Shifting Priorities in the Federal Budget

Presentation to the Stanford Institute for Economic Policy Research
Douglas W. Elmendorf
Director
May 13, 2014

Notes for the slides can be found at the end of the presentation.
Under current law, the future of the federal budget will be strikingly different from its past in two key ways:

Federal debt will be much larger relative to the size of the economy than it has been in almost all of our history.

A much larger share of federal spending will go to benefits for older Americans and for health care, and a much smaller share will go to other activities.
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, based on whatever **evidence** is available

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

Provide **explanations of the analysis** to the extent feasible
Under Current Law, What Is the Outlook for Overall Federal Deficits, Debt, Spending, and Revenues?
Federal Deficits Are Projected To Rise Again Beginning in 2016

Percentage of GDP

- Average Deficit, 1974 to 2013 (-3.1%)
- Surpluses
- Deficits

Federal Debt Held by the Public Is Projected to Be at Historically High Levels
Federal Spending and Revenues Are Both Projected to be Above Their 40-Year Averages
Under Current Law, How Will the Composition of Federal Spending Change?
Federal Transfer Payments and Taxes Shift Resources to Elderly Households From Younger Households, On Average

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

Dollars per Household
About 45 Percent of Federal Spending in 2013 Went for Social Security, Medicare, and Medicaid
Under Current Law, Federal Spending for Health Care Is Growing Much Faster Than Other Spending and the Economy

<table>
<thead>
<tr>
<th>Percentage of GDP</th>
<th>Social Security</th>
<th>Major Health Care Programs</th>
<th>Other Noninterest Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average, 1974-2013</td>
<td>4.3</td>
<td>2.8</td>
<td>11.2</td>
</tr>
<tr>
<td>2014</td>
<td>4.9</td>
<td>4.8</td>
<td>9.3</td>
</tr>
<tr>
<td>2024</td>
<td>5.6</td>
<td>5.9</td>
<td>7.3</td>
</tr>
</tbody>
</table>
By 2020, under current law:

Federal spending for Social Security and the major health care programs will be roughly 50 percent larger relative to GDP than it has been, on average, during the past 40 years.

Federal spending for all other programs taken together will be a smaller percentage of GDP than it has been in at least 70 years.
Federal Spending for Major Health Care Programs Will Increase Relative to GDP for Three Main Reasons

<table>
<thead>
<tr>
<th></th>
<th>Percentage of Projected Growth in Spending Through:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2023</td>
</tr>
<tr>
<td>Population Aging</td>
<td>21</td>
</tr>
<tr>
<td>Rising Costs of Health Care Per Person</td>
<td>26</td>
</tr>
<tr>
<td>Expansion of Federal Subsidies for Health Insurance Through</td>
<td>53</td>
</tr>
<tr>
<td>Medicaid and Exchanges</td>
<td></td>
</tr>
</tbody>
</table>

CBO
The Share of the Population Age 65 or Older Is Rising Substantially

Population Age 65 or Older as a Percent of the Population Ages 20 to 64

- Actual
- Projected

CBO
Growth in Health Care Spending Per Beneficiary in Excess of GDP Growth Has Varied a Lot

“Excess Cost Growth” for Total Health Care Spending

So-called “excess cost growth,” or ECG, is the amount by which health care costs per beneficiary (adjusted for changes in the age profile of beneficiaries over time) outpace the maximum sustainable output of the economy per person.
Under Current Law, Federal Spending for Each Major Health Care Program Will Grow Rapidly
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:

<table>
<thead>
<tr>
<th>Spending Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicare (net of offsetting receipts)</td>
<td>$858 Billion</td>
</tr>
<tr>
<td>Medicaid and CHIP</td>
<td>$582 Billion</td>
</tr>
<tr>
<td>Exchange subsidies and related items</td>
<td>$137 Billion</td>
</tr>
</tbody>
</table>

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

- People over age 65: Three-fifths
- Blind and disabled: One-fifth
- Others: One-fifth
By 2023, Discretionary Spending Is Projected to Reach Its Lowest Percentage of GDP in Decades
Statutory caps constrain *total defense* and *total nondefense* discretionary appropriations.

The difficult decisions about how large the appropriations will be for *specific programs and activities* will be made year-by-year in the future.
There Are Two Main Approaches for Limiting Defense Spending

To lower the Department of Defense’s costs, policymakers could:

- Reduce the size of the military (for example, the number of brigade combat teams or major warships);

- Decrease the per-unit funding provided to man, equip, train, and operate forces; or

- Some combination of those two approaches.
If Savings Came Almost Entirely From Cutting Force Structure, the Required Cuts Would Be More Than 20 Percent

<table>
<thead>
<tr>
<th></th>
<th>Active and Reserve Forces</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Planned Force in 2017</td>
</tr>
<tr>
<td><strong>Army Brigade Combat Teams</strong></td>
<td>66</td>
</tr>
<tr>
<td><strong>Navy Major Warships</strong></td>
<td>244</td>
</tr>
<tr>
<td><strong>Marine Corps Regiments</strong></td>
<td>11</td>
</tr>
<tr>
<td><strong>Air Force Fighter Aircraft</strong></td>
<td>1,100</td>
</tr>
</tbody>
</table>

Notes: Planned force and illustrative reductions reflect DoD’s 2014 budget request. Illustration assumes that reductions are spread evenly across all four services. Reductions are based on CBO’s cost projections; reductions would be about one-third smaller under DoD’s costing assumptions.
Federal Nondefense Investment Improves the Private Sector’s Ability to Invest, Produce, and Distribute Goods and Services

Percentage of GDP


Physical Capital

Education and Training

Research and Development
If Investment Remains the Same Share of Nondefense Discretionary Spending as in the Past, It Is Projected to Reach Its Lowest Percentage of GDP in Decades
Spending for Means-Tested Programs and Tax Credits for Low-Income People Rose Sharply in the Recession
What Are the Implications of the Shift in Federal Spending Under Current Law?
Deciding to sharply increase federal spending on benefits for older Americans and for health care relative to the size of the economy may be sensible (or not). Deciding to sharply decrease federal spending on other activities relative to the size of the economy may be sensible (or not).

However, many observers worry that we have not explicitly decided as a society to make these changes. Rather, we seem to be drifting into the changes because spending for the largest benefit programs is determined by formulas for benefits per person that allow spending to grow without explicit action, whereas spending for many other federal activities is set through annual appropriations.
The largest federal programs are becoming much more expensive because of the retirement of the baby boomers and the rising costs of health care. As a result, even with federal spending for all programs other than Social Security and the major health care programs on track to reach its smallest share of GDP in at least 70 years, federal debt remains on an unsustainable path.

Therefore, we will need to cut benefits from those large programs, raise tax revenue above its historical percentage of GDP to pay for the rising cost of those programs, or adopt a combination of those approaches.
Endnotes

**Slides 5 through 7:** For more information, see *Updated Budget Projections: 2014 to 2024* (April 2014), www.cbo.gov/publication/45229.

**Slide 8:** For more information, see *The Distribution of Household Income and Federal Taxes, 2010* (December 2013), www.cbo.gov/publication/44604.

**Slide 10:** For more information, see *The Distribution of Federal Spending and Taxes in 2006* (November 2013), www.cbo.gov/publication/44698.


**Slide 12:** For more information, see *Updated Budget Projections: 2014 to 2024* (April 2014), www.cbo.gov/publication/45229. 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.)

**Slides 14 through 16:** For more information, see Chapters 2 and 3 of *The 2013 Long-Term Budget Outlook* (September 2013), www.cbo.gov/publication/44521.

**Slides 17 through 19:** For more information, see *Updated Budget Projections: 2014 to 2024* (April 2014), www.cbo.gov/publication/45229.

**Slides 21 and 22:** For more information, see “Options for Reducing Defense Budgets to Meet Funding Limits Under the Budget Control Act,” *CBO Blog*, December 9, 2013.

**Slides 23 and 24:** For more information, see *Federal Investment* (December 2013), www.cbo.gov/publication/44974. Projections are based on *Updated Budget Projections: Fiscal Years 2013 to 2023* (May 2013) and have not been updated for CBO’s most recent budget projections published in April 2014.

**Slide 25:** For more information, see *Updated Budget Projections: 2014 to 2024* (April 2014), www.cbo.gov/publication/45229.