



Shifting Priorities in the Federal Budget

**Presentation to the Stanford Institute for
Economic Policy Research**

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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

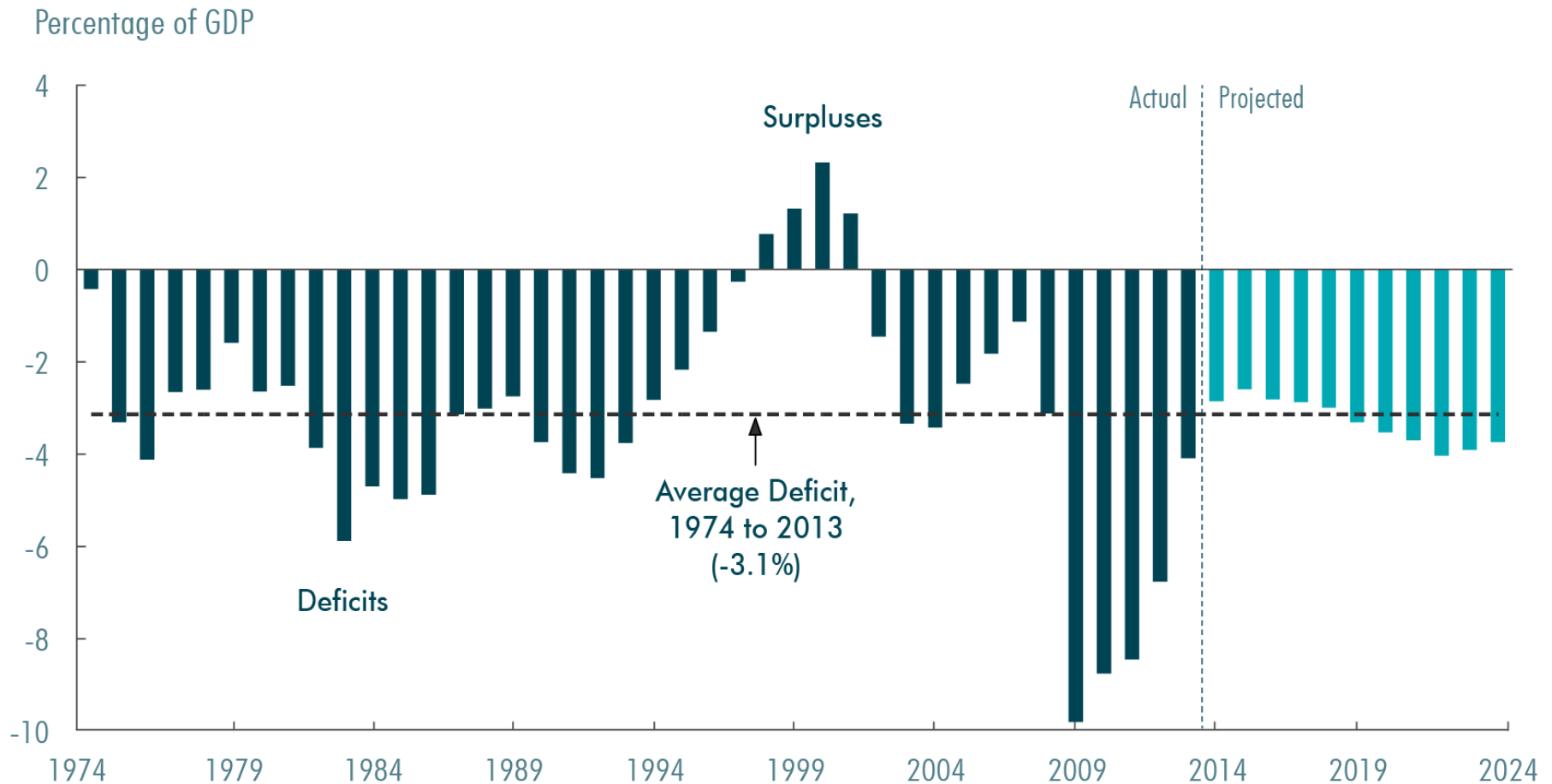
Incorporate **behavioral responses** to the extent feasible, based on whatever **evidence** is available

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

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

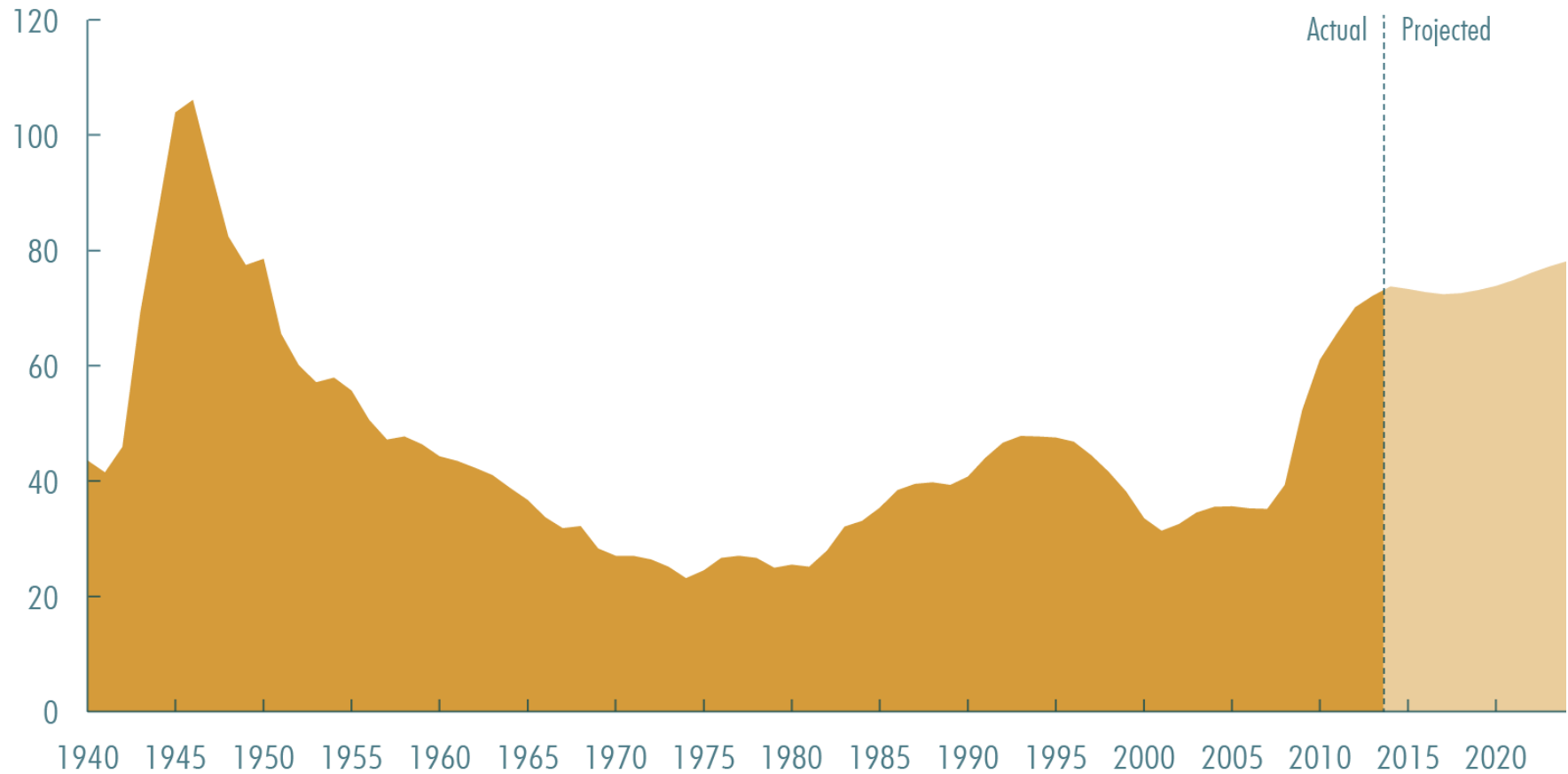
Under Current Law, What Is the Outlook for Overall Federal Deficits, Debt, Spending, and Revenues?

Federal Deficits Are Projected To Rise Again Beginning in 2016



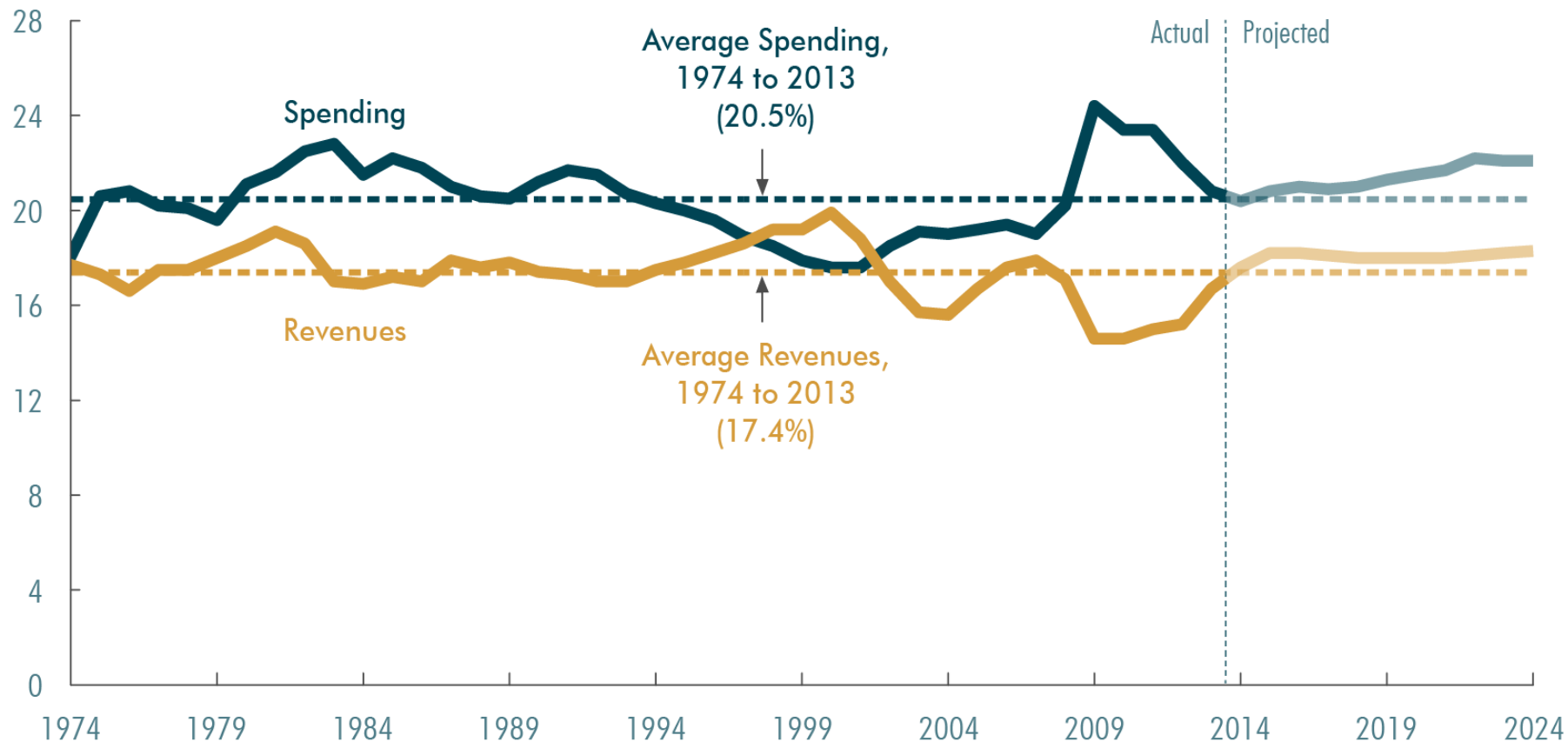
Federal Debt Held by the Public Is Projected to Be at Historically High Levels

Percentage of GDP

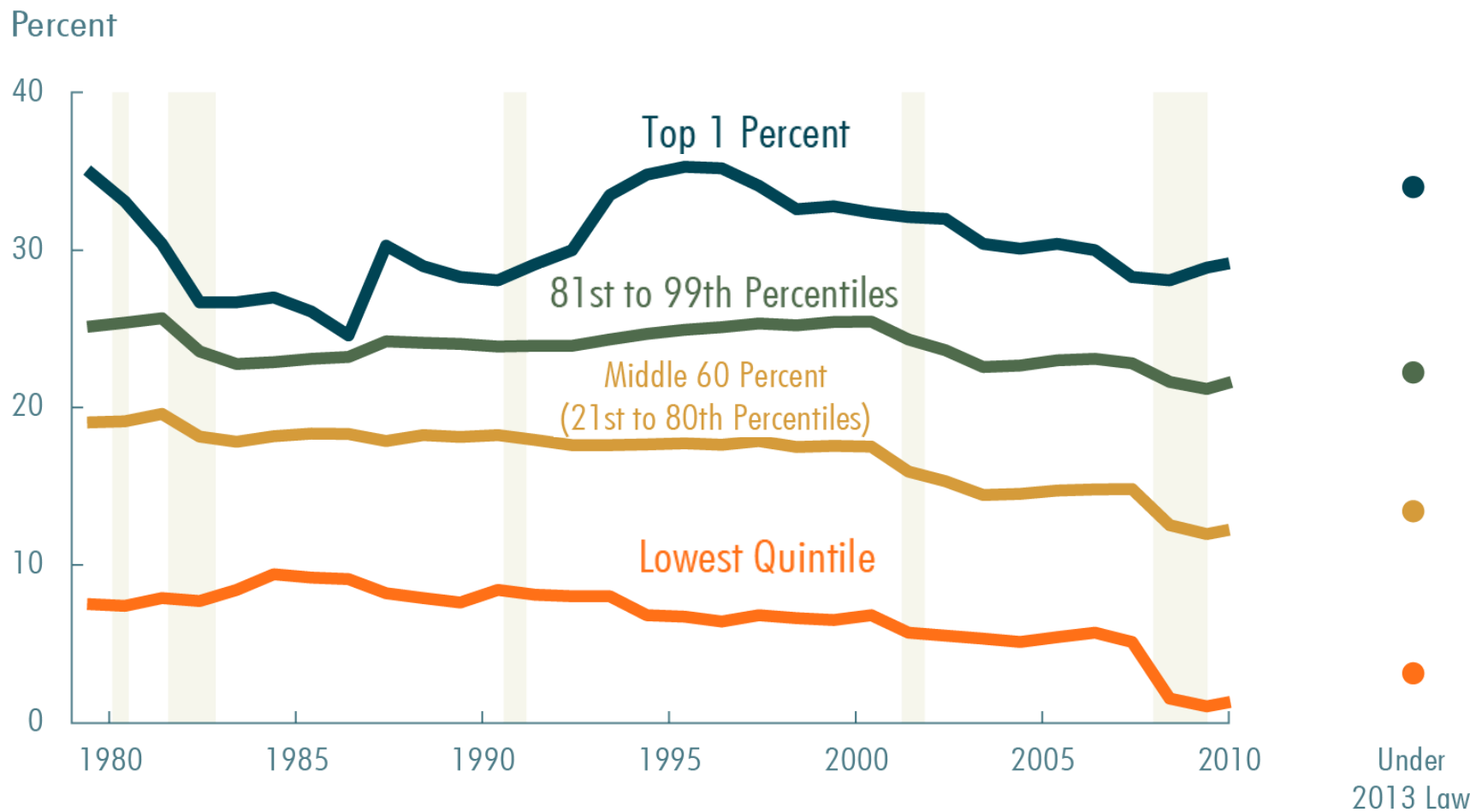


Federal Spending and Revenues Are Both Projected to be Above Their 40-Year Averages

Percentage of GDP



For Most Income Groups, Average Federal Tax Rates in 2013 Were Well Below Their Averages for the 1979–2010 Period



Under Current Law, How Will the Composition of Federal Spending Change?

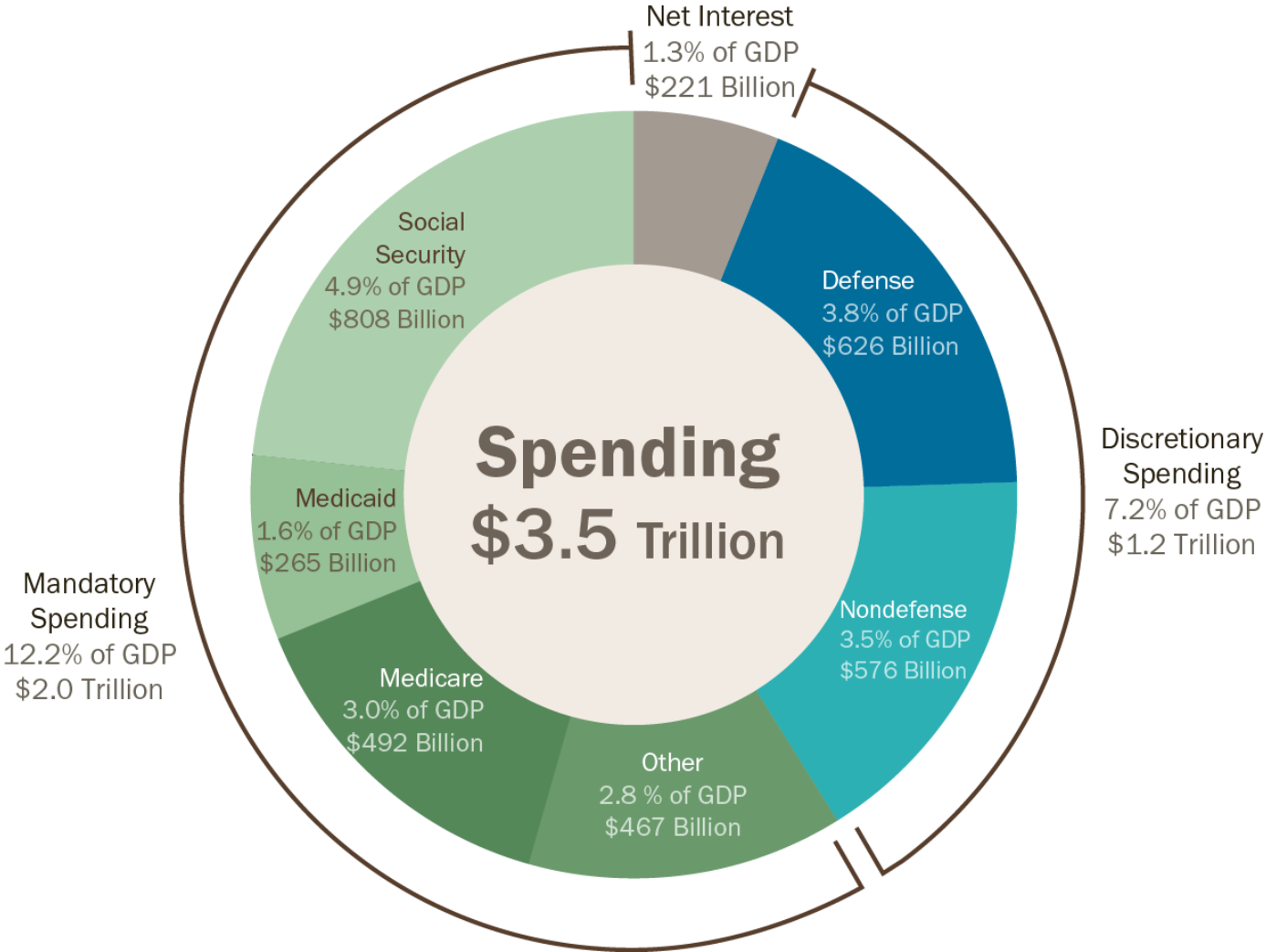
Federal Transfer Payments and Taxes Shift Resources to Elderly Households From Younger Households, On Average

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

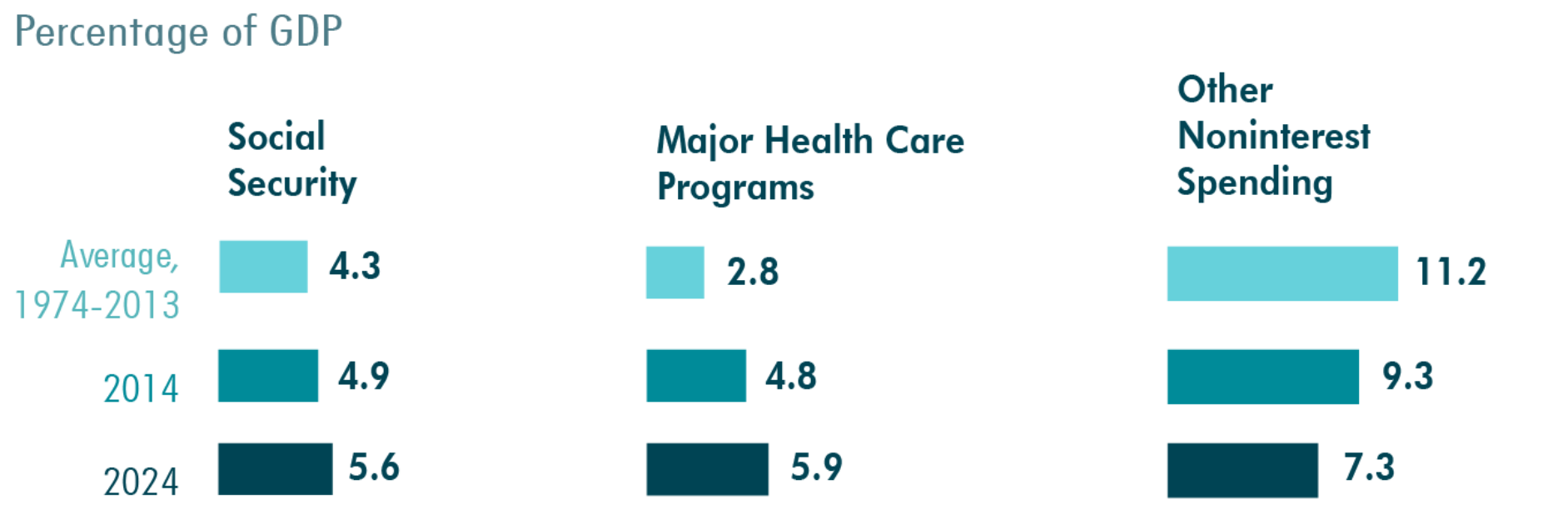
Dollars per Household



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



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.

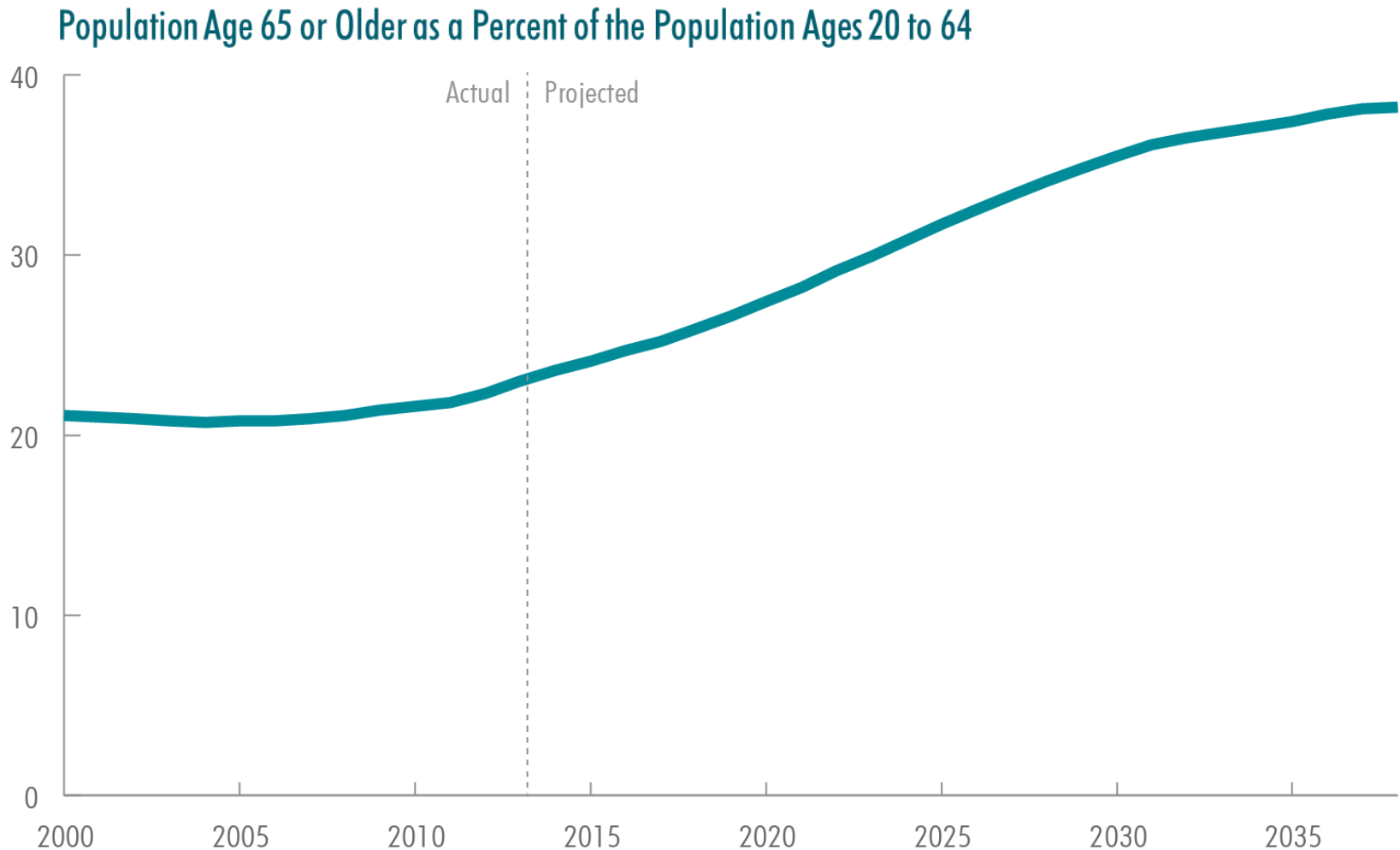
Federal spending for all other programs taken together will be a smaller percentage of GDP than it has been in at least 70 years.

Federal Spending for Major Health Care Programs Will Increase Relative to GDP for Three Main Reasons

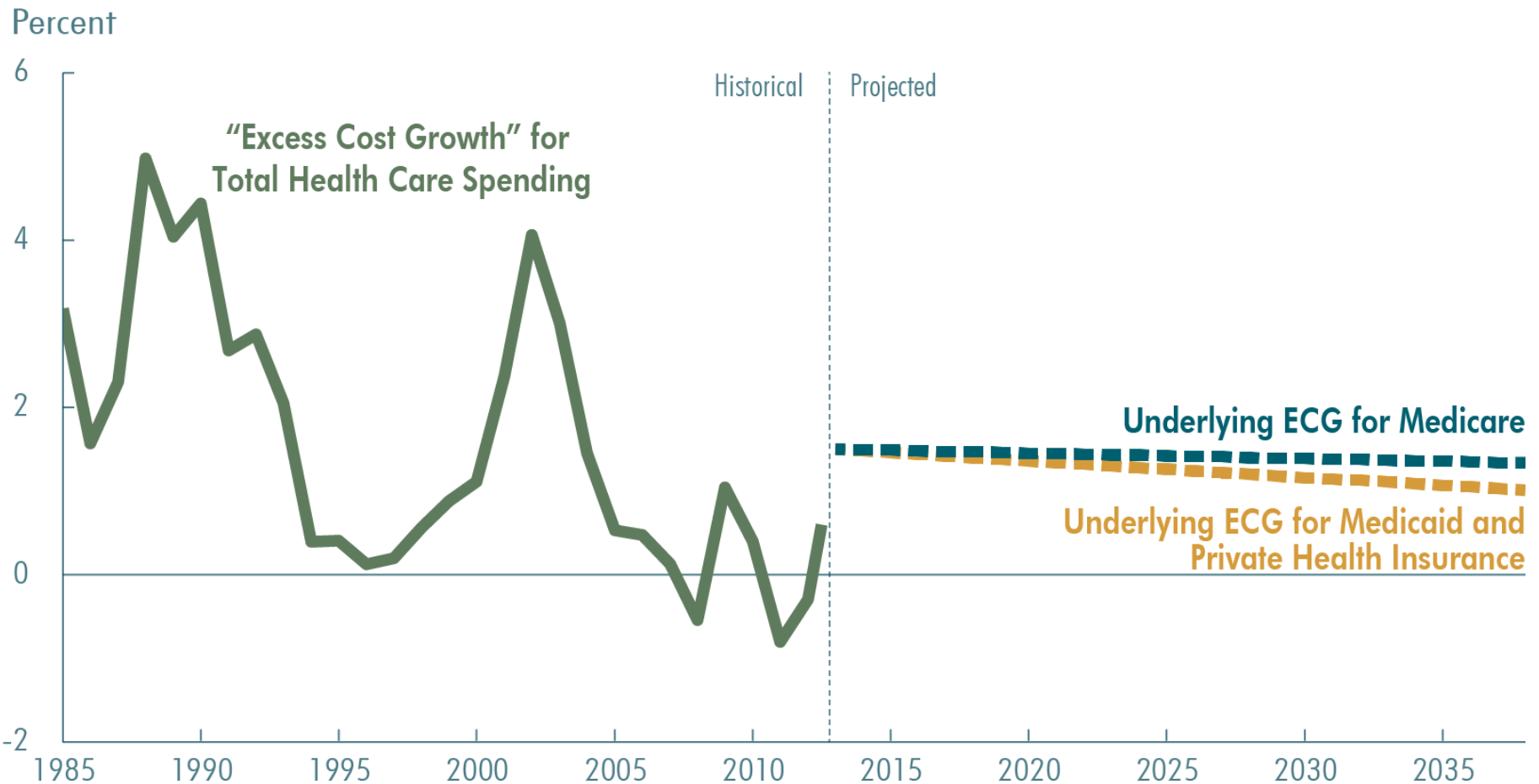
Percentage of Projected Growth in Spending Through:

	2023	2038
Population Aging	21	35
Rising Costs of Health Care Per Person	26	40
Expansion of Federal Subsidies for Health Insurance Through Medicaid and Exchanges	53	26

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



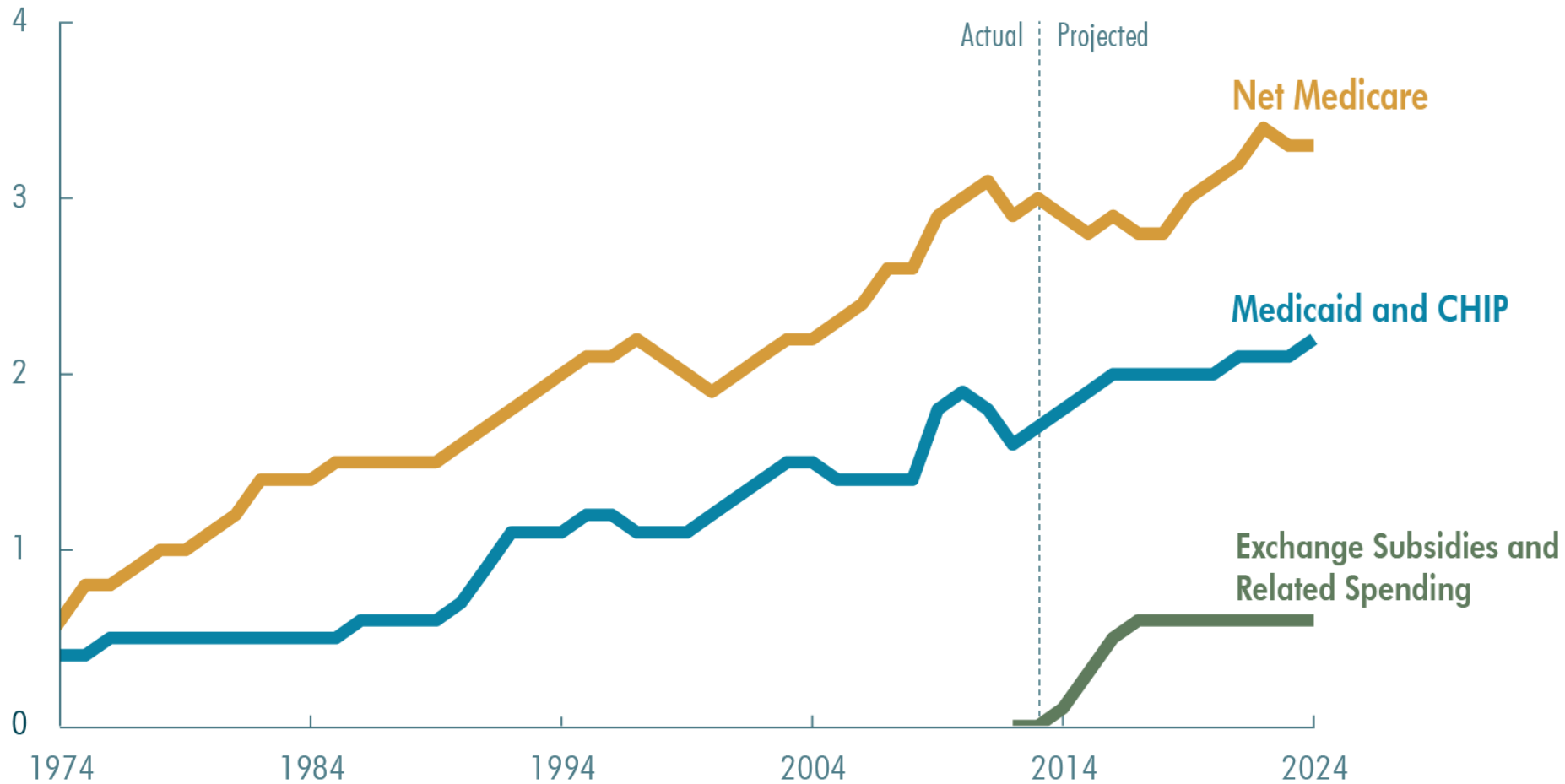
Growth in Health Care Spending Per Beneficiary in Excess of GDP Growth Has Varied a Lot



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.

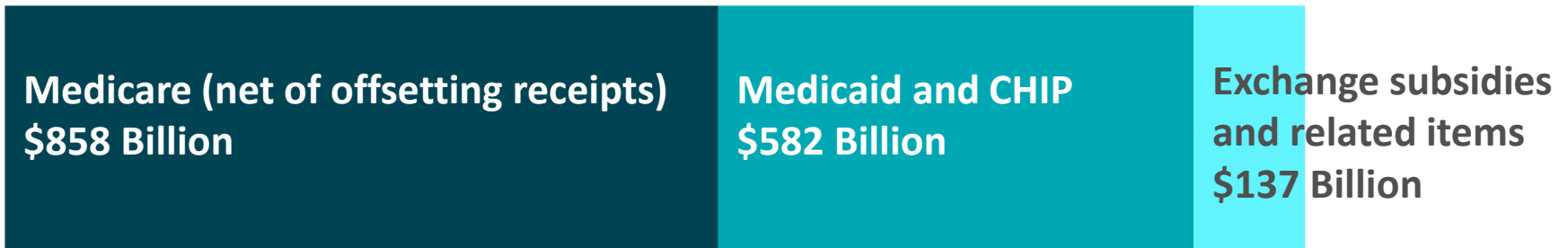
Under Current Law, Federal Spending for Each Major Health Care Program Will Grow Rapidly

Percentage of GDP



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

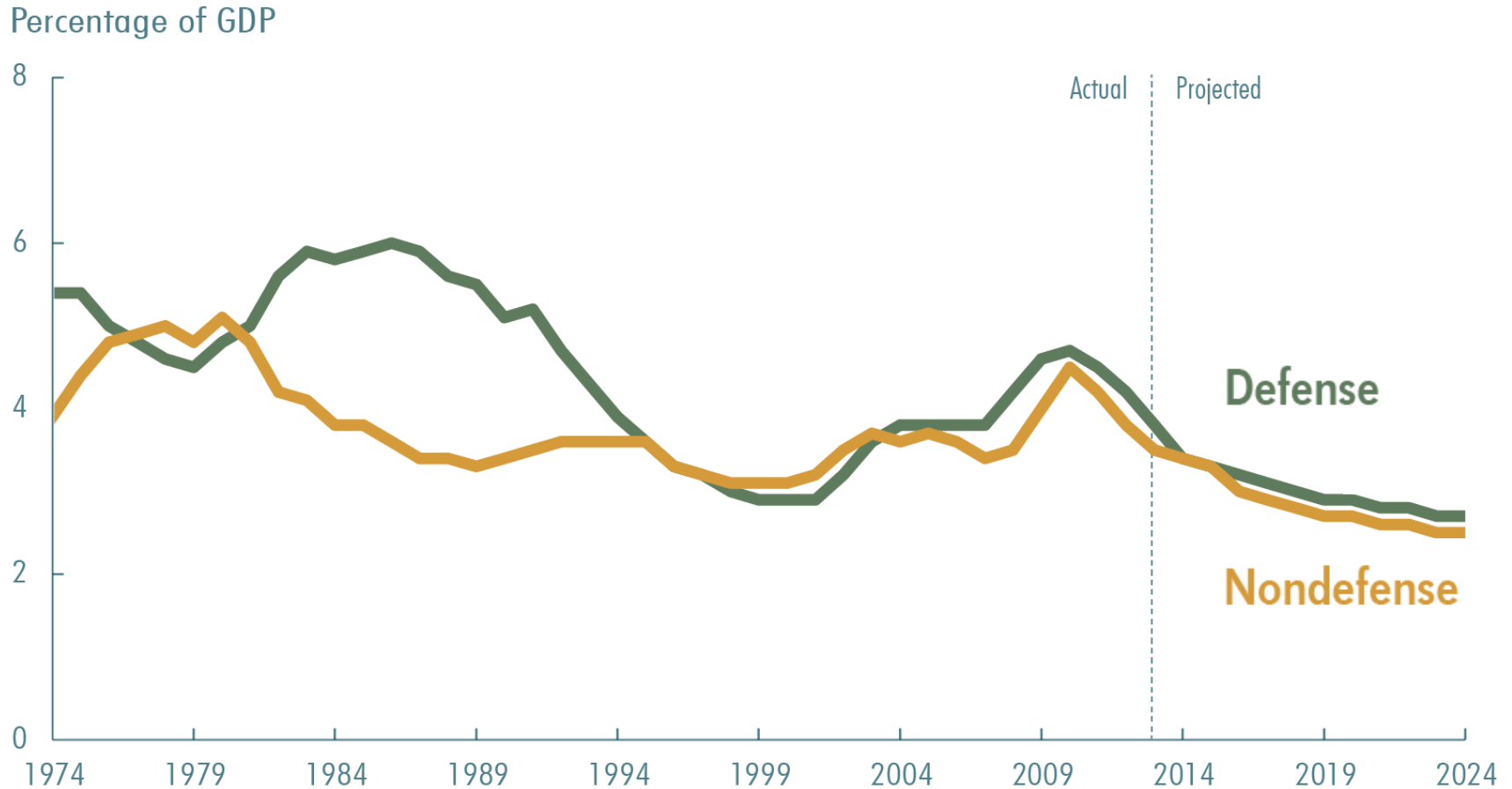
CBO's projections for 2024:



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



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.

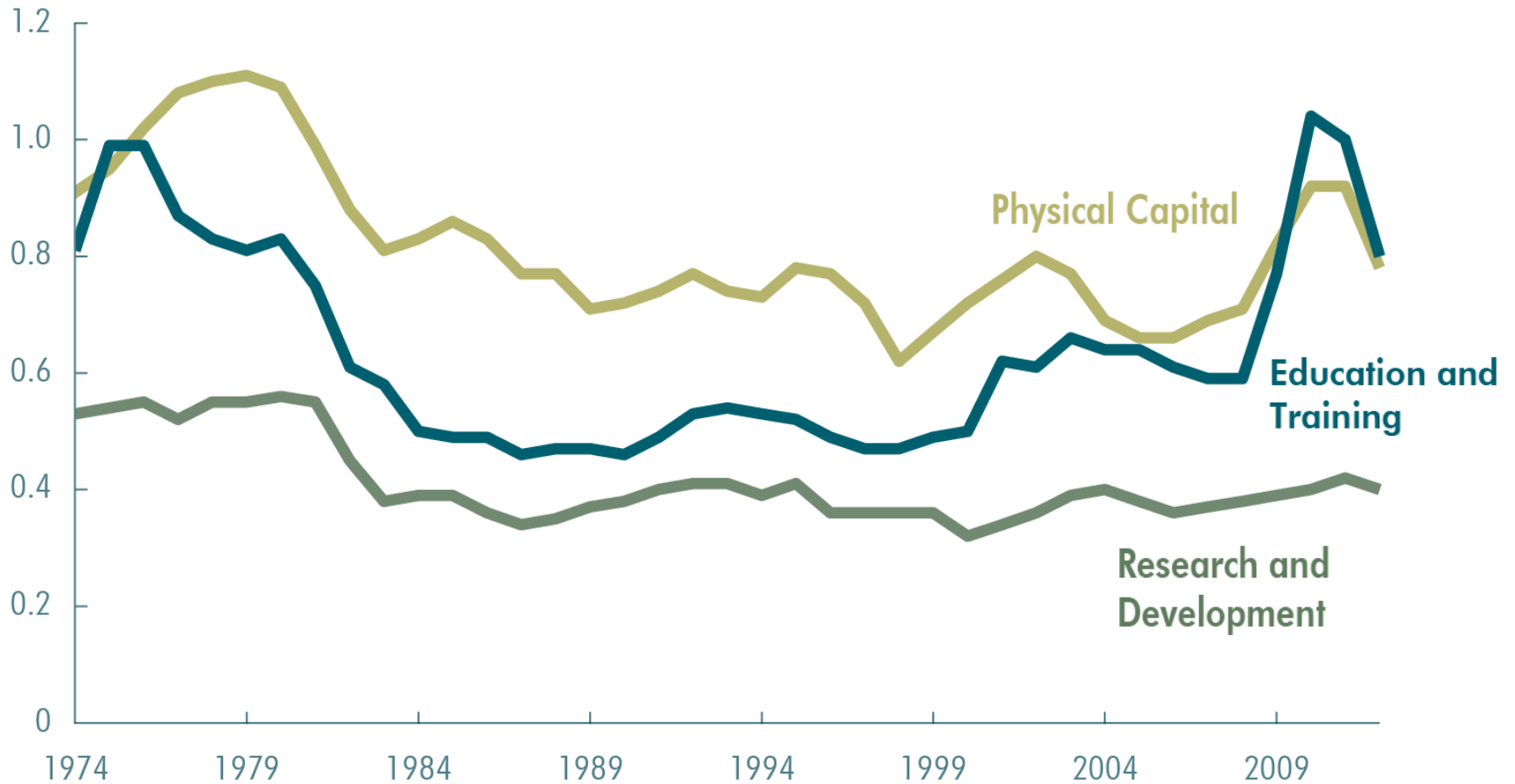
If Savings Came Almost Entirely From Cutting Force Structure, the Required Cuts Would Be More Than 20 Percent

	Active and Reserve Forces	
	Planned Force in 2017	Illustrative Reductions by 2021
Army Brigade Combat Teams	66	16
Navy Major Warships	244	51
Marine Corps Regiments	11	3
Air Force Fighter Aircraft	1,100	260

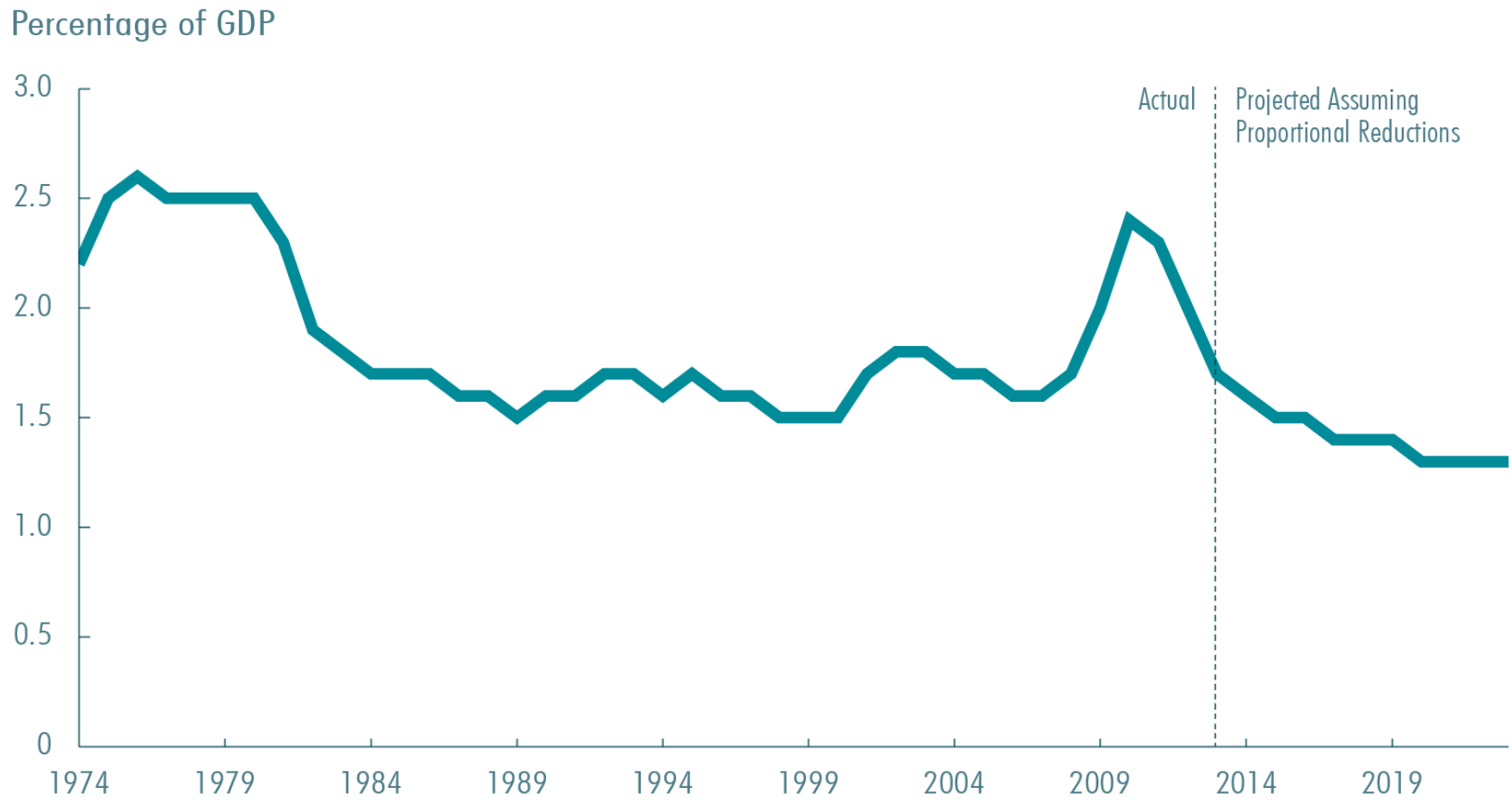
Notes: Planned force and illustrative reductions reflect DoD's 2014 budget request. Illustration assumes that reductions are spread evenly across all four services. Reductions are based on CBO's cost projections; reductions would be about one-third smaller under DoD's costing assumptions.

Federal Nondefense Investment Improves the Private Sector's Ability to Invest, Produce, and Distribute Goods and Services

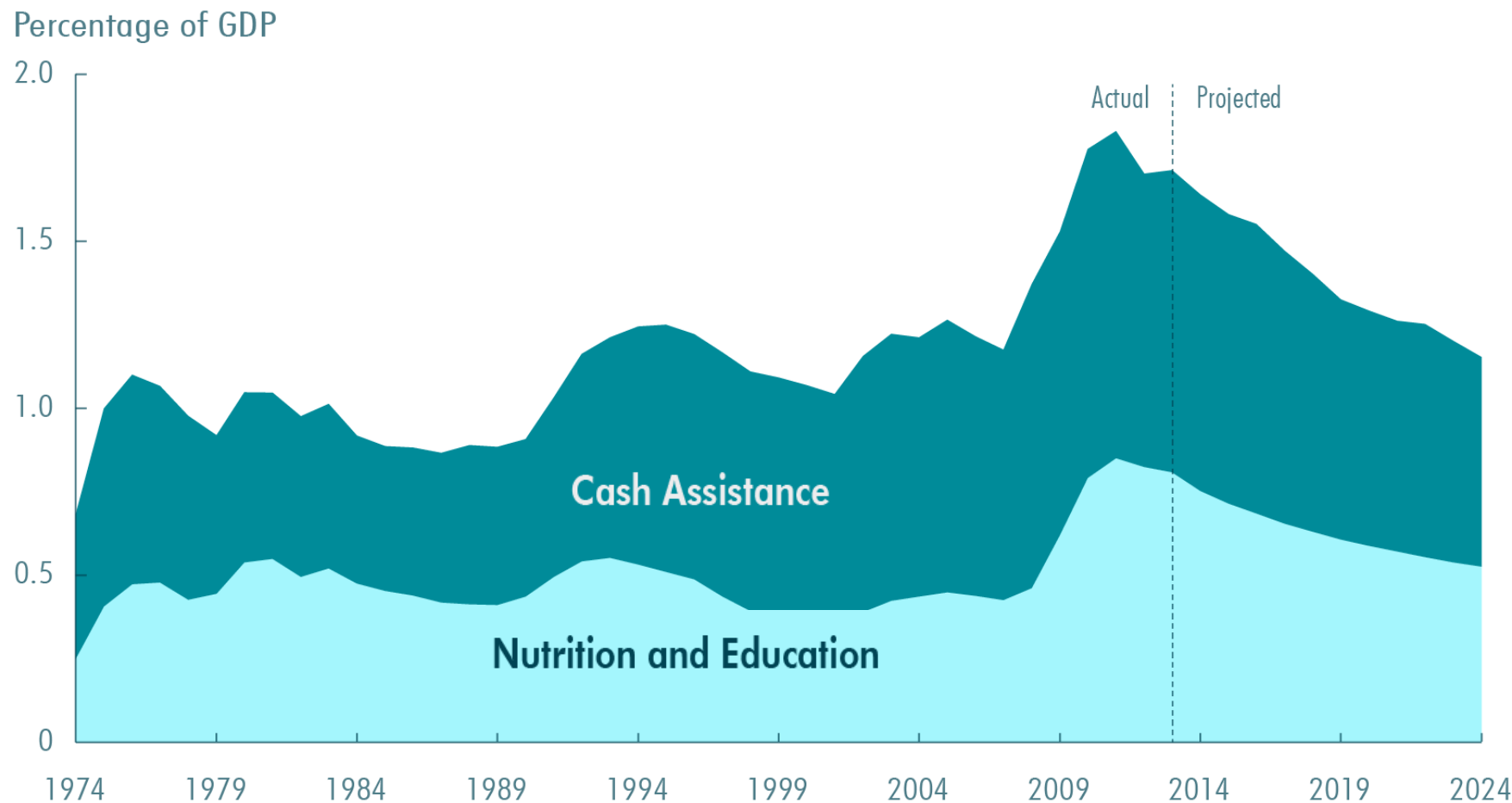
Percentage of GDP



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 11: For more information, see *The Federal Budget in 2013: An Infographic* (April 2014), www.cbo.gov/publication/45278, and *Updated Budget Projections: 2014 to 2024* (April 2014), www.cbo.gov/publication/45229.

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.