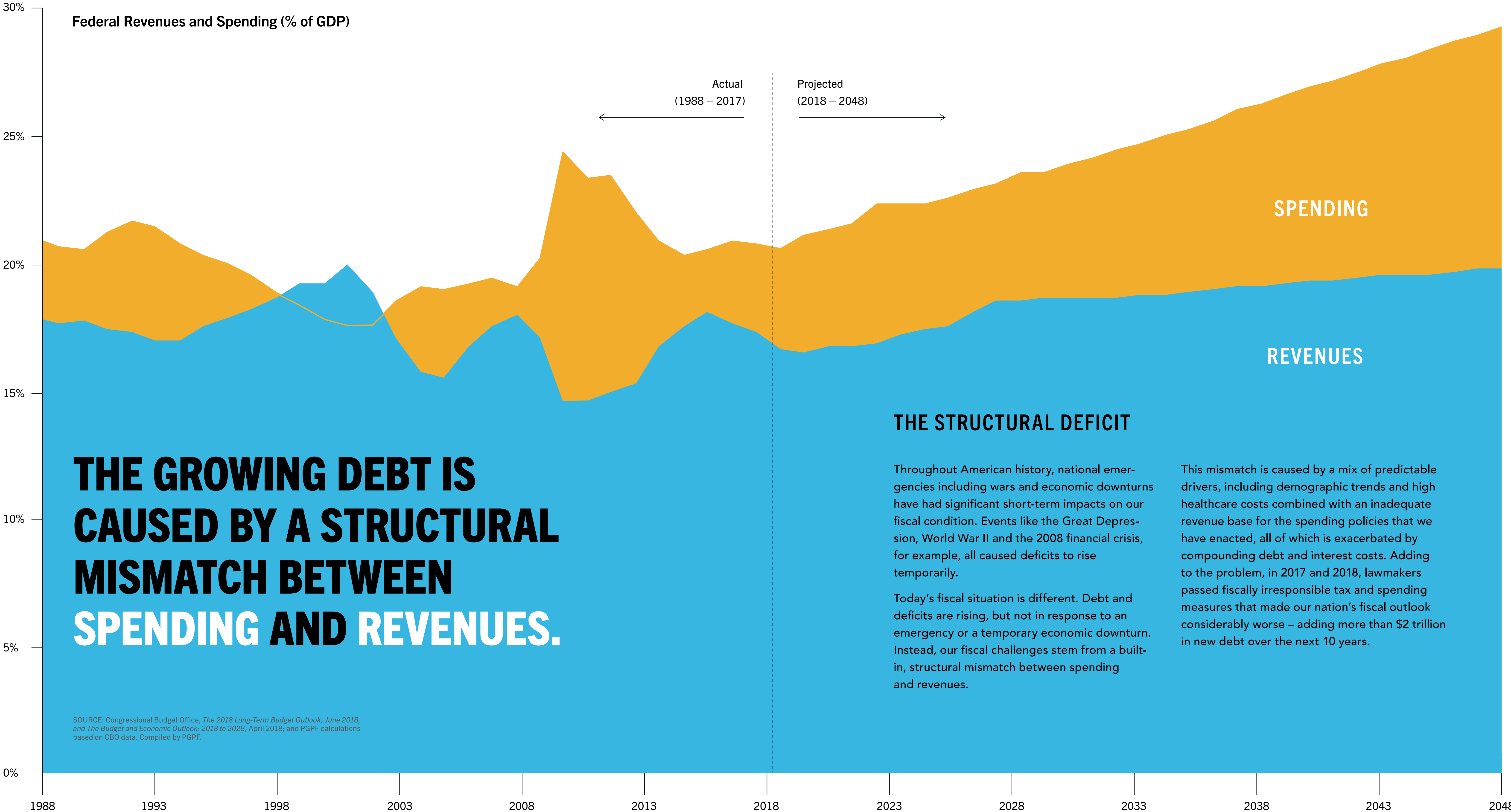
In 2018, gross federal debt exceeded $21 trillion, by far an all-time high. Budget deficits will soon exceed $1 trillion per year, and over the next decade we are on pace to add $12.4 trillion to the national debt. As a share of gross domestic product (GDP), debt held by the public has already reached its highest level since 1950, and it is on pace to nearly equal the size of our entire economy by 2028. Deficits and debt are projected to increase rapidly in the future, with no end in sight.

Debt Held by the Public (% of GDP)



SOURCE: Congressional Budget Office, *The 2018 Long-Term Budget Outlook*, June 2018. Compiled by PGPF.

Federal Revenues and Spending (% of GDP)



THE GROWING DEBT IS CAUSED BY A STRUCTURAL MISMATCH BETWEEN SPENDING AND REVENUES.

SOURCE: Congressional Budget Office, *The 2018 Long-Term Budget Outlook*, June 2018, and *The Budget and Economic Outlook: 2018 to 2028*, April 2018; and PGPF calculations based on CBO data. Compiled by PGPF.

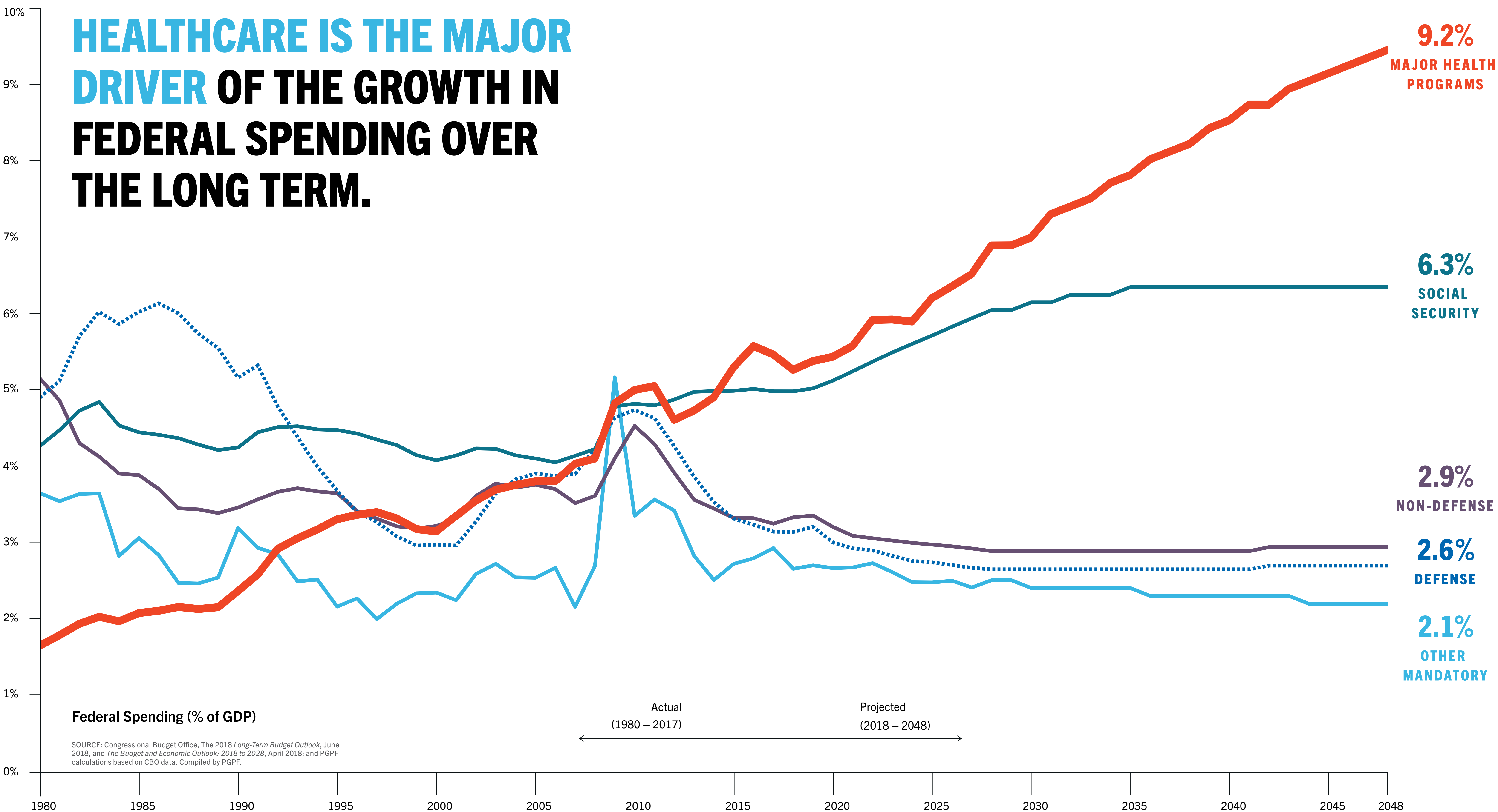
THE STRUCTURAL DEFICIT

Throughout American history, national emergencies including wars and economic downturns have had significant short-term impacts on our fiscal condition. Events like the Great Depression, World War II and the 2008 financial crisis, for example, all caused deficits to rise temporarily.

Today's fiscal situation is different. Debt and deficits are rising, but not in response to an emergency or a temporary economic downturn. Instead, our fiscal challenges stem from a built-in, structural mismatch between spending and revenues.

This mismatch is caused by a mix of predictable drivers, including demographic trends and high healthcare costs combined with an inadequate revenue base for the spending policies that we have enacted, all of which is exacerbated by compounding debt and interest costs. Adding to the problem, in 2017 and 2018, lawmakers passed fiscally irresponsible tax and spending measures that made our nation's fiscal outlook considerably worse – adding more than $2 trillion in new debt over the next 10 years.

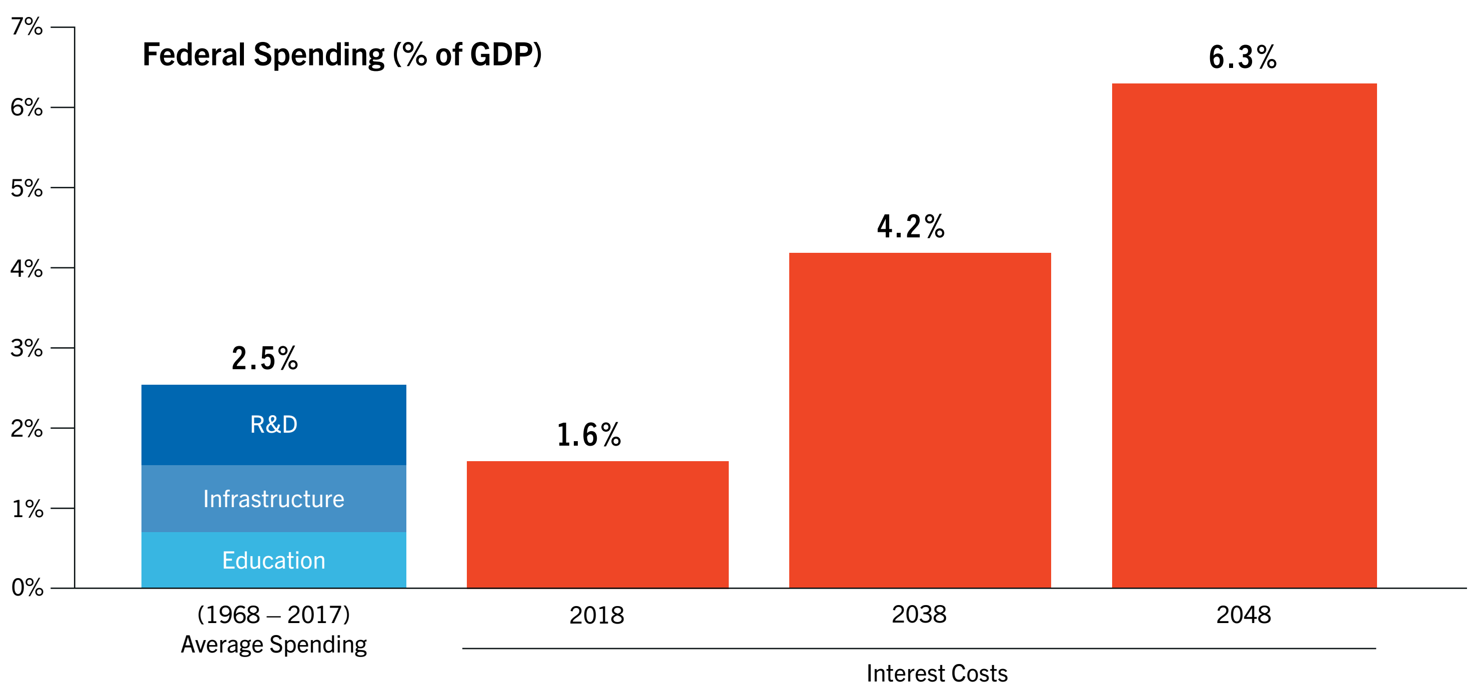
HEALTHCARE IS THE MAJOR DRIVER OF THE GROWTH IN FEDERAL SPENDING OVER THE LONG TERM.



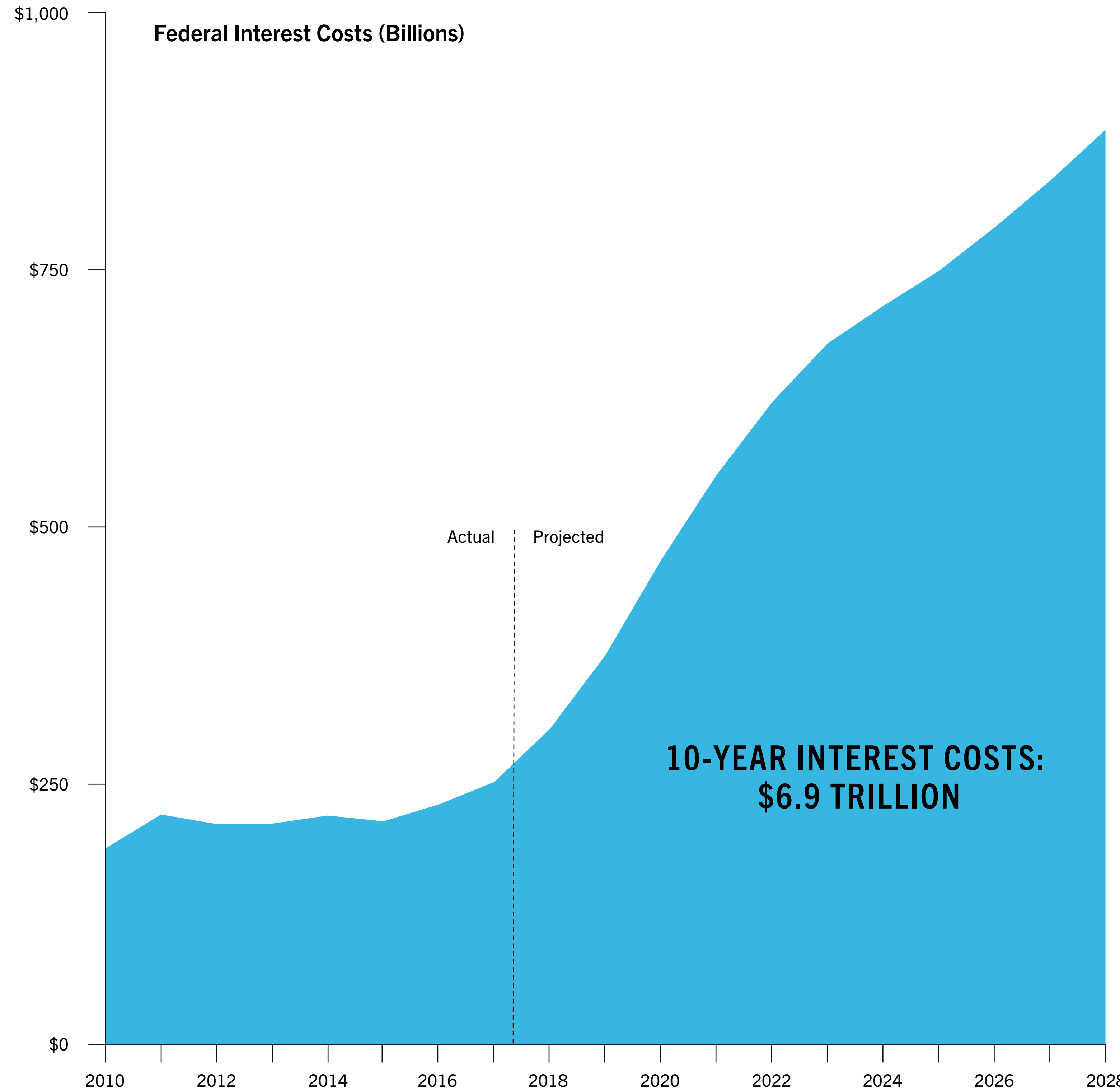
Federal Spending (% of GDP)

SOURCE: Congressional Budget Office, The 2018 *Long-Term Budget Outlook*, June 2018, and *The Budget and Economic Outlook: 2018 to 2028*, April 2018; and PGPF calculations based on CBO data. Compiled by PGPF.

BY 2048, INTEREST COSTS ARE PROJECTED TO BE MORE THAN TWICE WHAT THE FEDERAL GOVERNMENT HAS HISTORICALLY SPENT ON R&D, INFRASTRUCTURE AND EDUCATION, COMBINED.



SOURCE: Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2019*, February 2018; Congressional Budget Office, *The 2018 Long-Term Budget Outlook*, June 2018. Compiled by PGPF. NOTE: Infrastructure excludes defense.



SOURCE: Congressional Budget Office, *An Analysis of the President's 2019 Budget*, May 2018, and *The Budget and Economic Outlook: 2018 to 2028*, April 2018. Compiled by PGPF.

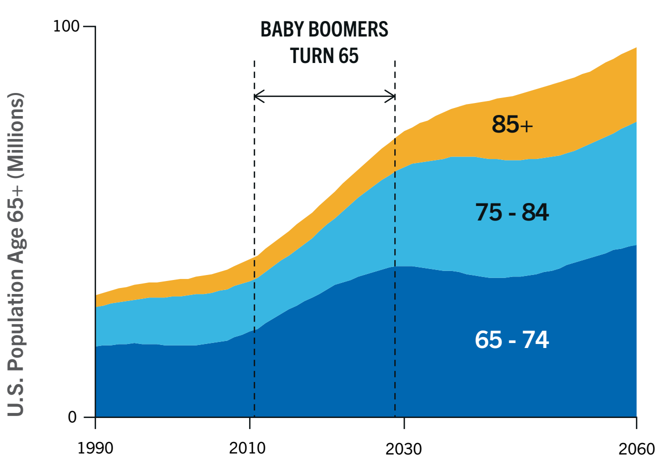
KEY DRIVERS OF DEBT

Demographics

The Baby Boom generation – 73 million strong – has already begun to leave the workforce and access federal healthcare and retirement programs. Today, and every day for the next 11 years, roughly 10,000 baby boomers will celebrate their 65th birthday. Over the next 35 years, the number of people 65 and older will climb by 35 million, an increase of 67%. Not only will the number of older Americans increase, but they are also expected to live longer in retirement due to significant improvements in life expectancy.

These trends mean that the government will spend more for the important programs that serve this growing population of older Americans, including Social Security, Medicare and Medicaid. In fact, these trends are the essence of our nation's fiscal challenge: spending on Social Security and the major health programs accounts for 100% of the increase in federal non-interest spending over the long term, relative to the size of the economy.

The elderly population is growing rapidly and living longer



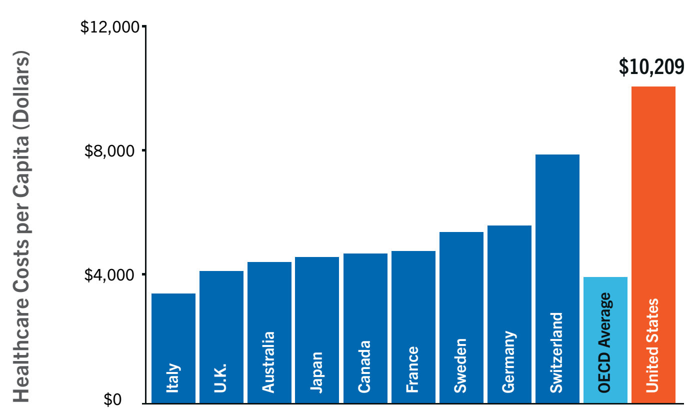
SOURCE: U.S. Census Bureau, *National Intercensal Estimates* and *2017 National Population Projections*, September 2018. Compiled by PGPF.

Healthcare Costs

Overall spending on U.S. healthcare totals a staggering $3.7 trillion, or 18% of the economy. Despite spending more than $10,000 per capita, health outcomes in the U.S. are no better, and are in some cases worse, than other advanced nations. While healthcare costs have grown less rapidly in recent years, they are projected to keep rising – faster than inflation, wages or the overall economy.

This combination of an inefficient healthcare system with our aging population creates a "perfect storm" of challenges for the U.S. economy, as seniors, who consume more healthcare than younger Americans, are entering retirement at historically high rates, living longer in retirement, and accessing the most expensive and inefficient healthcare system among advanced economies.

U.S. per capita healthcare spending is more than twice the average of other developed countries



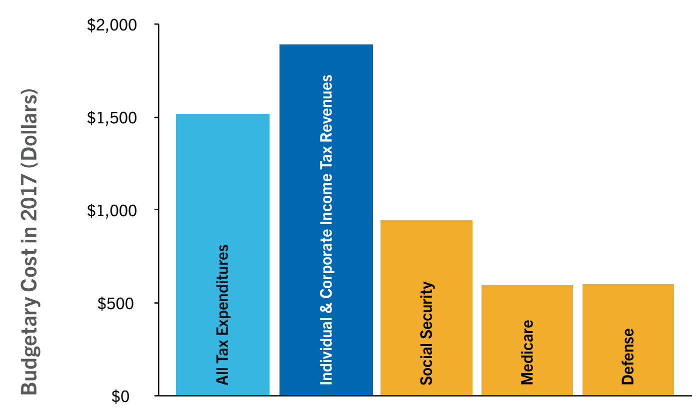
SOURCE: Organisation for Economic Co-operation and Development, *OECD Health Statistics 2018*, June 2018. Compiled by PGPF.

Inadequate Revenues

It would be one thing if our tax code were designed to fund all the promises we're making. But it's not. The U.S. tax system does not generate enough revenue to cover the spending policymakers have chosen. Even though there are many options to choose from that would increase revenue, lawmakers have failed to tap new sources that would pay for their priorities.

Our tax code is also overly complex, confusing, inefficient and unfair. For example, it remains riddled with tax expenditures, or "tax breaks," that provide financial benefits to specific activities and groups, but not others. These tax breaks – which total $1.5 trillion annually – are a lot like government spending in disguise, and they increase annual deficits. They also create market distortions that are damaging to economic growth and productivity.

Tax expenditures are large in comparison to other parts of the budget



SOURCE: Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2019*, February 2018; and the Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2017-2021*, May 2018. Compiled by PGPF.

What Is a Trust Fund?

"Trust fund" implies a secure source of funding. However, a federal trust fund is not a traditional "fund"– it is an accounting mechanism used to track inflows and outflows for specific programs.

> "Trust funds are the ultimate oxymoron: they aren't funded and can't be trusted."
>
> — PETE PETERSON

For example, Social Security took in surplus revenue in the past, however, the funds were actually spent on other programs during those years. The "trust fund" accounted for this by tracking it as "Government Account Series" securities – effectively an IOU to ourselves. Today, the Social Security program is running a deficit, and the federal government is forced to borrow to fund the program – the same as if there was no trust fund at all.

Although many are under the impression that trust funds guarantee sustainability, ultimately, trust funds are not separate from the rest of the federal budget and these programs depend on our broader fiscal sustainability. To ensure the long-term strength and solvency of important programs like Medicare and Social Security, we must address our nation's mounting debt and deficits.

WHY DEBT MATTERS

"WHAT DOES THIS MEAN FOR ME?"

Put simply, a stable fiscal foundation is essential for a strong and prosperous American economy. Rising debt matters because it harms our economy and threatens the opportunities available to every American, today and in the future.

A nation saddled with debt will have less to invest in its own future, as higher interest costs crowd out important public investments that can fuel economic growth – areas like education, research and development, and infrastructure. In fact, interest costs are the fastest-growing part of the federal budget, and are projected to climb from $315 billion in 2018 to $914 billion by 2028. Over the next decade, interest will total nearly $7 trillion, rising to become the third largest federal "program." Remarkably, by 2020 we will we spend more on interest than on children.

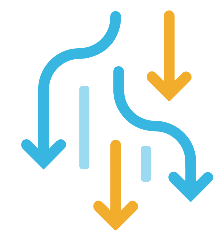
Growing federal debt also diminishes the amount of private capital for investment, which reduces income over time. It shrinks business and consumer confidence and lowers certainty. Our growing debt pushes up interest rates, which makes it harder for Americans to afford college, buy a home or start a business. And it also depresses wages: if we fail to improve our fiscal outlook, a four-person family, on average, could see its income reduced by $16,000 annually in 30 years.

Our fiscal security is also closely linked to our national security and our ability to maintain a leading role in the world. As a result of our fiscal irresponsibility, the United States stands alone as the only advanced economy in the world whose debt-to-GDP ratio is anticipated to rise over the next five years. As debt grows, not only are we more beholden to creditors around the globe, but we have fewer resources to invest in strength at home. By 2023, the Congressional Budget Office (CBO) projects that the United States will spend more on interest than on national defense.

Additionally, dangerously high debt not only makes a fiscal crisis more likely, it leaves policymakers with less flexibility to deal with unexpected events, such as significant recessions, wars or natural disasters.

And, importantly, America's debt imperils the safety net and the most vulnerable in our society. If our government does not have the resources and the stability of a sustainable budget, these essential programs, and those who need them most, are put in jeopardy.

THE IMPACT OF HIGH AND RISING DEBT



LOWER PRODUCTIVITY, CERTAINTY AND ECONOMIC OPPORTUNITY

CROWDING OUT OF PUBLIC AND PRIVATE INVESTMENTS, WHICH WILL REDUCE FUTURE ECONOMIC GROWTH

LESS FISCAL FLEXIBILITY TO RESPOND TO UNFORESEEN CHALLENGES

HIGHER LIKELIHOOD OF A FISCAL CRISIS IN THE UNITED STATES

SPENDING MORE ON INTEREST THAN ON CHILDREN BY 2020

REDUCTION IN 4-PERSON FAMILY INCOME BY $16,000 IN 2048

THE U.S. IS THE ONLY ADVANCED ECONOMY WITH RISING DEBT-TO-GDP.

Change in Debt, 2017 – 2023 (% of GDP)

SOURCE: International Monetary Fund, *World Economic Outlook*, April 2018. Compiled by PGPF.

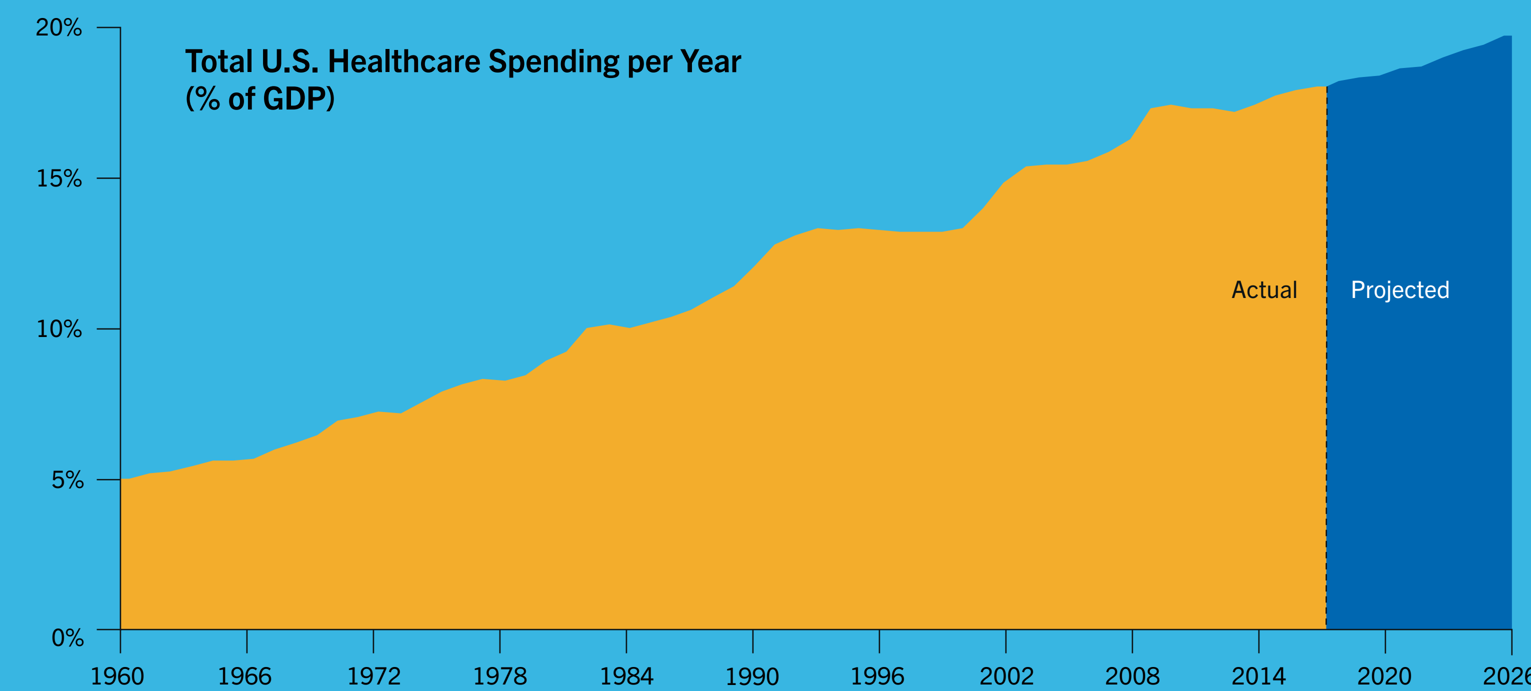
HEALTHCARE: OUR CENTRAL FISCAL AND ECONOMIC CHALLENGE

By definition, addressing America's fiscal and economic challenges means addressing the future of healthcare in this country. Rising healthcare costs are a key driver of our fiscal imbalance – accounting for 70% of the increase in federal mandatory spending over the long term relative to the size of the economy.

An expensive healthcare system that delivers poor outcomes threatens our health, undermines our economy and strains the federal budget. At a total expenditure of approximately $3.7 trillion, or 18% of the national economy, the U.S. healthcare system is the most expensive in the world. Yet our health outcomes are worse than those of many other nations.

An inefficient healthcare system leaves our economy less competitive, reducing incomes and leaving fewer resources for productive activities that drive growth and innovation. This spending crowds out important public investments in our future like education, research and infrastructure.

Recognizing the significant economic and fiscal impacts of rising healthcare costs, the Foundation launched the Peterson Center on Healthcare in 2014. The Center is working to transform U.S. healthcare into a high-performance system by finding innovative solutions that improve quality and lower costs and then accelerating their adoption on a national scale. Read more on page 75.



SOURCE: Centers for Medicare and Medicaid Services, *National Health Expenditure Data*, February 2018. Compiled by PGPF.

THE PATH FORWARD

By any reasonable definition, the fiscal path we are on is unsustainable and dangerous, threatening the future we all want for our nation. Despite clear warning signs, policymakers have been unwilling to make responsible choices.

But there is a better path forward.

A sustainable long-term fiscal outlook will give our economy the best chance to succeed, creating conditions that encourage growth. A stable path enables an environment with greater access to capital, increased public and private investment, enhanced confidence, and a solid safety net. These factors, in turn, create a more vibrant economy, with rising wages and greater productivity and opportunity for Americans.

Many policy options exist to reduce America's long-term debt and lay a stronger foundation for future economic growth. Comprehensive plans generally phase in changes slowly to give people time to plan, and to avoid sudden economic shocks. While some plans would rely more on spending reductions and others more on tax increases, a combination of both would be more likely to receive bipartisan support and, therefore, would be more durable.

At the Peterson Foundation, we are actively working to bring our leaders and all Americans together around solutions for a growing, healthy economy and a sustainable fiscal outlook.