



Congressional Budget Office

A Tour of the Federal Budget and Possible Changes in Budget Policy

Presentation to Economics 10 at Harvard University

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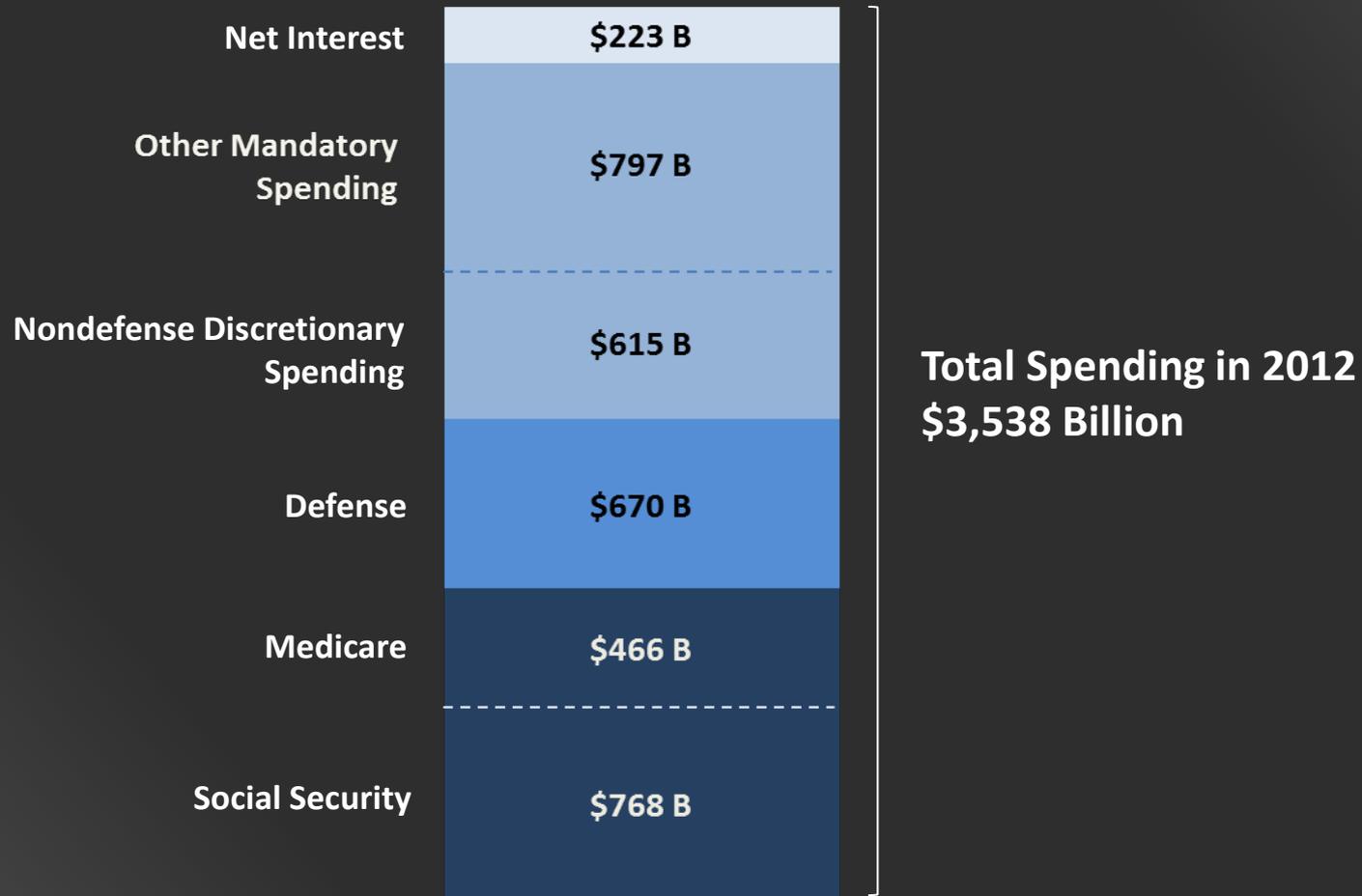
Director

April 26, 2013

Outline of the Talk

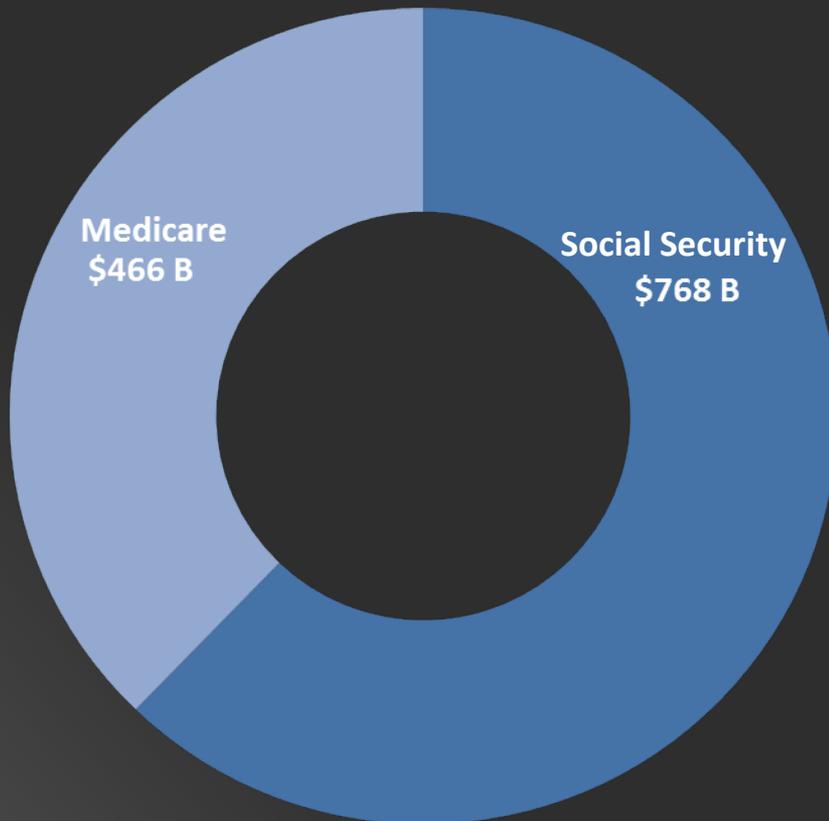
- Where Does Federal Spending Go and Federal Revenue Come From?
- How Has the Federal Budget Changed Over Time?
- What Will Happen to Federal Spending, Revenues, and Debt Under Current Law?
- What Will Be the Consequences of Those Trends?
- What Criteria Could Be Used to Evaluate Proposed Policy Changes?
- What Policy Changes Have Been Proposed?

Much of Federal Spending Goes to a Few Large Programs

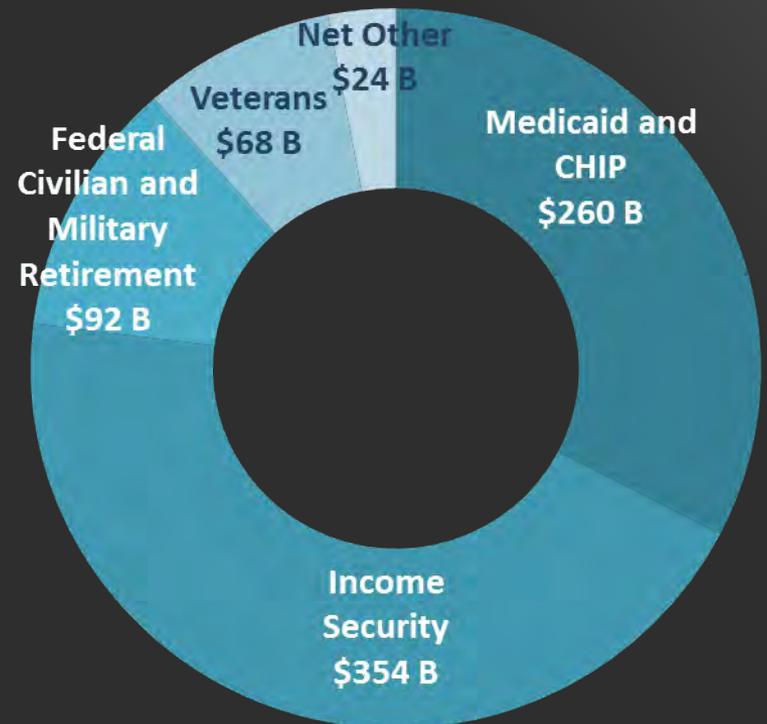


Mandatory Spending Totaled \$2,031 Billion in 2012

Social Security and Medicare
\$1,234 Billion

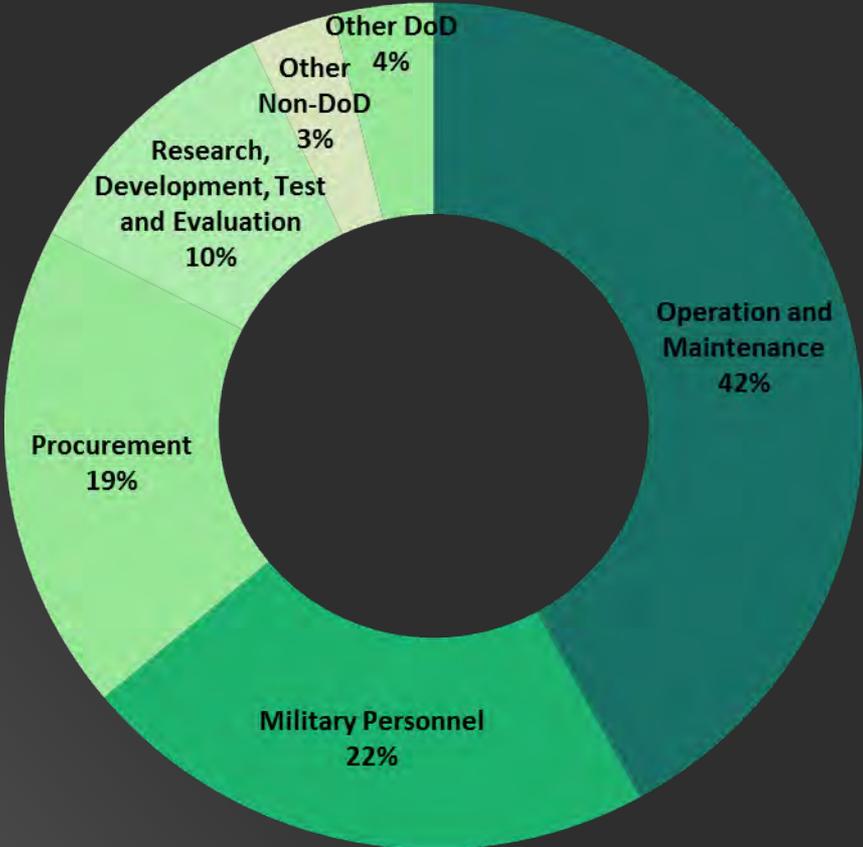


Other Mandatory Spending
\$797 Billion

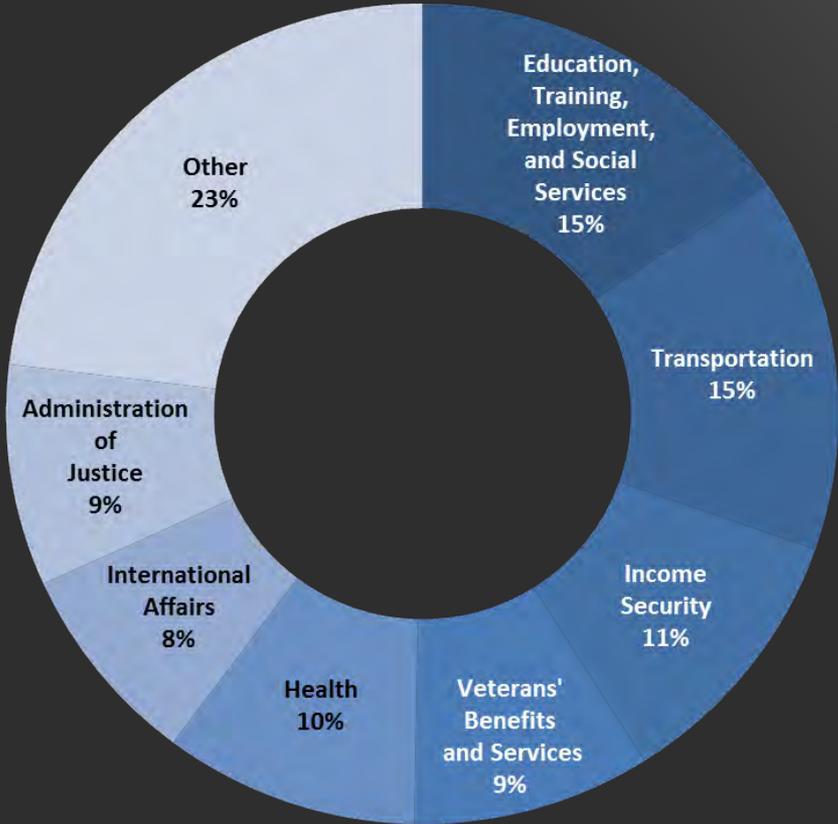


Discretionary Spending Totaled \$1,285 Billion in 2012

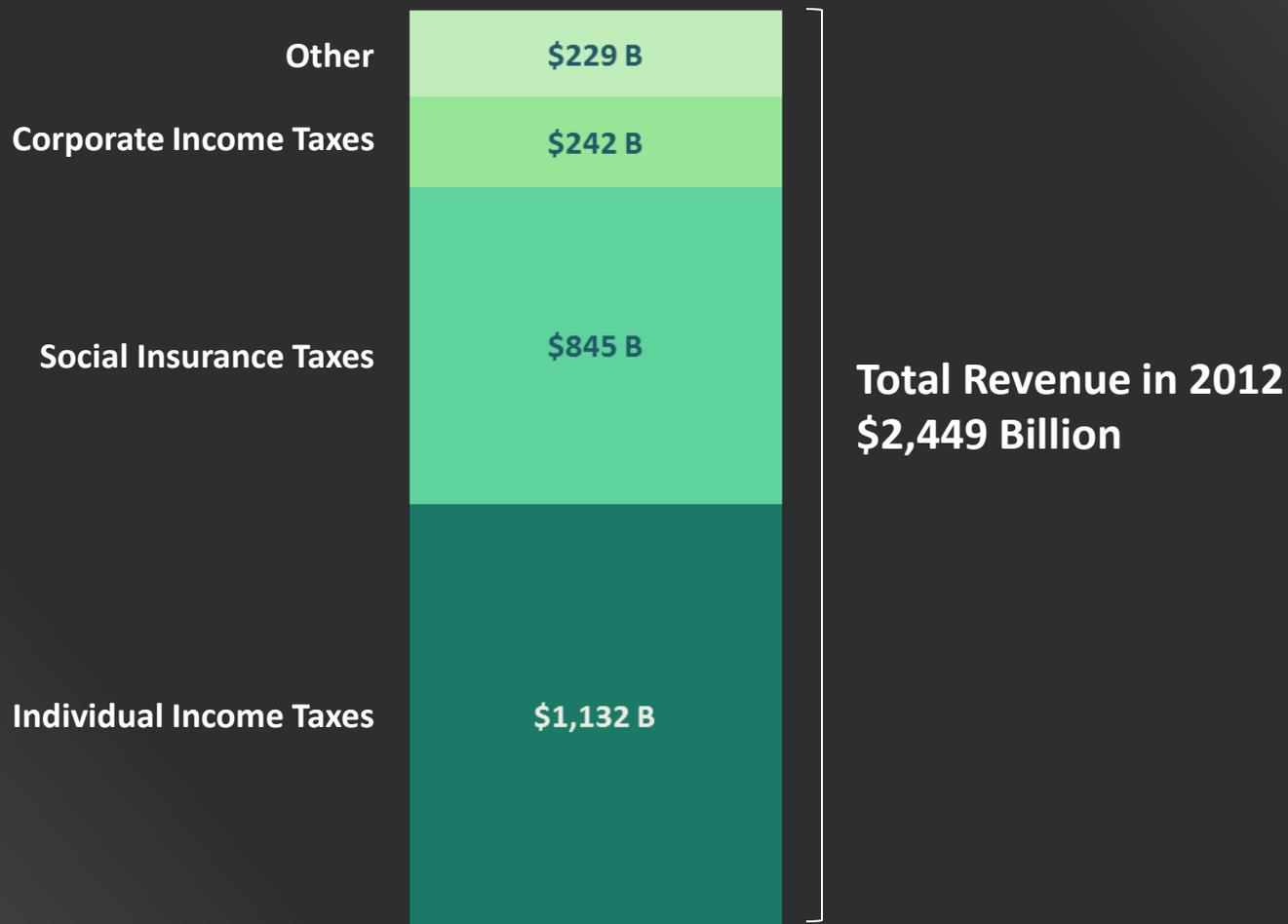
**Defense
\$670 Billion**



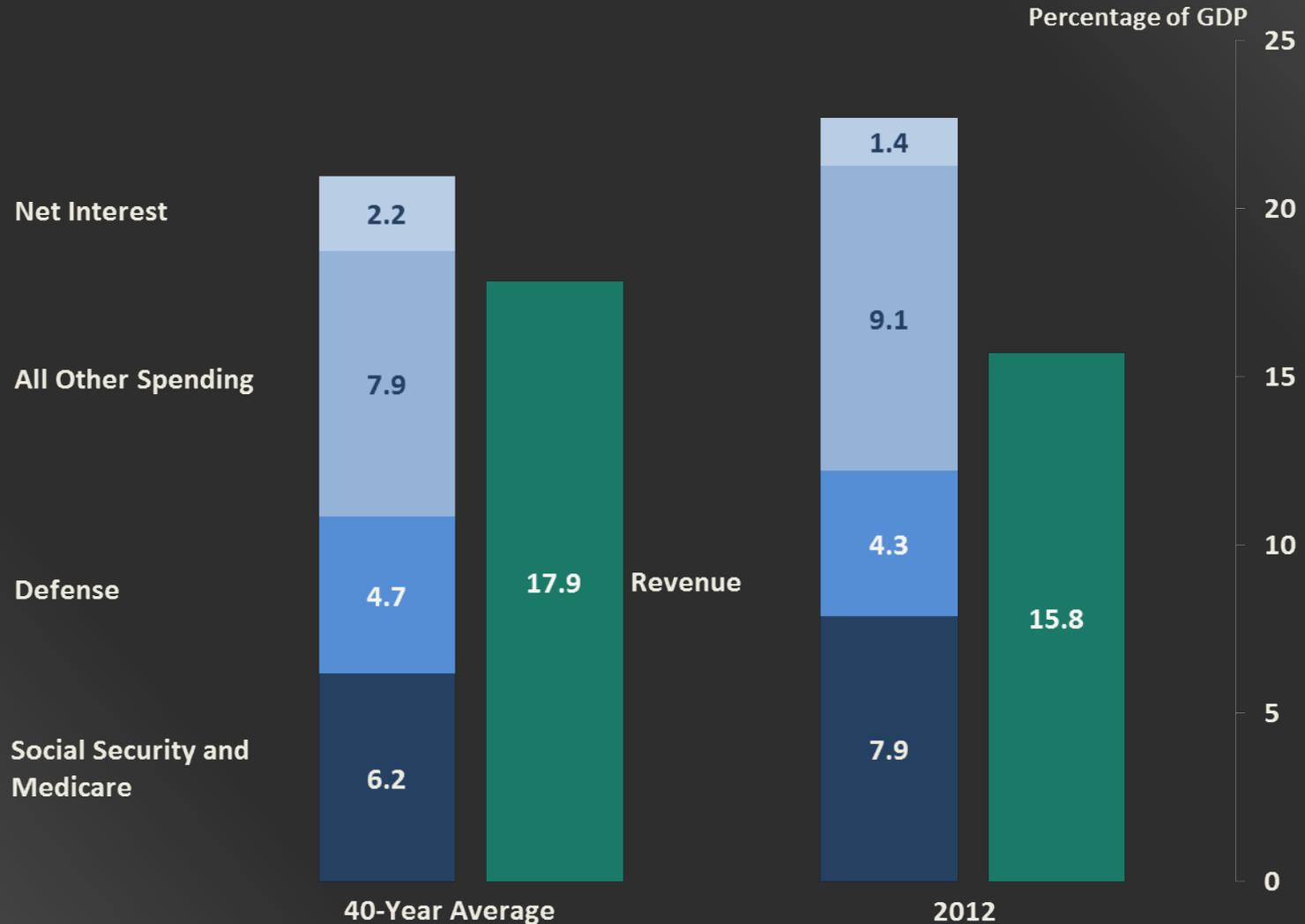
**Nondefense
\$615 Billion**



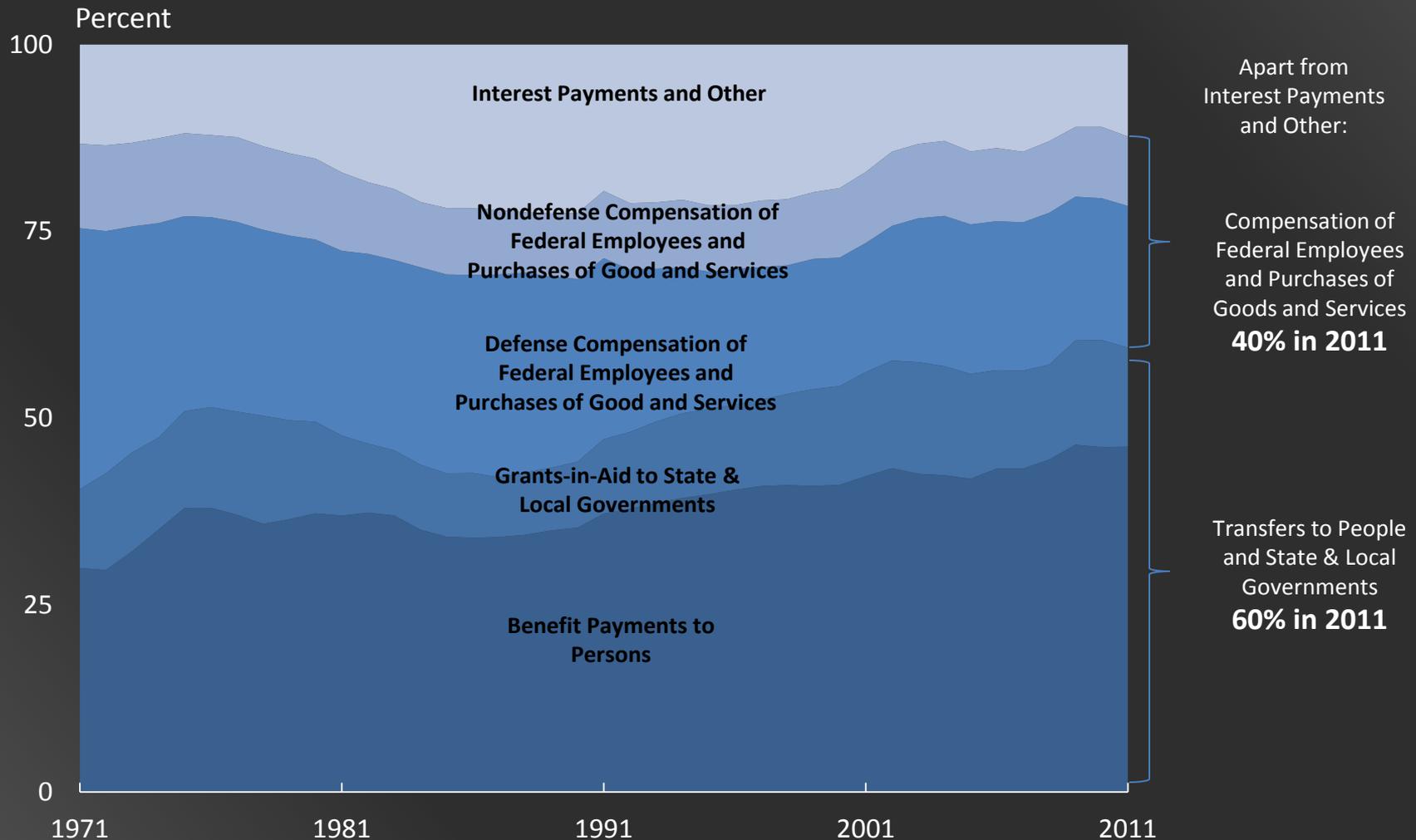
Federal Revenue Comes Mostly from Individual Income Taxes and Payroll Taxes



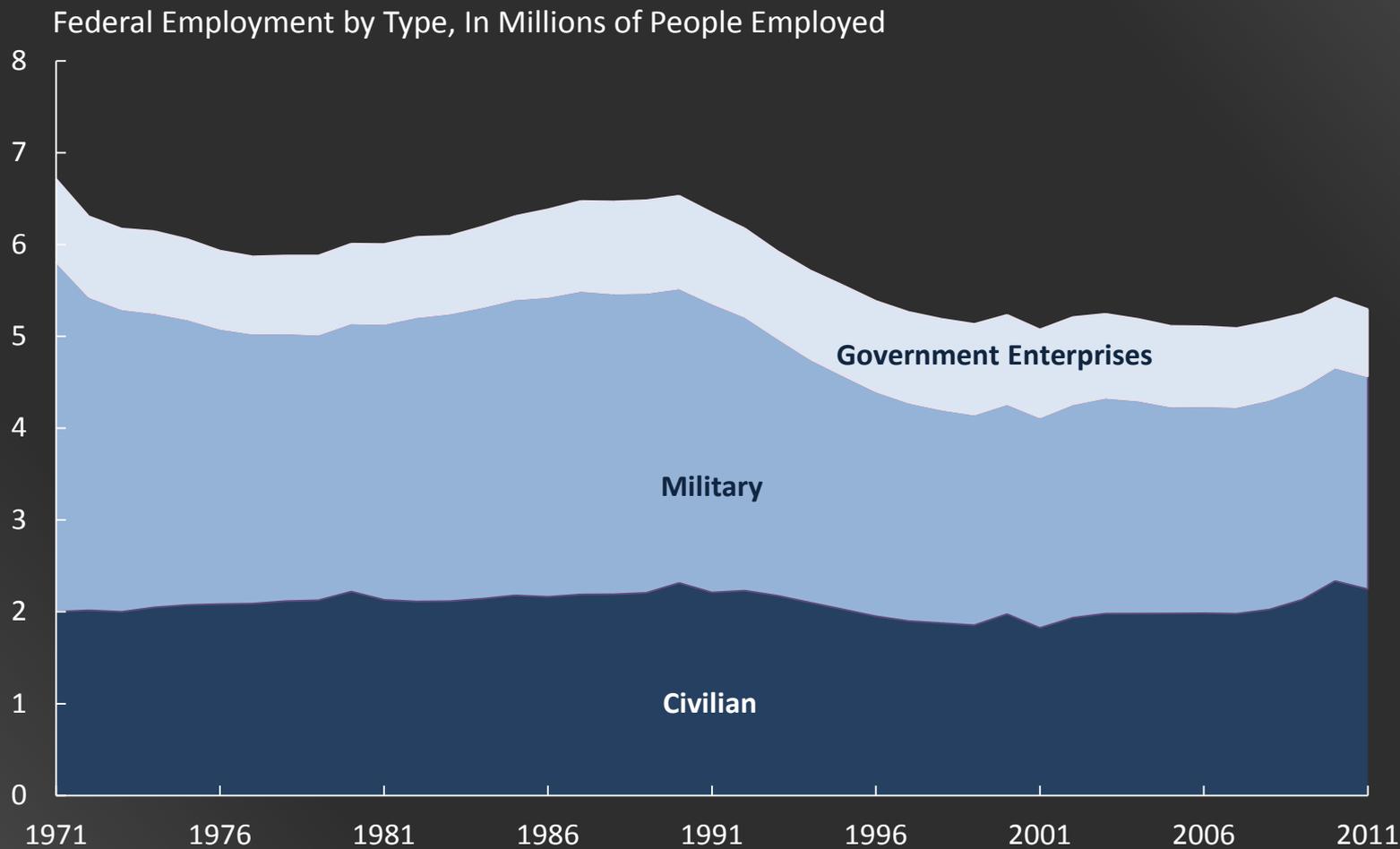
In 2012, Federal Revenue Was Low and Spending Was High Compared with Past Averages



A Growing Share of Federal Spending Is Transfers to People and State and Local Governments

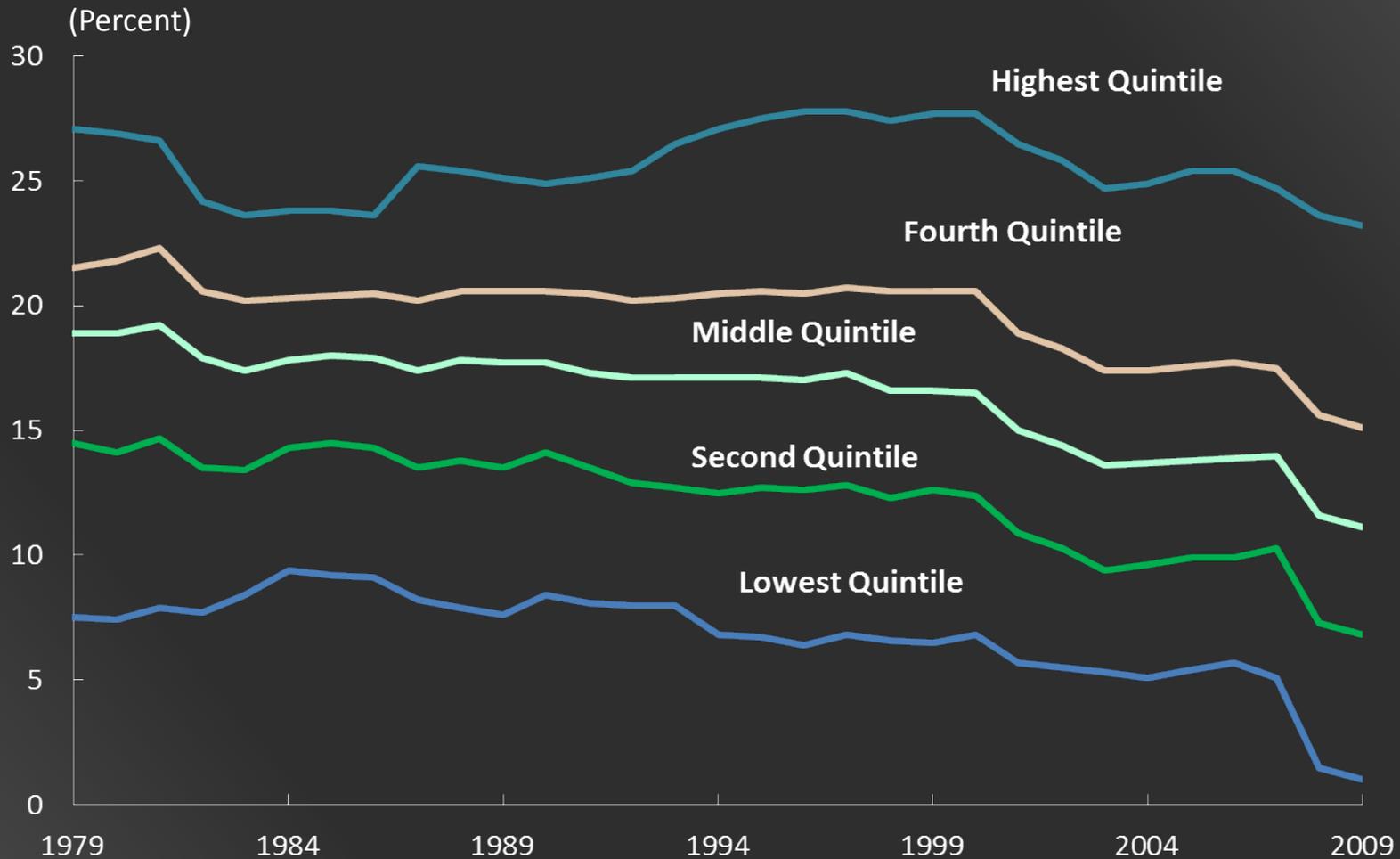


The Number of Civilians Employed by the Federal Government Has Changed Little Over the Past 30 Years



Based on data from the national income and product accounts.

Total Average Federal Tax Rates for All Households, by Before-Tax Income Group, 1979 to 2009

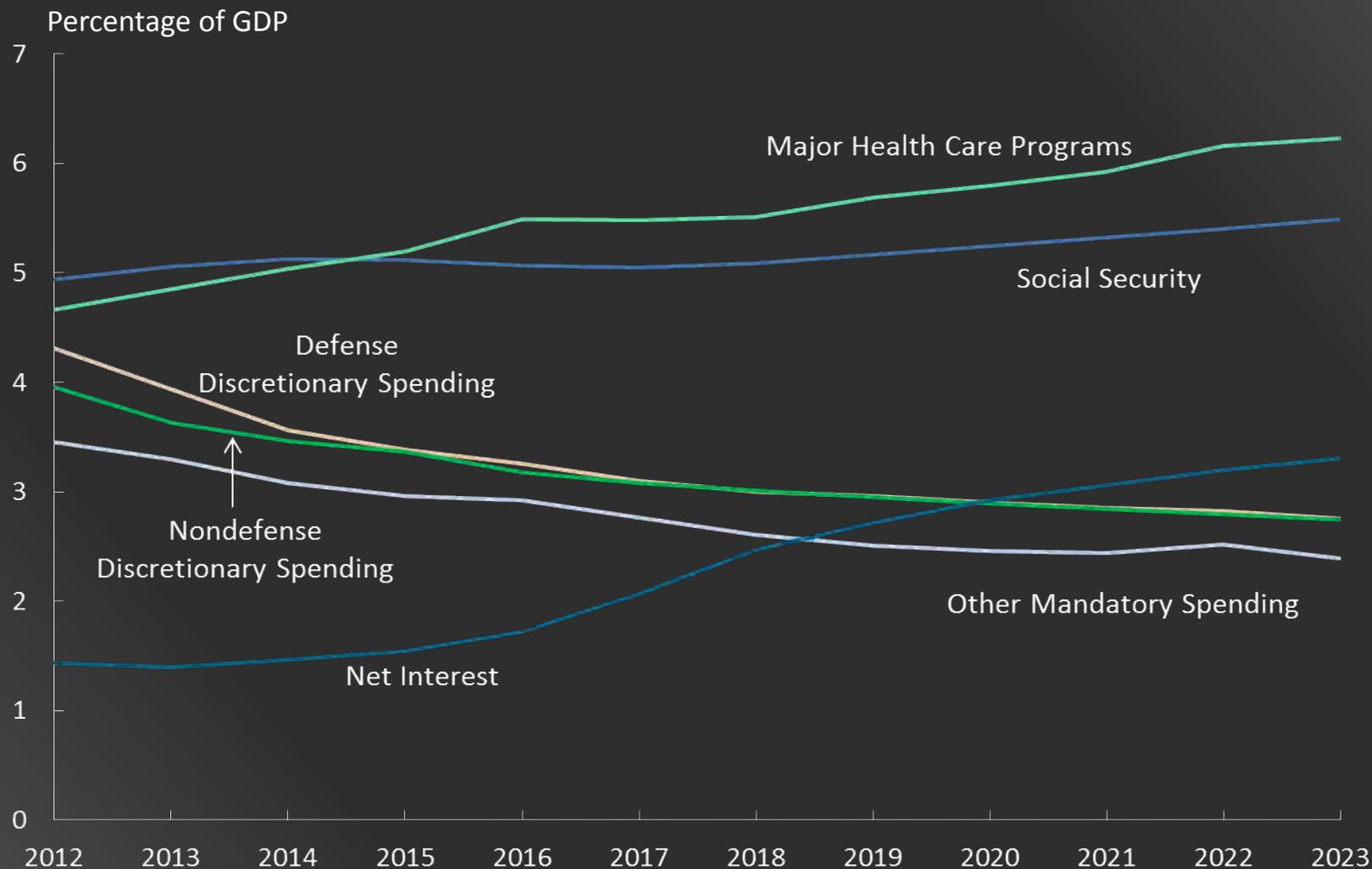


Based on data from *The Distribution of Household Income and Average Federal Tax Rates, 2008 and 2009* (July 2012).

By 2023 Under Current Law, Federal Spending Will Shift Further Toward Social Security and Medicare

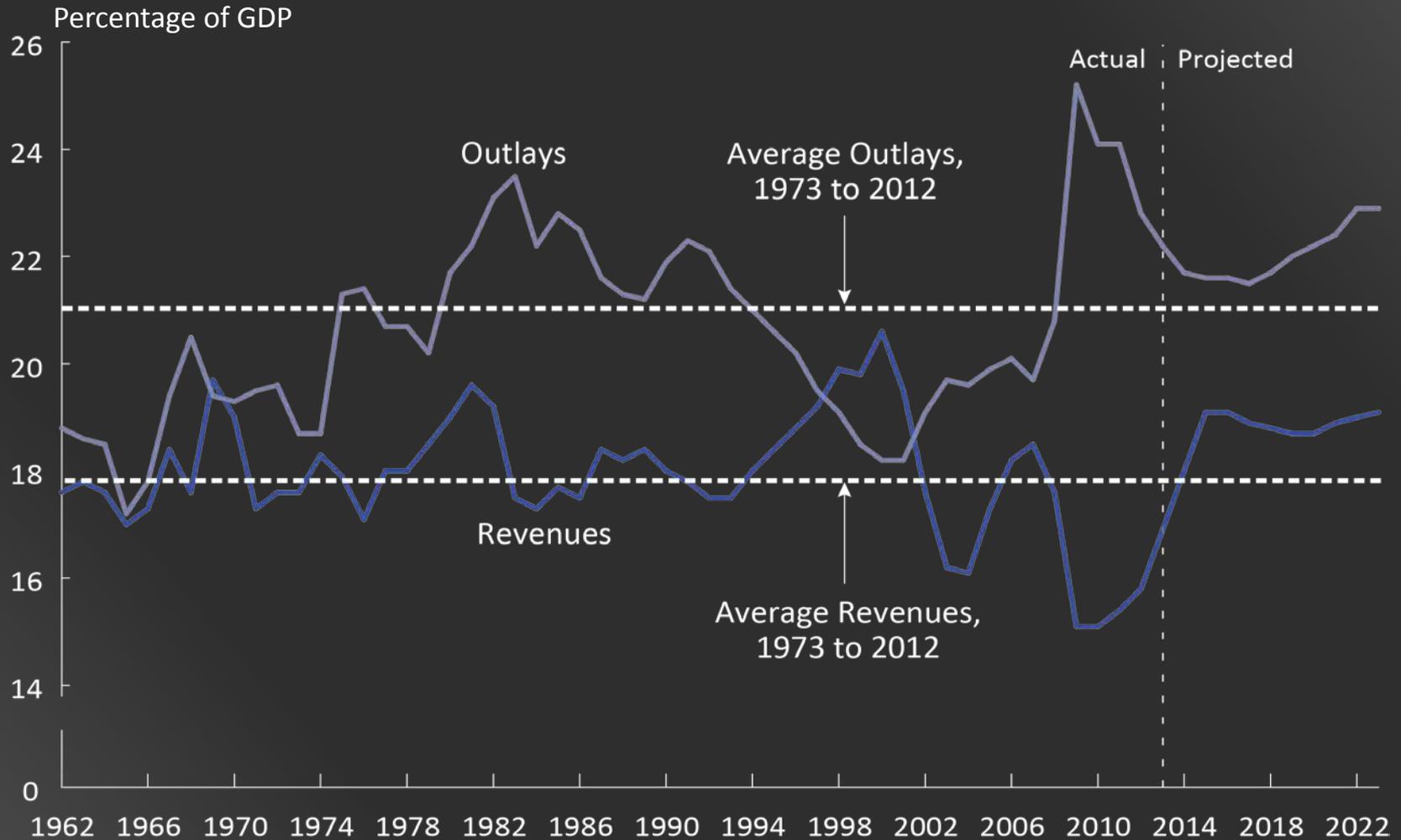


Under Current Law, Federal Spending on Social Security, Major Health Care Programs, and Interest Will Grow Relative to GDP



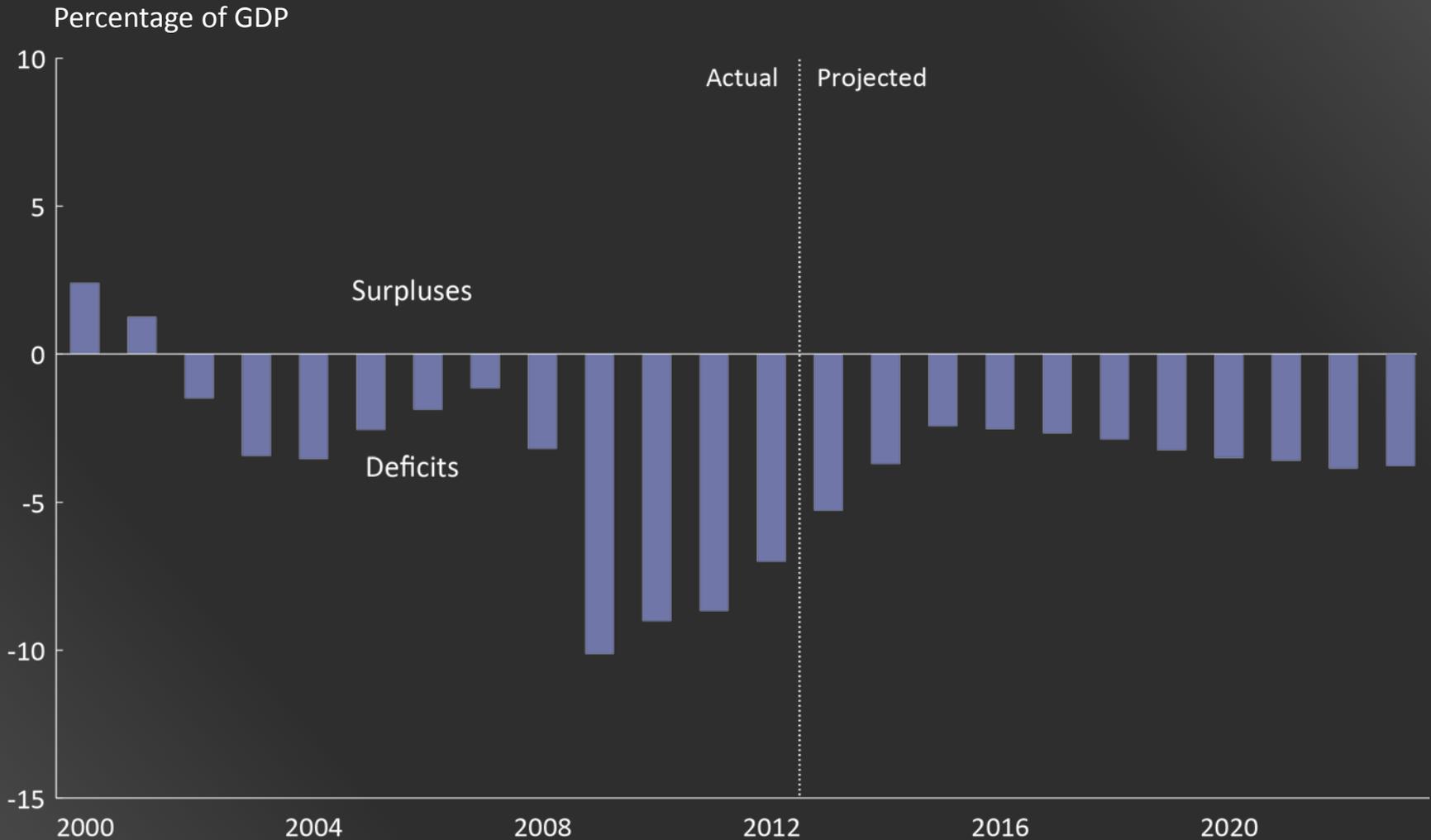
Projections from *The Budget and Economic Outlook: Fiscal Years 2013 to 2023* (February 2013).

Under Current Law, Federal Spending and Revenues Will Both Be Larger Relative to GDP than Historically



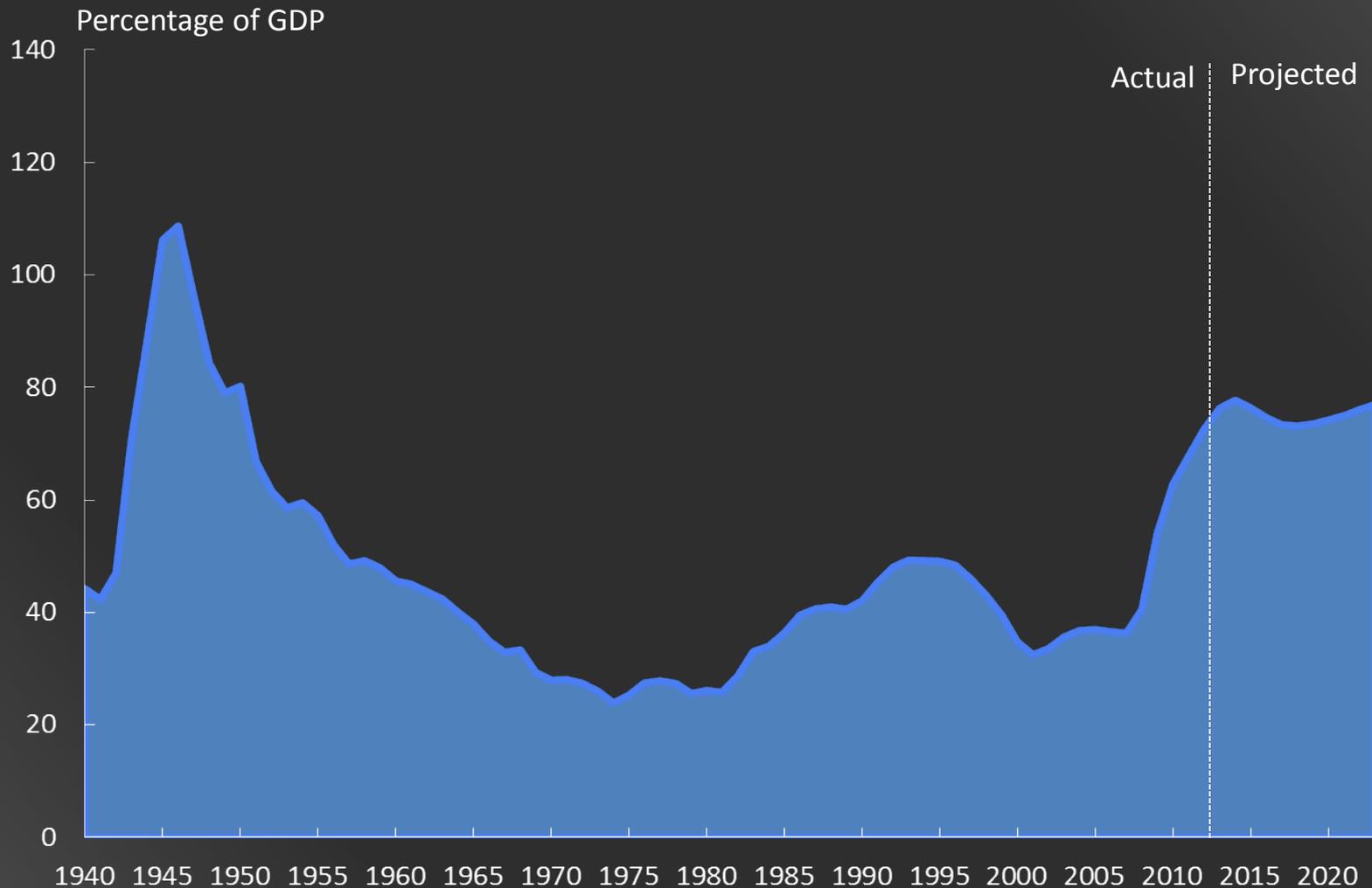
Projections from *The Budget and Economic Outlook: Fiscal Years 2013 to 2023* (February 2013).

Under Current Law, Federal Deficits Will Shrink Relative to GDP for a Few Years and Then Increase Again



Projections from *The Budget and Economic Outlook: Fiscal Years 2013 to 2023* (February 2013).

Under Current Law, Federal Debt Held by the Public Will Be Historically Large Relative to GDP



Projections from *The Budget and Economic Outlook: Fiscal Years 2013 to 2023* (February 2013).

High and Rising Debt Relative to the Size of the Economy Is a Significant Concern for Several Reasons

Crowding out of capital investment will be greater in the medium run and long run.

Lawmakers will have less flexibility to respond to unexpected challenges.

There will be a heightened risk of a fiscal crisis.

High and Rising Debt Relative to the Size of the Economy Is a Significant Concern for Several Reasons (Continued)

Debt would be even larger if current laws were modified to delay or undo certain scheduled changes in policy.

The caps on discretionary funding set in 2011 (preceding sequestration) are already very low relative to GDP.

Ten-year projections do not fully reflect long-term budget pressures. Under current law, federal debt appears to be on an unsustainable path.

Proposed Changes in Budget Policy Can Be Evaluated According to Many Criteria

How Much Would Debt Be Reduced?

- The more that debt is reduced, the more that the harms caused by high debt would be avoided—but also the greater the loss of government benefits and services or the greater the burdens of higher taxes.

How Quickly Would Debt Be Reduced?

- Deficit reduction would have a smaller negative impact on output and employment in the short run if it occurred after the economy was stronger and the Federal Reserve was raising interest rates.

Proposed Changes in Budget Policy Can Be Evaluated According to Many Criteria (Continued)

How Would Policy Changes Affect Longer-Term Economic Performance?

- Lower debt would be good for the economy, but higher marginal tax rates or smaller government investments would be a partly offsetting drag on the economy.

Who Would Bear the Burden of Policy Changes?

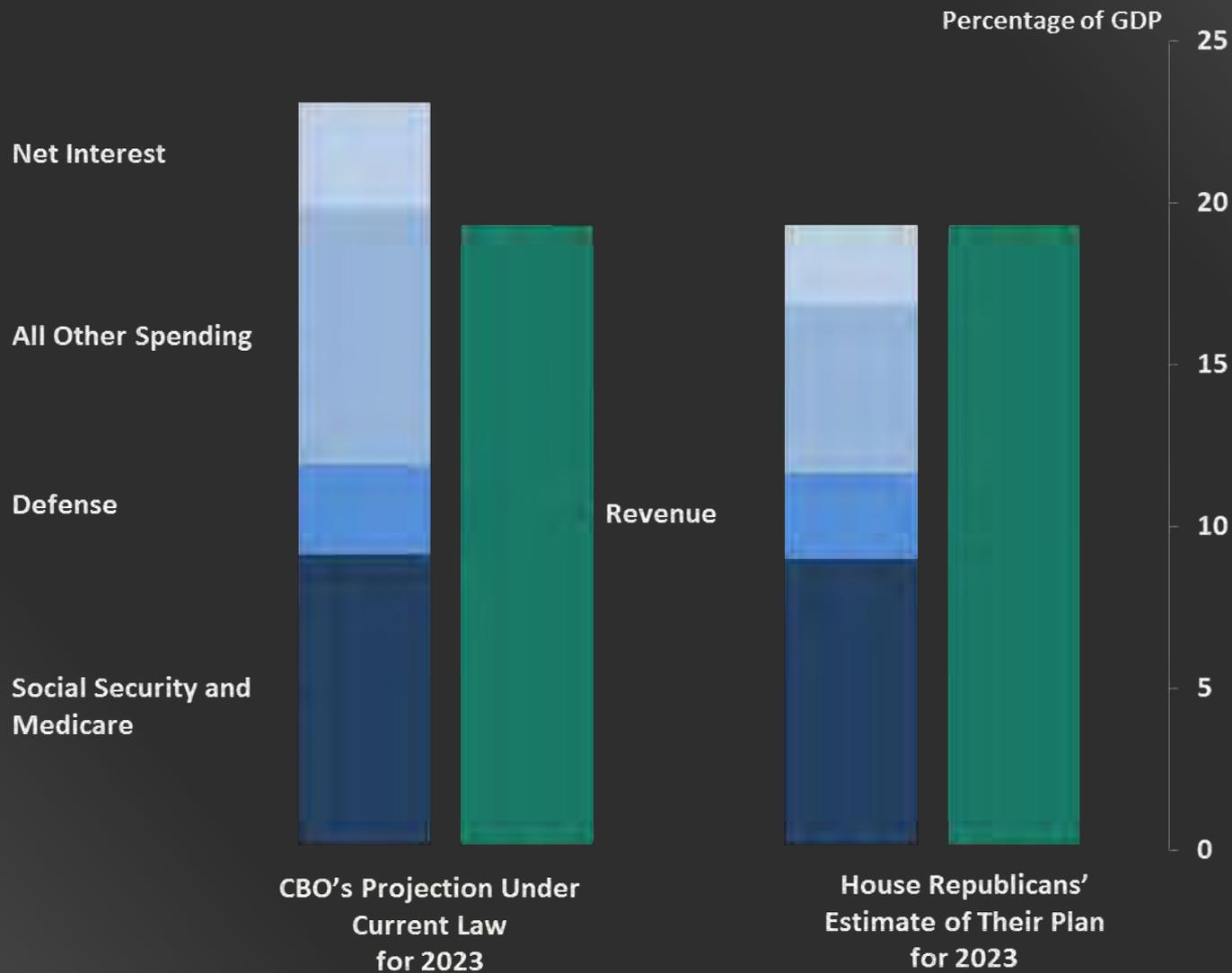
- There would be different effects on people at different income levels, on people with similar incomes but other differences, and on people in different generations.

Proposed Changes in Budget Policy Can Be Evaluated According to Many Criteria (Continued)

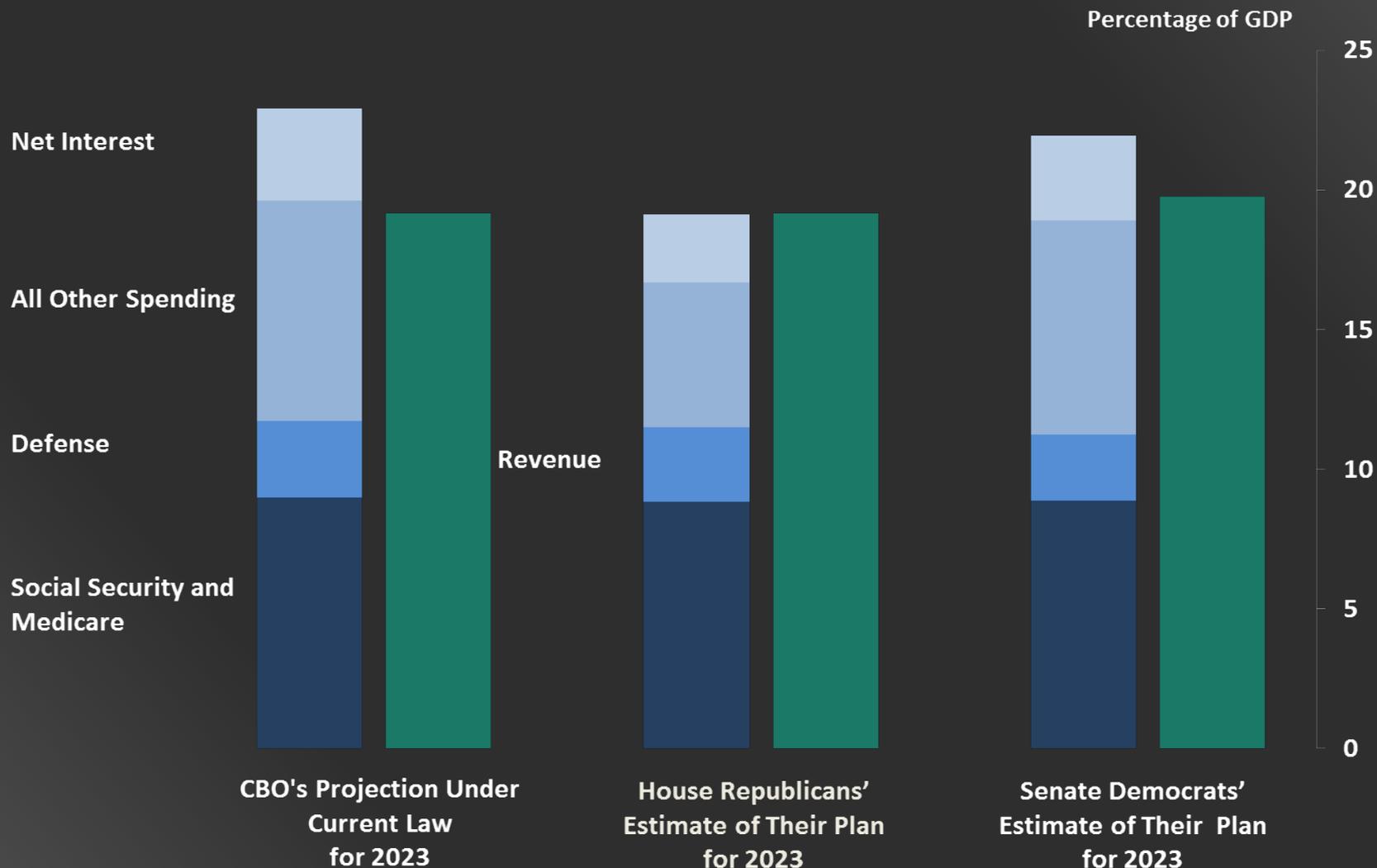
How Would the Country's Resources and Government's Resources Be Allocated?

- How much money should the government collect and what should it spend that money on?

House Republicans Estimate Their Plan Would Balance the Budget In 2023 Through Large Cuts to Many Programs Relative to Current Law



Senate Democrats Estimate Their Plan Would Reduce the Deficit In 2023 Through Changes in Spending and Taxes Relative to Current Law



The Budget Outlook Varies Under Different Projections

	40-Year Average	2012	CBO's Projection Under Current Law	House Republicans' Estimate of Their Plan	Senate Democrats' Estimate of Their Plan
(Percent of GDP)					
				2023	
Revenues	17.9	15.8	19.1	19.1	19.8
Total Outlays	21.0	22.8	22.9	19.1	21.9
Social Security and Medicare	6.2	7.9	9.0	8.8	8.9
Defense	4.7	4.3	2.8	2.7	2.4
Net Interest	2.2	1.4	3.3	2.4	3.1
All other	7.9	9.1	7.9	5.2	7.7
Deficit	-3.1	-7.0	-3.8	0.0	-2.2

CBO Analyzes Many Possible Changes to Federal Spending and Revenues

CBO reports show budgetary effects and other effects of possible changes in law.

- *Reducing the Deficit: Revenue and Spending Options*
- Reports on individual programs
- *Choices for Deficit Reduction*

But CBO does not make policy recommendations.

CBO Analyzes Only Certain Types of Budget Proposals

President's Budget—CBO will release its analysis in mid-May.

Budget Resolutions—CBO does not analyze.

Other Proposals (Bowles-Simpson, think tanks, other Congressional groups)—CBO does not analyze.

Conclusion, Part 1

Under current law for 2023, federal spending for Social Security and Medicare will be nearly 3 percent of GDP larger than it has averaged during the past 40 years—while federal spending for defense will be nearly 2 percent of GDP smaller, and federal spending for all other programs will be the same share of GDP. Interest payments will be about 1 percent of GDP larger because the debt will be much larger, and revenues will be about 1 percent of GDP larger.

Altogether, the deficit will be about 1 percent of GDP larger than its average during the past 40 years.

Conclusion, Part 2

House Republicans estimate that their plan would balance the budget in 2023. Relative to current law for 2023, they would leave revenues and spending for Social Security, Medicare, and defense at roughly the same shares of GDP, but would cut all other spending taken together by about one-third.

Senate Democrats estimate that their plan would reduce the deficit to about 2 percent of GDP in 2023. Relative to current law for 2023, they would raise revenues by about $\frac{3}{4}$ percent of GDP, reduce defense spending by about $\frac{1}{2}$ percent of GDP, leave Social Security and Medicare spending at roughly the same shares of GDP, and trim all other spending by a bit.

Conclusion, Part 3

Key Implication of CBO's Budget Projections:
Putting the debt on a sustainable path will ultimately require increases in taxes or cuts in government benefits or services for people who consider themselves to be in the middle class.