Fiscal Policy and Automatic Stabilizers

Presentation at the Hutchins Center on Fiscal and Monetary Policy at Brookings

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If current laws remain generally the same, growing deficits are projected to raise federal debt held by the public to 86 percent of gross domestic product (GDP) by 2026—up from 74 percent at the end of 2015 and a little more than twice the average of the past five decades.
Total Deficits or Surpluses

Percentage of GDP

Deficits

Surpluses

Average Deficit, 1966 to 2015 (-2.8%)

Actual

Projected
Federal Debt Held by the Public

Percentage of GDP

Actual

Projected

CONGRESSIONAL BUDGET OFFICE
High and rising debt has a number of consequences:

• Lawmakers would have less flexibility to use tax and spending policies to respond to unexpected challenges.

• Federal spending on interest payments would rise substantially when interest rates increased from their current levels to more typical ones.

• The likelihood of a fiscal crisis in the United States would increase.
• There would be a greater risk that investors would become unwilling to finance the government’s borrowing needs unless they were compensated with very high interest rates; if that happened, interest rates on federal debt would rise suddenly and sharply.

• Because federal borrowing reduces total saving in the economy over time, the nation’s capital stock would ultimately be smaller than it would be if debt was smaller, and productivity and total wages would be lower.
Over the next few years, CBO anticipates a near elimination of slack in the economy, as evidenced by the closing gap between GDP and potential GDP.
GDP and Potential GDP

Trillions of 2009 Dollars

Historical  |  Projected

Potential GDP

GDP

2001  |  2006  |  2011  |  2016  |  2021  |  2026
CBO expects that automatic stabilizers will provide less economic stimulus over the next few years.

Automatic stabilizers are the automatic increases in revenues and decreases in outlays in the federal budget that occur when the economy strengthens, and the opposite changes that occur when the economy weakens.
Contribution of Automatic Stabilizers to Budget Deficits and Surpluses

Percentage of GDP

Historical | Projected
Contribution of Automatic Stabilizers to the Deficit as a Share of Potential GDP

Percent

<table>
<thead>
<tr>
<th>Beginning of Recession</th>
<th>After Four Quarters</th>
<th>After Eight Quarters</th>
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<td>1969, Fourth Quarter</td>
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<td>2007, Fourth Quarter</td>
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Budget Deficits and Surpluses With and Without Automatic Stabilizers

Percentage of GDP

Historical  Projected

For more information, see:
