Confronting the Nation’s Fiscal Policy Challenges

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Real Gross Domestic Product

Trillions of 2005 Dollars, Logarithmic Scale

Potential GDP

Actual
Projected

GDP
Net Job Growth per Month

Thousands of jobs

2007 2008 2009 2010 2011

-1,000 -800 -600 -400 -200 0 200 400
Unemployment Rate

Percent


Actual  Projected
Percentage change in prices from previous year

- **Core**
- **Overall**

Actual | Projected
Deficits in CBO’s Baseline and Assuming a Continuation of Certain Policies

Percentage of GDP

- **Baseline**
- **Extend Tax Policies**
- **Maintain Medicare's Payment Rates for Physicians**
- **Additional Debt Service**

Yearly Breakdown:
- **2011**: 8.6%
- **2012**: 8.2%
- **2013**: 5.7%
- **2014**: 3.8%
- **2015**: 3.2%
- **2016**: 3.4%
- **2017**: 3.4%
- **2018**: 3.4%
- **2019**: 3.4%
- **2020**: 3.4%
- **2021**: 3.4%
Federal Debt Held by the Public

Percentage of GDP

Actual

Projected

Continuation of Certain Policies

CBO's Baseline


0 10 20 30 40 50 60 70 80 90

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If no legislation originating from this Committee was enacted, the following would occur over the coming decade:

- **Reductions** in the caps on discretionary appropriations for defense would cut outlays by about $450 billion.

- **Reductions** in the caps on discretionary appropriations for nondefense purposes would cut outlays by about $300 billion.

- **Reductions** in mandatory spending would yield net savings of about $140 billion.

- **Debt-service costs** would decline by about $170 billion.

The total reduction in deficits would be about $1.1 trillion.
Fiscal Policy Choices

- How much deficit reduction should be accomplished?
- How quickly should deficit reduction be implemented?
- What forms should deficit reduction take?
Trade-offs in the Timing of Deficit Reduction

- Cutting spending or increasing taxes slowly would lead to a greater accumulation of government debt and might raise doubts about whether the longer-term deficit reductions would ultimately take effect.

- Implementing spending cuts or tax increases abruptly would give little time to plan and adjust. In addition, and particularly important given the current state of the economy, immediate spending cuts or tax increases would represent an added drag on the weak economic expansion.
Near-Term Economic Effects of Deficit Reduction

- Credible policy changes that would substantially reduce deficits later in the coming decade and beyond—without immediate spending cuts or tax increases—would both support the economic expansion in the next few years and strengthen the economy over the longer term.

- There is no inherent contradiction between using fiscal policy to support the economy today, while the unemployment rate is high and many factories and offices are underused, and imposing fiscal restraint several years from now, when output and employment will probably be close to their potential.
Revenues and Spending, Excluding Interest

Percentage of GDP

- **Revenues**
- **All Other Spending** (Excluding net interest)
- **Spending for Social Security, Medicare, and Other Major Health Care Programs**

- **Actual**
- **Projected**

Years: 1971 to 2021
Spending for Social Security, Medicare, and Other Major Health Care Programs

Percentage of GDP

Social Security

Medicare

Other Major Health Care Programs

Actual

Projected


0 1 2 3 4 5 6
Other Federal Spending, by Category

Percentage of GDP

- Defense Discretionary
- Nondefense Discretionary
- Other Mandatory

Actual vs. Projected

Federal Revenues and Spending Historically and in 2021 Under CBO’s Baseline

**Average, 1971–2010**

- **Deficit**: 2.8% of GDP
  - **Revenues**: 18.0% of GDP
    - **Social Security and Major Health Care Programs**: 7.2% of GDP
    - **Other Noninterest Spending**: 11.5% of GDP
    - **Interest**: 2.2% of GDP

**Total Spending**: 20.8% of GDP

**Current Law in 2021**

- **Deficit**: 1.2% of GDP
  - **Revenues**: 20.9% of GDP
    - **Social Security and Major Health Care Programs**: 12.2% of GDP
    - **Other Noninterest Spending**: 7.7% of GDP
    - **Interest**: 2.8% of GDP

**Total Spending**: 22.7% of GDP
Cumulative Budgetary Effect of Major Income Tax Expenditures, 2010 to 2014

- Exclusion of Employers' Contributions for Health Care, Health Insurance Programs, and Long-Term Care Insurance Premiums
- Net Exclusion of Pension Contributions and Earnings
- Deduction of Mortgage Interest on Owner-Occupied Residences
- Reduced Rate of Taxation on Long-Term Capital Gains and Dividends
- Earned Income Tax Credit
- Deduction of Nonbusiness State and Local Government Income Taxes, Sales Taxes, and Personal Property Taxes
Conclusion

Given the aging of the population and rising costs for health care, attaining a sustainable federal budget will require the United States to deviate from the policies of the past 40 years in at least one of the following ways:

- Raise federal revenues significantly above their average share of GDP;
- Make major changes to the sorts of benefits provided for Americans when they become older; or
- Substantially reduce the role of the rest of the federal government relative to the size of the economy.