



# Congressional Budget Office

## **Making Choices About Federal Spending and Taxes**

**Presentation to the Economic Club of Minnesota**

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Notes for each slide can be found at the end of the presentation.

The federal budget deficit has fallen sharply from its peak in 2009 of \$1.4 trillion and nearly 10 percent of GDP—to about \$500 billion and 3 percent of GDP estimated for 2014.

But the nation has not made the fundamental choices it needs to make.

Federal debt remains on an unsustainable path, and the composition of federal spending is changing dramatically from what it has been in the past.

**What Is the Outlook for the Budget Under Current Law?**

**What Criteria Might Be Used to Evaluate Policy Changes?**

# CBO Provides Objective, Nonpartisan Information to the Congress

CBO makes **baseline projections** of federal budget outcomes under current law

CBO makes **estimates of the effects of changes in federal policies** (sometimes in collaboration with JCT):

- Legislation being developed by committees

- Conceptual proposals being discussed on the Hill or elsewhere

CBO makes **no recommendations**

# CBO's Estimates...

Focus on the **next 10 years**, but **sometimes look out 20 years** or more

Are meant to reflect the **middle of the distribution** of possible outcomes

Incorporate **behavioral responses** to the extent feasible

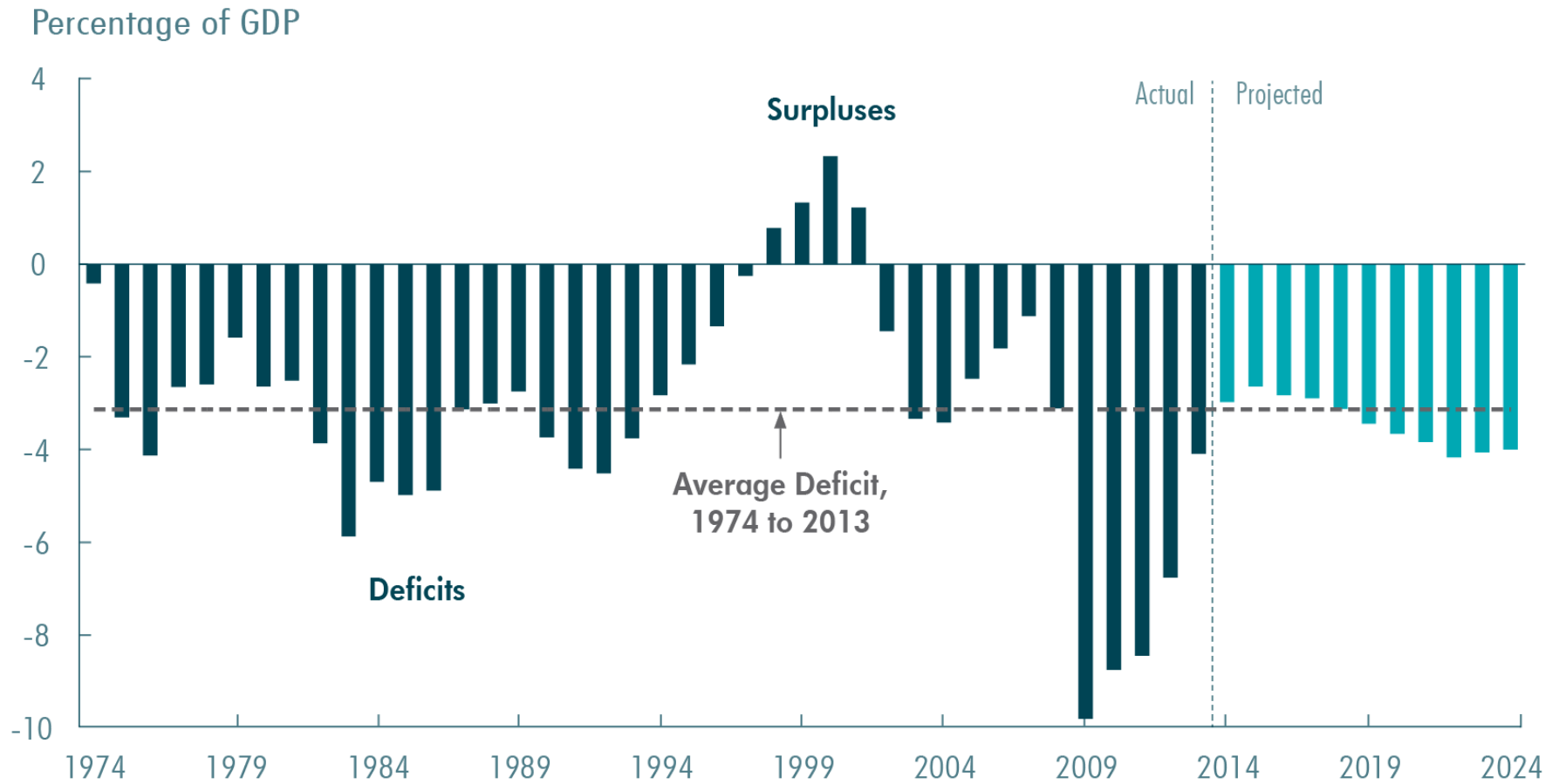
Use whatever **evidence** can be brought to bear given available resources and time

Change in **response to new analysis** by CBO and others

Provide **explanations of the analysis** to the extent feasible

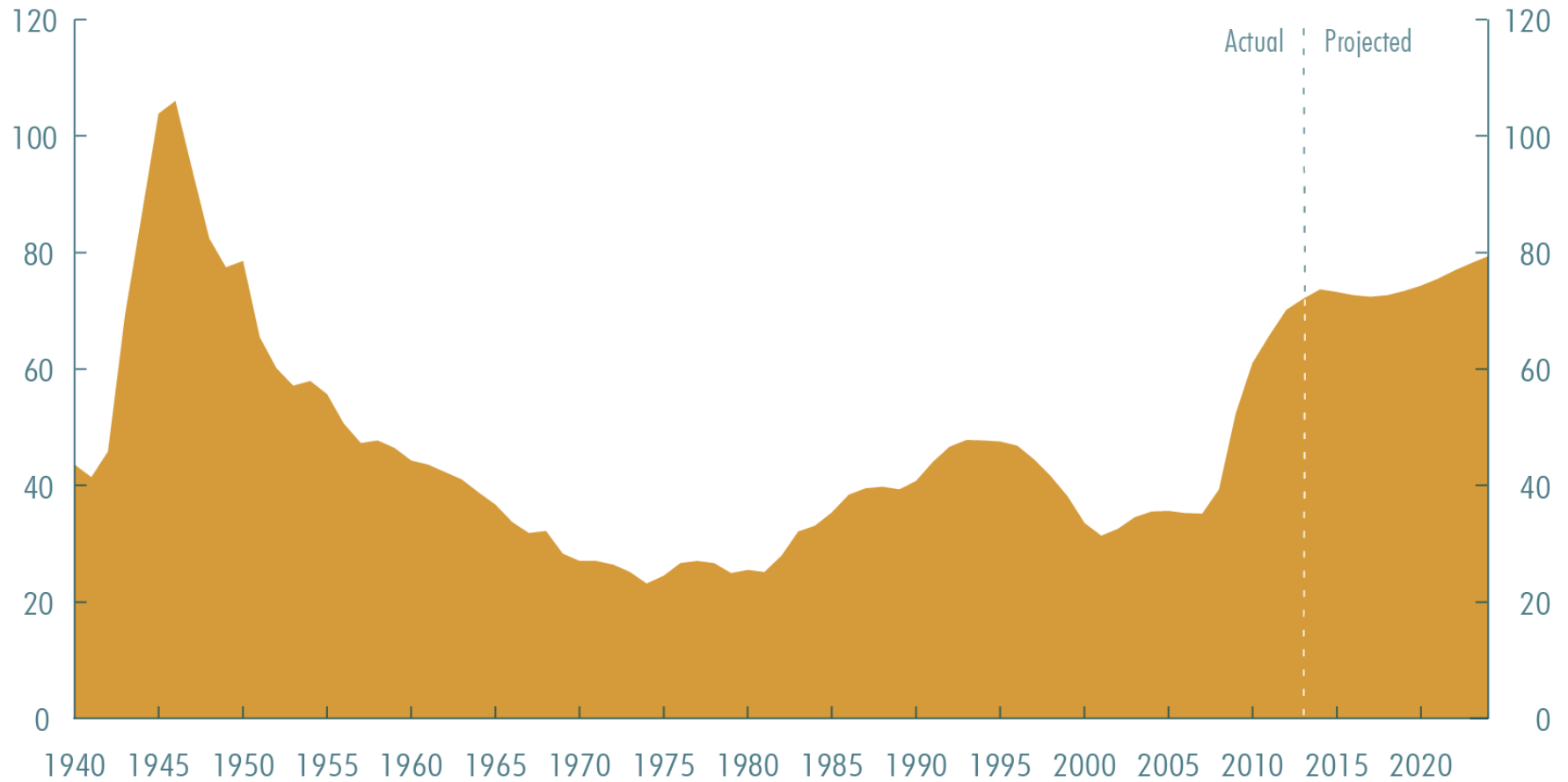
# **What Is the Outlook for the Budget Under Current Law?**

# Total Federal Deficits or Surpluses



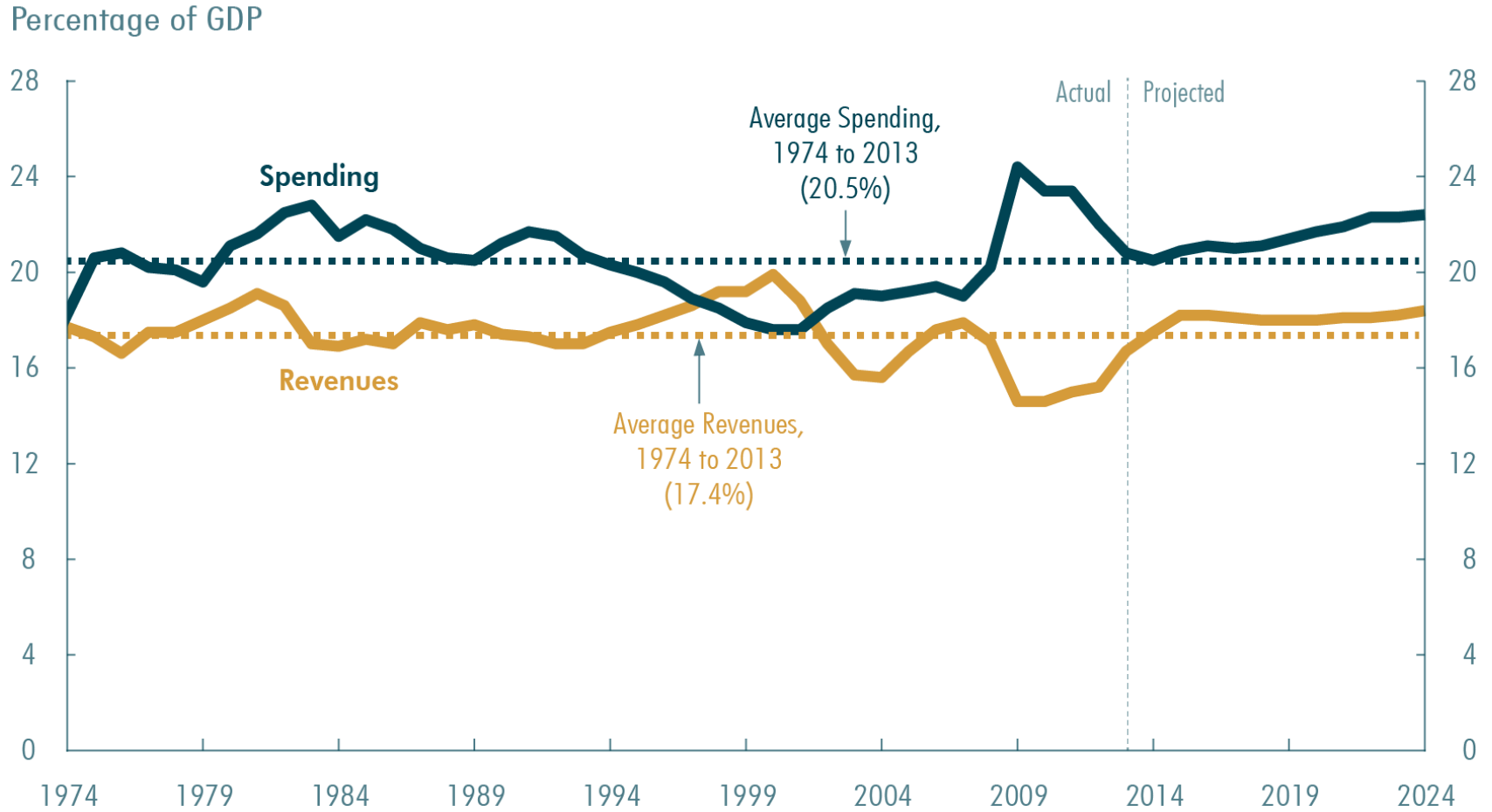
# Federal Debt Held by the Public

Percentage of GDP



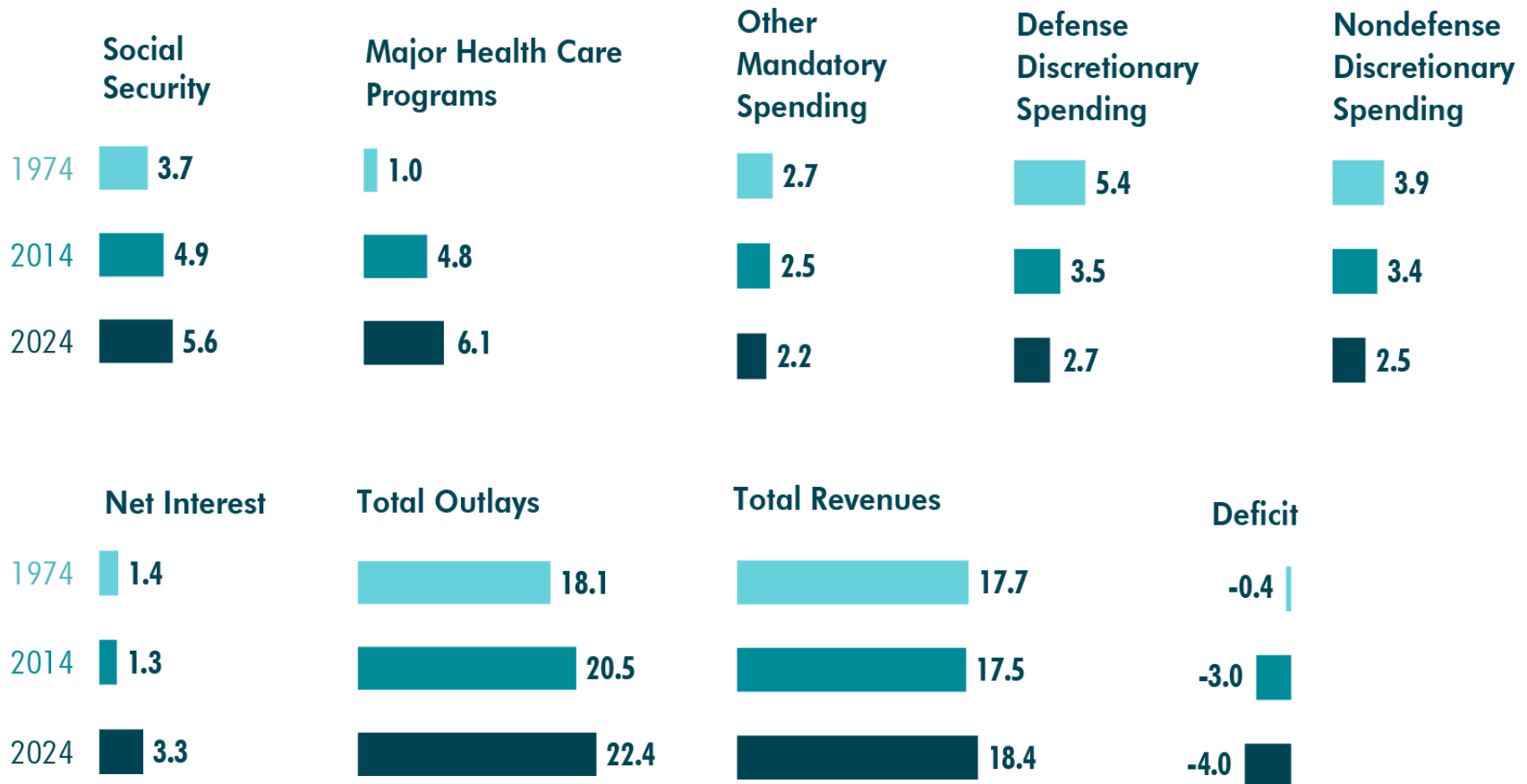


# Total Spending and Revenues



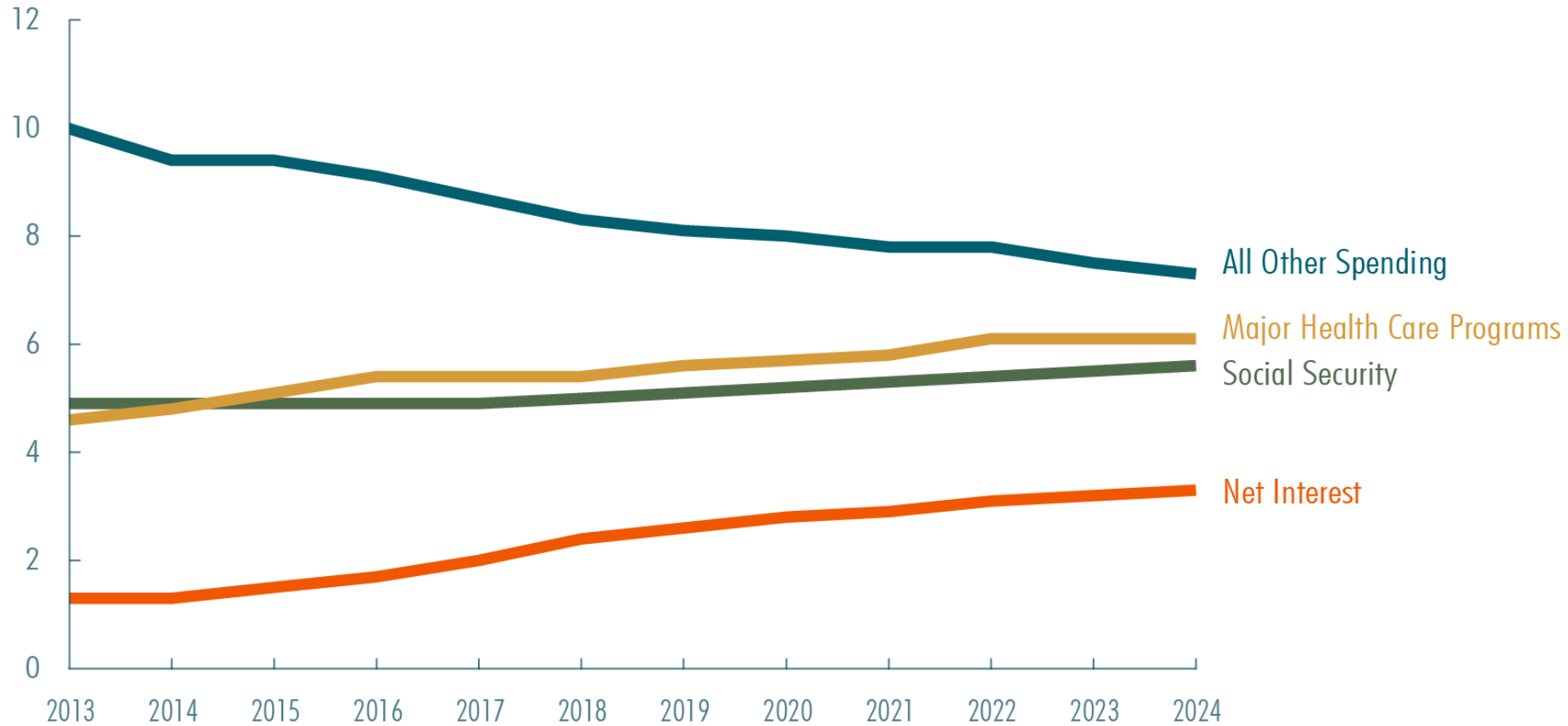
# Spending and Revenues Projected in CBO's Baseline, Compared with Levels in 1974

Percentage of GDP



# Projected Spending in Major Budget Categories

Percentage of GDP



# What Is Causing the Shift in the Composition of Federal Spending?

**Aging** of the population

**Expansion of federal subsidies** for health insurance

Rising **health care costs** per person

Return of **interest rates** to more typical levels

**Caps** on discretionary funding

# **What Criteria Might Be Used to Evaluate Policy Changes?**

**What role** would the federal government play in society?

**How much** would deficits be reduced?

What would the **economic impact** be?

Who would bear **the burden** of proposed changes in tax and spending policies?

# What Role Would the Federal Government Play in Society?

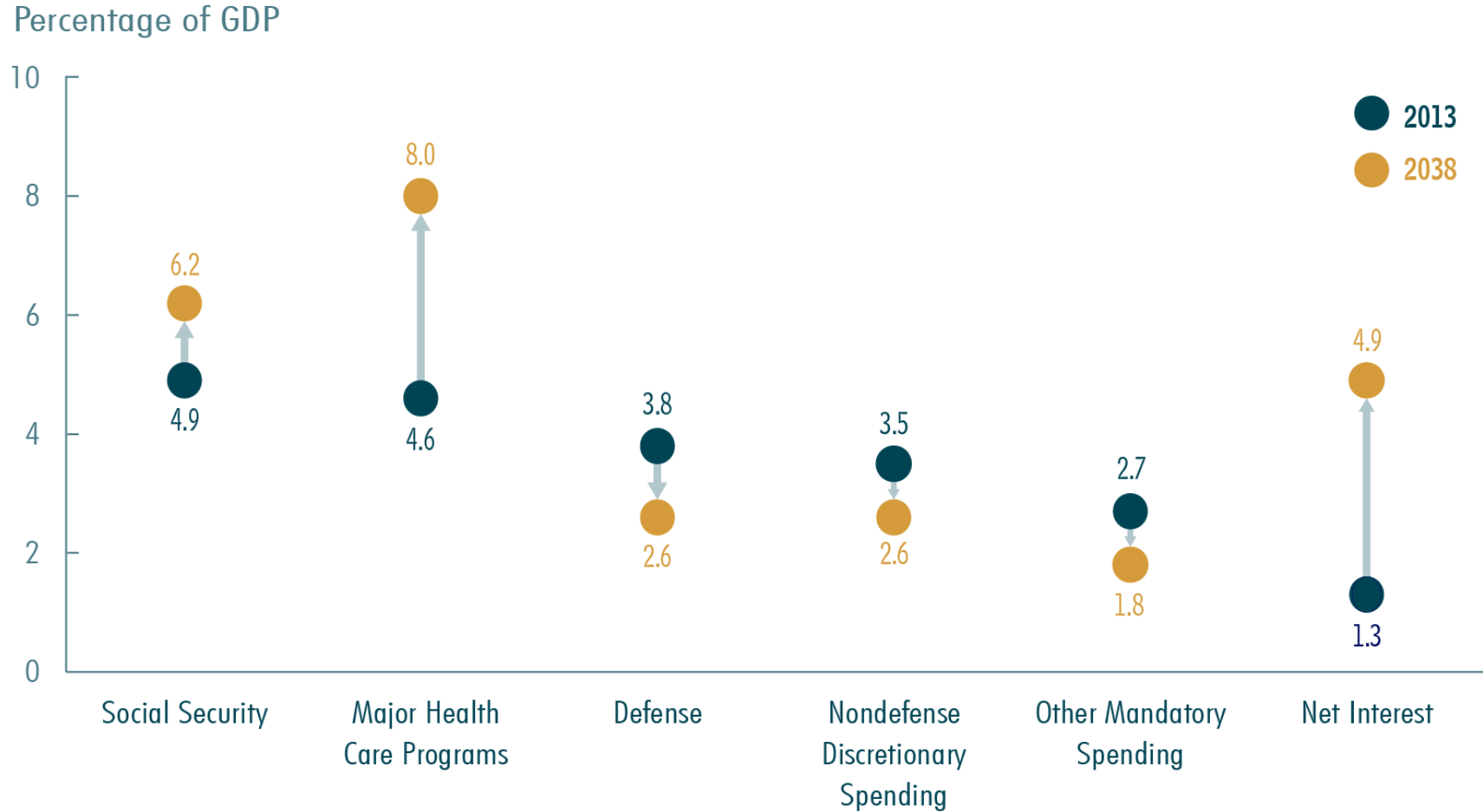
**Amount of federal spending** relative to the size of the economy

**Composition** of federal spending

**Amount of federal taxes**

Magnitude of **tax expenditures**

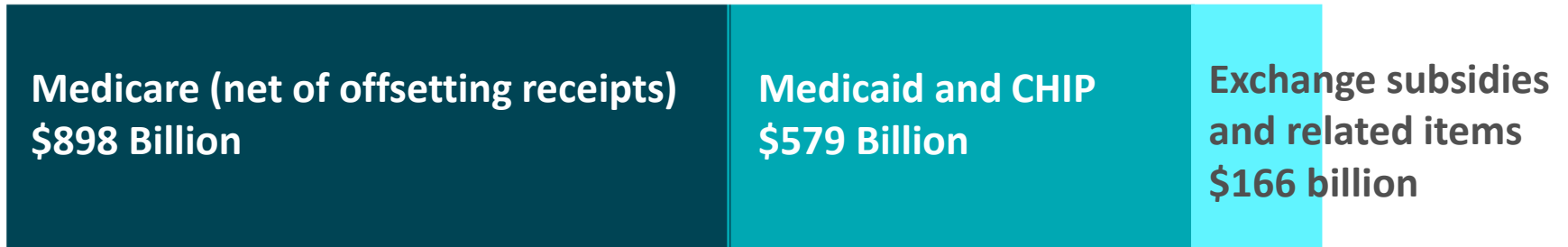
# Components of Federal Spending for 2013 and Projected in CBO's Extended Baseline for 2038





# Even After the Affordable Care Act Is Fully Implemented, Most Federal Dollars for Health Care Will Support Care for Older People

CBO's projections for 2024:



Federal spending in 2024 for the major health care programs will finance care for:



# How Much Would Deficits Be Reduced?

What would be the effect in 25 years if deficits in this decade were reduced by:\*

**\$2 Trillion** Debt-to-GDP ratio would be close to what it is today

**\$4 Trillion** Debt-to-GDP ratio would be close to its 40-year average

\* The reduction in deficits is assumed to occur gradually and to be maintained after the decade at the percentage of GDP reached in the tenth year; amounts exclude interest costs.

To reduce deficits in this decade by \$4 trillion would require:

**Cuts of nearly one-fifth**

In benefits from Social Security and major health care programs

*Or*

**Cuts of more than one-fifth**

In other noninterest spending

*Or*

**Increases of one-tenth**

In taxes

*Or*

**Some combination** of those changes

# What Would the Economic Impact Be?

In the **short term**, reductions in federal spending or increases in federal taxes would generally reduce demand for goods and services, thereby lowering output and employment.

That effect would tend to be **especially strong under current economic conditions**.

## What Would the Economic Impact Be? (Cont.)

In the **long term**, reductions in federal deficits would generally increase national saving and investment, thereby raising output and income.

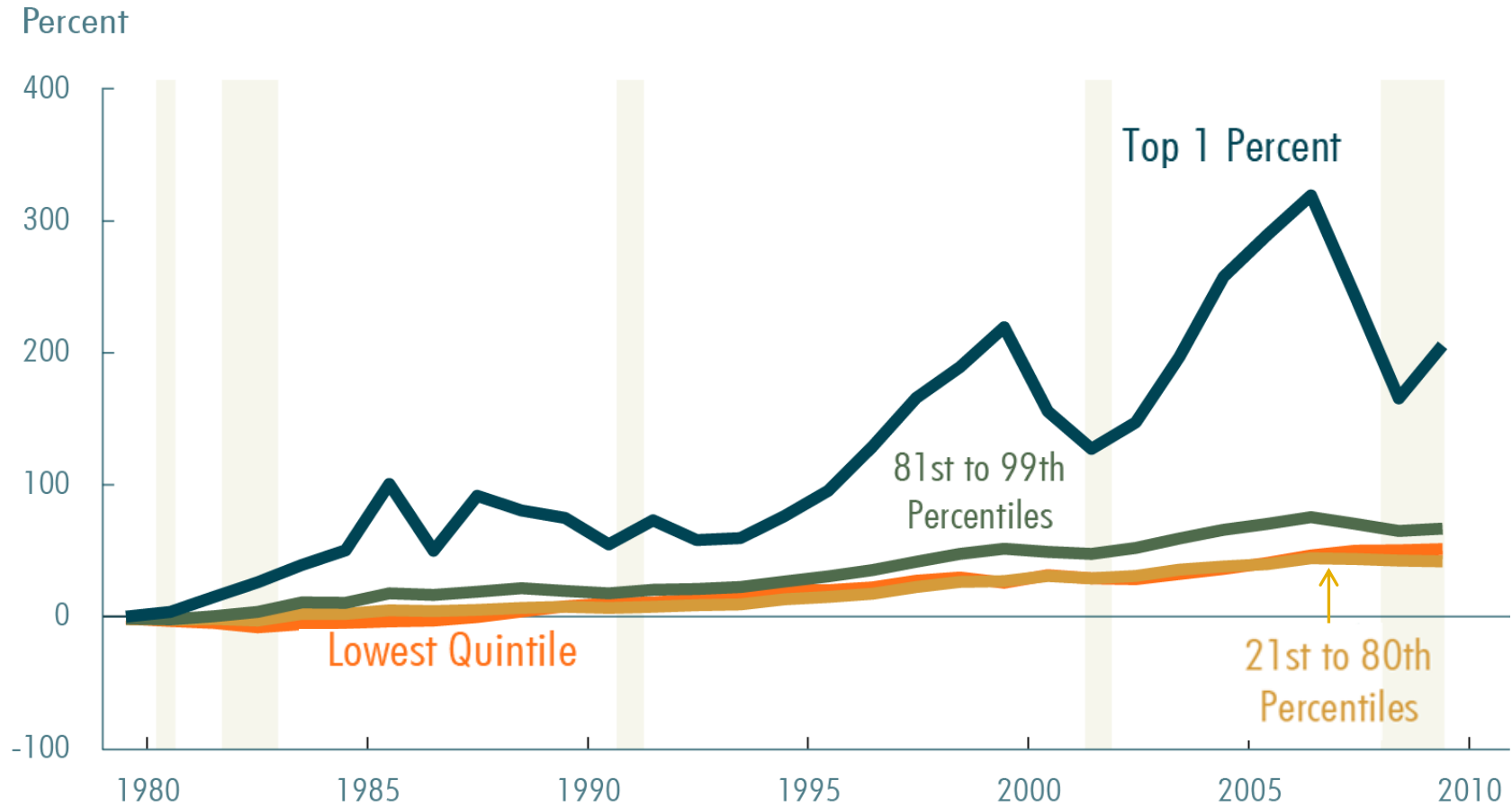
The positive effects of deficit reduction over the long term might be partly offset by the negative effects of:

**Increases in marginal tax rates**, which reduce people's incentive to work and save and thus future output.

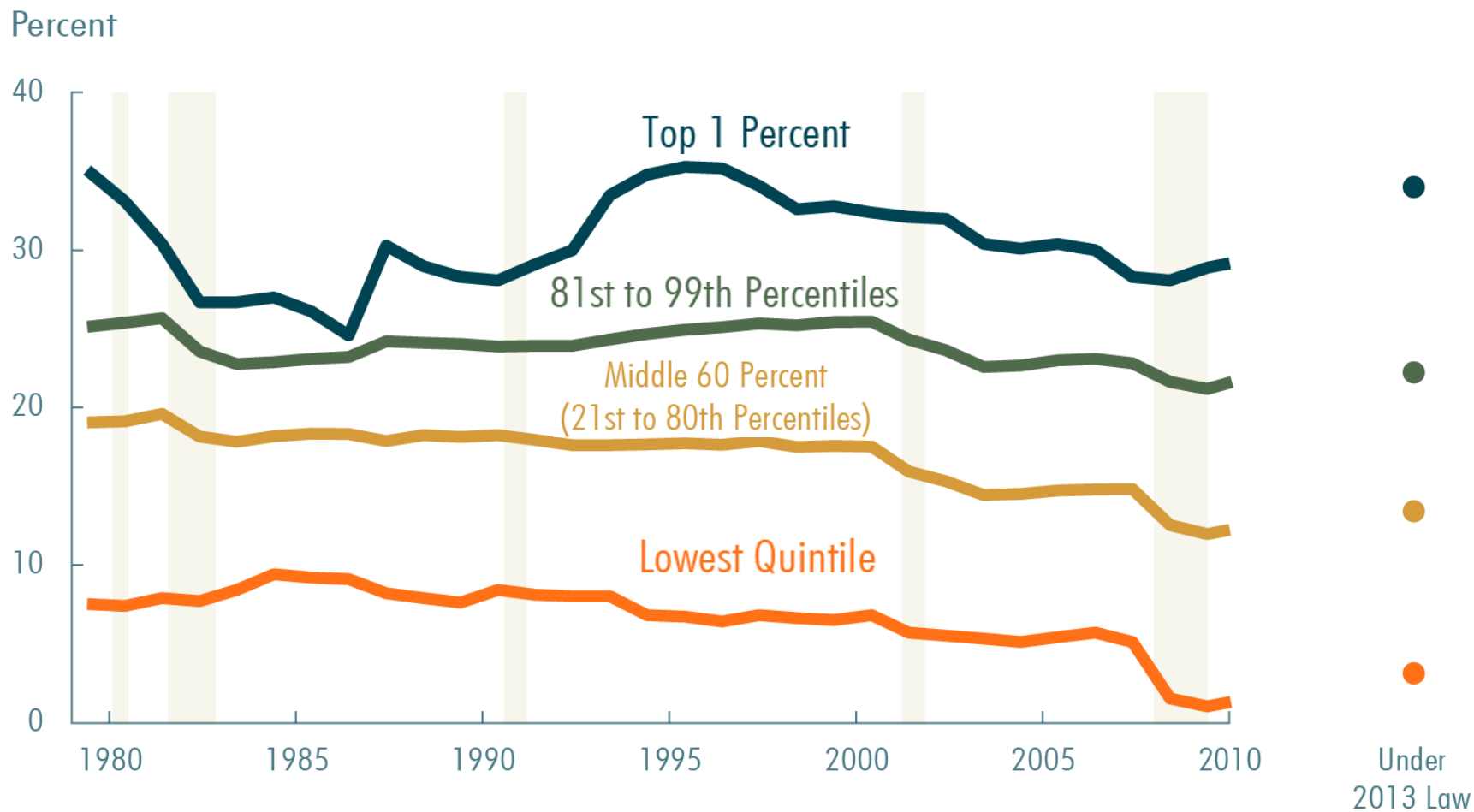
**Decreases in federal investment** in infrastructure and education, which reduce future output.

# **Who Would Bear the Burden of Proposed Changes in Tax and Spending Policies?**

# Cumulative Growth in Average Inflation-Adjusted After-Tax Income, by Income Group, 1979 to 2010

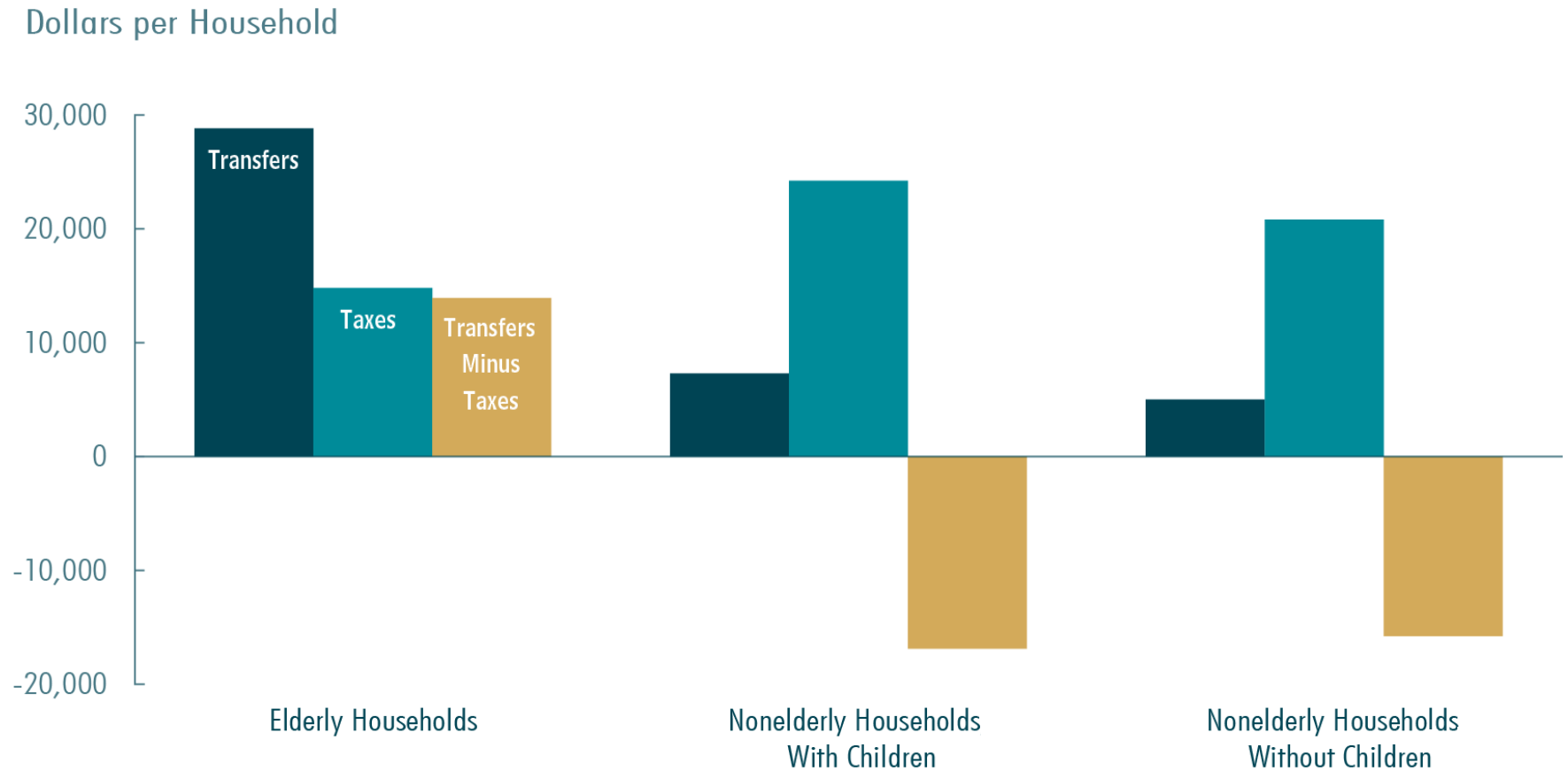


# Average Federal Tax Rates, by Income Group, 1979 to 2010 and Under 2013 Law





# Average Transfers, Taxes, and Transfers Minus Taxes per Household, by Type of Household, 2006



# Average Transfers, Taxes, and Transfers Minus Taxes for Nonelderly Households, by Income Group, 2006



Note: \* = between zero and \$500.

# Conclusion

Relative to the size of the economy, debt remains **historically high** and is on an **upward trajectory** by 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, increase tax revenue to pay for them, cut other federal spending to even lower levels by historical standards, or adopt some combination of those approaches.

# Endnotes

**Slides 6 through 10:** For more information, see *The Budget and Economic Outlook: 2014 to 2024* (February 2014), [www.cbo.gov/publication/45010](http://www.cbo.gov/publication/45010).

**Slide 9:** Major health care programs consist of Medicare, Medicaid, the Children’s Health Insurance Program, and subsidies offered through health insurance exchanges and related spending. (Medicare spending is net of offsetting receipts.)

**Slide 10:** Major health care programs consist of Medicare, Medicaid, the Children’s Health Insurance Program, and subsidies offered through health insurance exchanges and related spending. (Medicare spending is net of offsetting receipts.) Other mandatory spending is all mandatory spending other than that for Social Security and major health care programs.

**Slides 11 through 25:** For more information, see *Choices for Deficit Reduction: An Update* (December 2013), [www.cbo.gov/publication/44967](http://www.cbo.gov/publication/44967).

**Slide 15:** For more information, see *The Budget and Economic Outlook: 2014 to 2024* (February 2014), [www.cbo.gov/publication/45010](http://www.cbo.gov/publication/45010) and *The 2013 Long-Term Budget Outlook* (September 2013), [www.cbo.gov/publication/44521](http://www.cbo.gov/publication/44521).

**Slide 16:** For more information, see *The Budget and Economic Outlook: 2014 to 2024* (February 2014), [www.cbo.gov/publication/45010](http://www.cbo.gov/publication/45010).

**Slide 17:** For more information, see *The 2013 Long-Term Budget Outlook* (September 2013), [www.cbo.gov/publication/44521](http://www.cbo.gov/publication/44521).

**Slides 22 and 23:** For more information, see *The Distribution of Household Income and Federal Taxes, 2010* (December 2013), [www.cbo.gov/publication/44604](http://www.cbo.gov/publication/44604).

**Slides 24 and 25:** For more information, see *The Distribution of Federal Spending and Taxes in 2006* (November 2013), [www.cbo.gov/publication/44698](http://www.cbo.gov/publication/44698).