The Federal Budget: The Deficit is Down But the Fundamental Challenge Remains

Presentation to the Macroeconomic Advisers’ Washington Policy Seminar
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Note: Data in the figures reflect recent revisions by the Bureau of Economic Analysis to estimates of gross domestic product (GDP) in past years and CBO’s extrapolation of those revisions to projected future GDP.
Federal Debt Held by the Public

Percentage of GDP

Actual

January 2007
Current-Law Projection

Federal Debt Held by the Public

Percentage of GDP

- Actual
- January 2007 Current-Law Projection
- January 2011 Current-Law Projection

Year:
- 1980
- 1985
- 1990
- 1995
- 2000
- 2005
- 2010
- 2015
- 2020
Federal Debt Held by the Public

Percentage of GDP

January 2011
Current-Law Projection

January 2007
Current-Law Projection

May 2013
Current-Law Projection

Federal Budget Deficit

Percentage of GDP


January 2011 Projection with Certain Tax Cuts Extended and AMT Indexed
January 2011 Current-Law Projection
May 2013 Current-Law Projection

Actual
Federal Spending for Major Health Care Programs

Percentage of GDP

- Actual
- January 2011 Current-Law Projection
- May 2013 Current-Law Projection

Discretionary Spending

Percentage of GDP

- Actual
- January 2011 Current-Law Projection
- May 2013 Current-Law Projection

Years: 2011 to 2023
Net Interest Payments

Percentage of GDP

Actual

January 2011 Current-Law Projection

May 2013 Current-Law Projection

Spending for Social Security

Percentage of GDP

Actual

January 2011 Current-Law Projection

May 2013 Current-Law Projection
Other Mandatory Spending

Percentage of GDP

- Actual
- May 2013 Current-Law Projection
- January 2011 Current-Law Projection


CONGRESSIONAL BUDGET OFFICE
Federal Revenues

Percentage of GDP

- January 2011 Current-Law Projection
- May 2013 Current-Law Projection
- January 2011 Projection with Certain Tax Cuts Extended and AMT Indexed
- Actual

Revision to Projected Deficit in 2020

Between January 2011 projection assuming extension of certain expiring tax provisions and indexing of AMT, and May 2013 projection under current law:

<table>
<thead>
<tr>
<th>Spending</th>
<th>Percent of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major Health Care Programs</td>
<td>-0.6</td>
</tr>
<tr>
<td>Discretionary Programs</td>
<td>-1.0</td>
</tr>
<tr>
<td>Net Interest Payments</td>
<td>-1.2</td>
</tr>
<tr>
<td>Social Security</td>
<td>0.0</td>
</tr>
<tr>
<td>Other Mandatory Programs</td>
<td>0.2</td>
</tr>
</tbody>
</table>

| Revenues                        | +0.3           |

| Deficit                         | -2.9           |
Federal Debt Held by the Public

Percentage of GDP

- Actual
- January 2007 Current-Law Projection
- January 2011 Current-Law Projection
- May 2013 Current-Law Projection


GDP Percentage Range: 0 to 80
The Choices Facing Policymakers

If policymakers wanted to take action to reduce future budget deficits....

Their key choices would be about:

- *How much* to reduce deficits,
- *Through what policies*, and
- *With what timing*.
How Much to Reduce Deficits

Economic analysis does not say what the optimal amount of federal debt is.

To give a sense of how much deficit reduction would be required to reach an illustrative target (not a recommendation!): Suppose that policymakers wanted to reduce debt from its current 73 percent of GDP to its 40-year average of 38 percent, and to make that reduction of 35 percent linearly over 35 years—that is, by 1 percent of GDP per year.

To achieve that goal with policy changes that phased in over time would require changes that save nearly $2 trillion over the coming decade.
What Policies to Use to Reduce Deficits

Context for Policy Choices:

Historical and projected growth of federal spending relative to the size of the economy can be attributed almost entirely to growth in spending for a few large programs—namely, Social Security and the major health care programs.
Projected Spending and Revenues Under CBO’s Baseline Compared with Historical Experience

### Percentage of GDP

#### Social Security
- **Average, 1973–2012**: 4.2%
- **2012**: 4.8%
- **2023**: 5.3%

#### Major Health Care Programs
- **Average, 1973–2012**: 2.7%
- **2012**: 4.5%
- **2023**: 5.9%

#### Other Noninterest Programs
- **Average, 1973–2012**: 11.2%
- **2012**: 11.3%
- **2023**: 7.6%

#### Net Interest
- **Average, 1973–2012**: 2.2%
- **2012**: 1.4%
- **2023**: 3.1%

### Total Outlays

#### Average, 1973–2012**: 20.4%
- **2012**: 22.0%
- **2023**: 21.8%

### Total Revenues

- **Average, 1973–2012**: 17.4%
- **2012**: 15.2%
- **2023**: 18.5%

### Deficit
- **Average, 1973–2012**: -3.0%
- **2012**: -6.8%
- **2023**: -3.3%
## Funding for Discretionary Programs

### Changes in Discretionary Funding Between 2007 and 2013:

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>7 percent</td>
</tr>
<tr>
<td>Excluding funding for overseas military operations and in response to hurricanes</td>
<td>12 percent</td>
</tr>
<tr>
<td>Excluding funding for overseas military operations and in response to hurricanes, adjusted for inflation</td>
<td>-1 percent</td>
</tr>
</tbody>
</table>
Average Federal Tax Rates, by Income Group

- Top 1 Percent
- 81st to 99th Percentiles
- Middle Three Quintiles (21st to 80th Percentiles)
- Lowest Quintile

Percentage of Income Taxable Income
What Timing to Use to Reduce Deficits

Waiting to cut federal spending or increase taxes would lead to a greater accumulation of debt and would increase the size of the policy adjustments needed to achieve any chosen debt target.

However, implementing spending cuts or tax increases quickly would weaken the economic expansion and give people little time to plan and adjust to the policy changes.

The negative short-term effects of deficit reduction on output and employment would be especially strong now, because output is so far below its potential (or maximum sustainable) level that the Federal Reserve is keeping short-term interest rates near zero and could not lower them further to offset the impact of changes in fiscal policy.
Even if policy changes were not implemented for a few years, however, making decisions about those changes quickly would give people more time to plan and would tend to increase output and employment in the next few years by holding down longer-term interest rates, reducing uncertainty, and enhancing businesses’ and consumers’ confidence.
Conclusion

The federal budget deficit has fallen faster than we expected. However, relative to the size of the economy, debt remains historically high and is on an upward trajectory in the second half of the coming decade.

The fundamental federal budgetary challenge has hardly been addressed: The largest federal programs are becoming much more expensive because of the retirement of the baby boomers and the rising costs of health care, so we need to cut back on those programs or increase tax revenue to pay for them.