Shifting Priorities in the Federal Budget

Presentation at Cornell University

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Director

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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 proposed changes in federal laws** (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

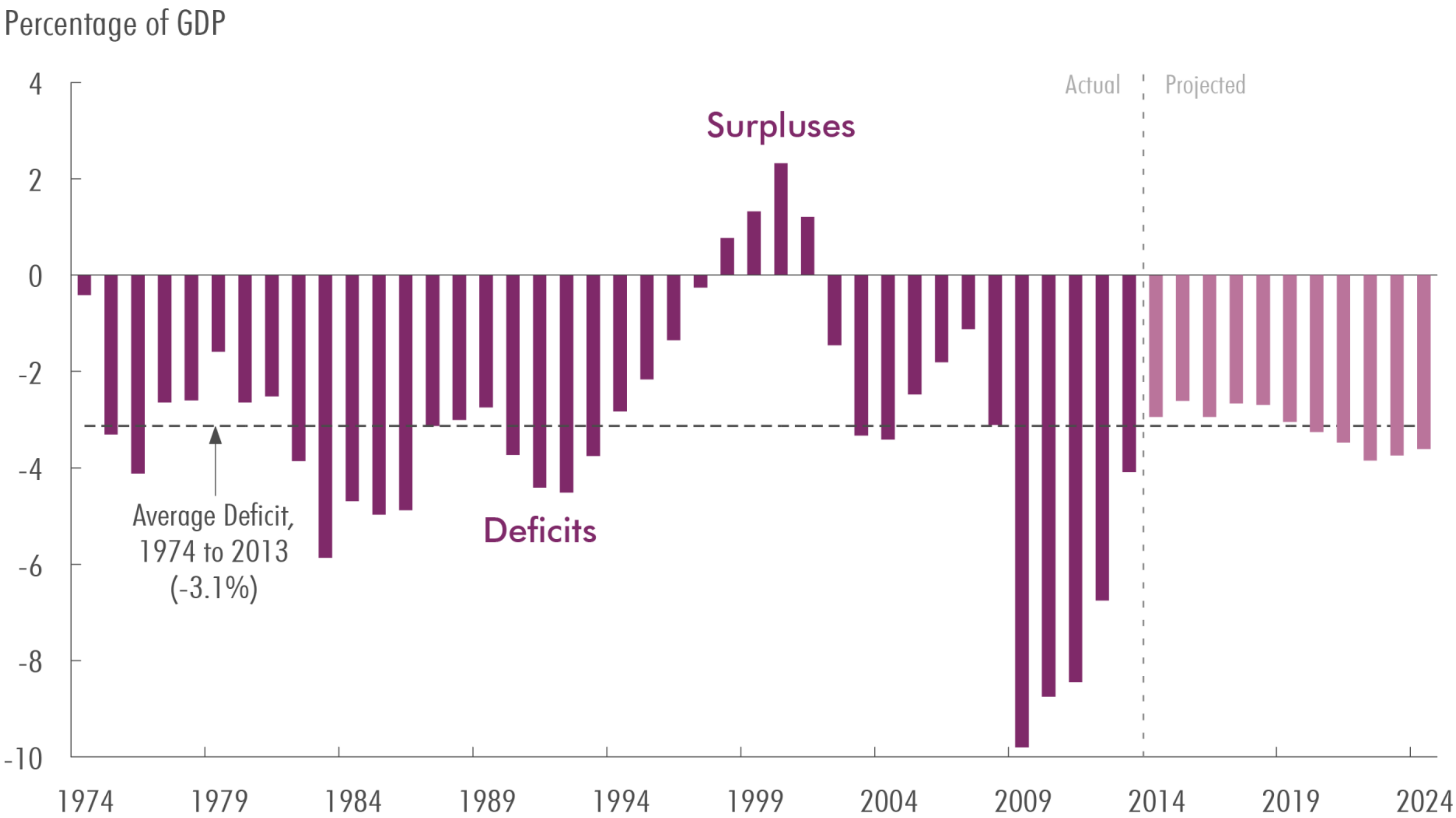
Incorporate **behavioral responses** to the extent feasible, based on whatever evidence is available

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

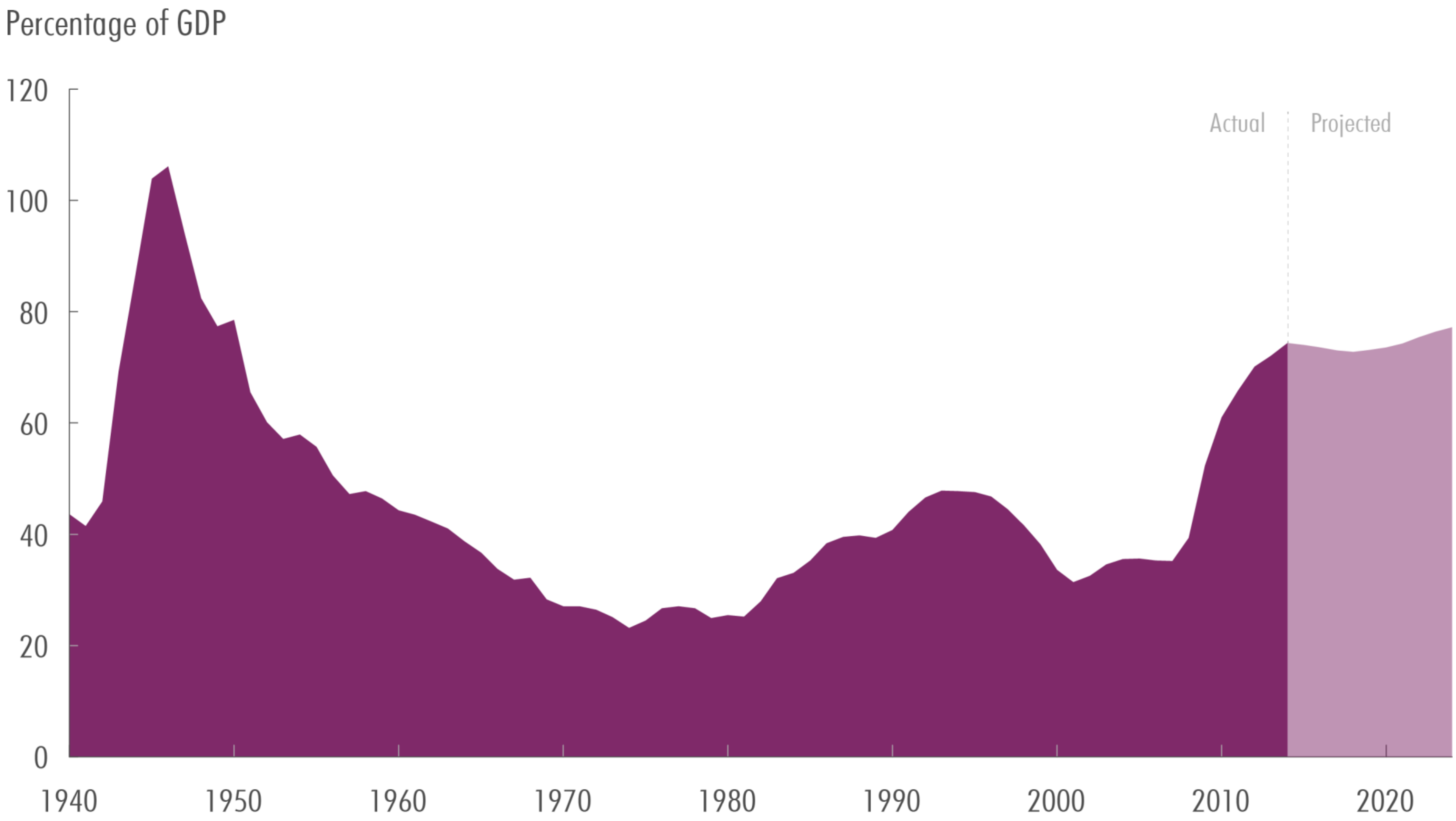
Provide **explanations of the analysis** to the extent feasible

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

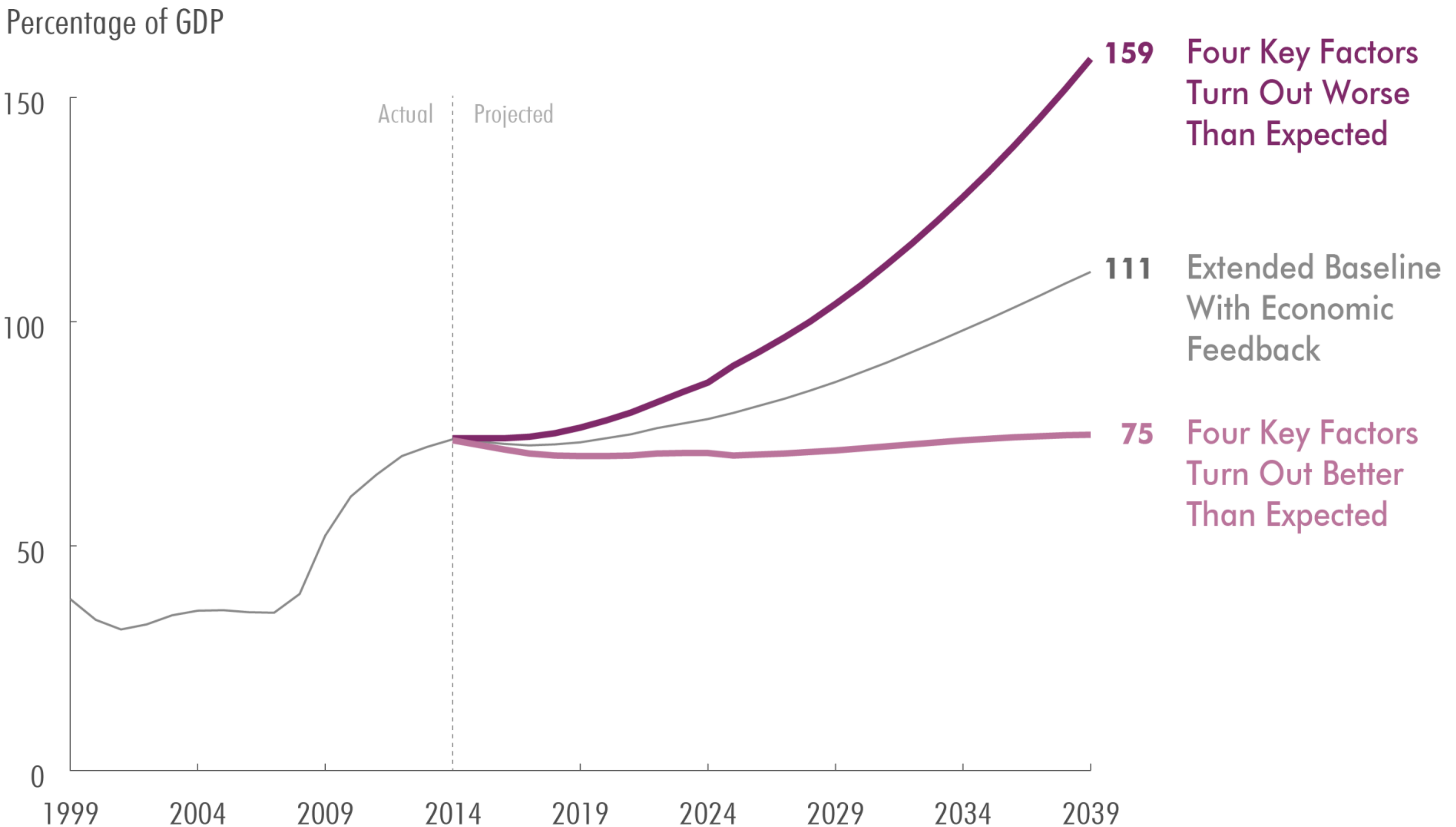
Federal Deficits or Surpluses



Federal Debt Held by the Public



Under Current Law, Federal Debt Would Increase Even Further in the Long Run

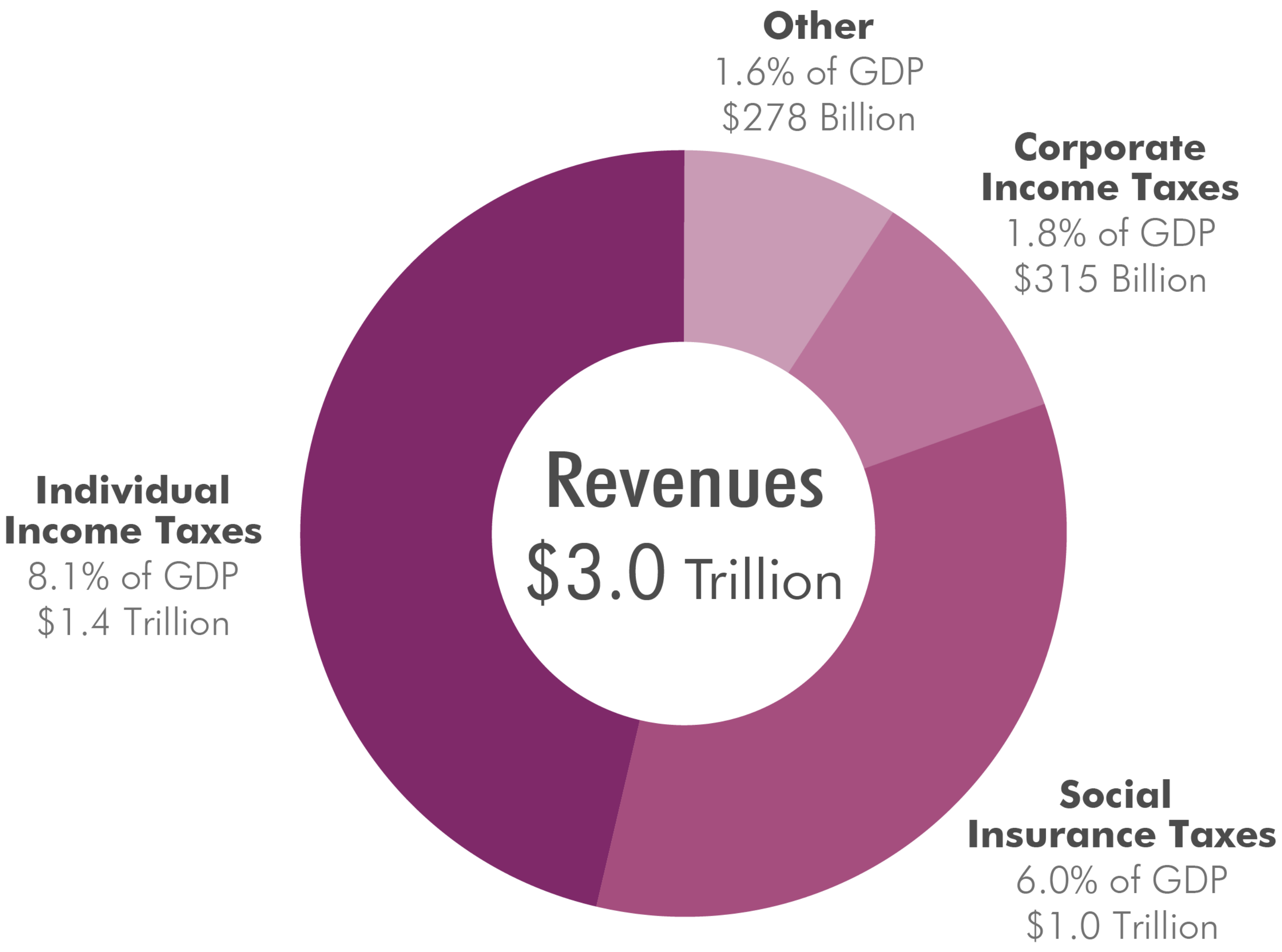


Such large and growing federal debt would have serious negative consequences:

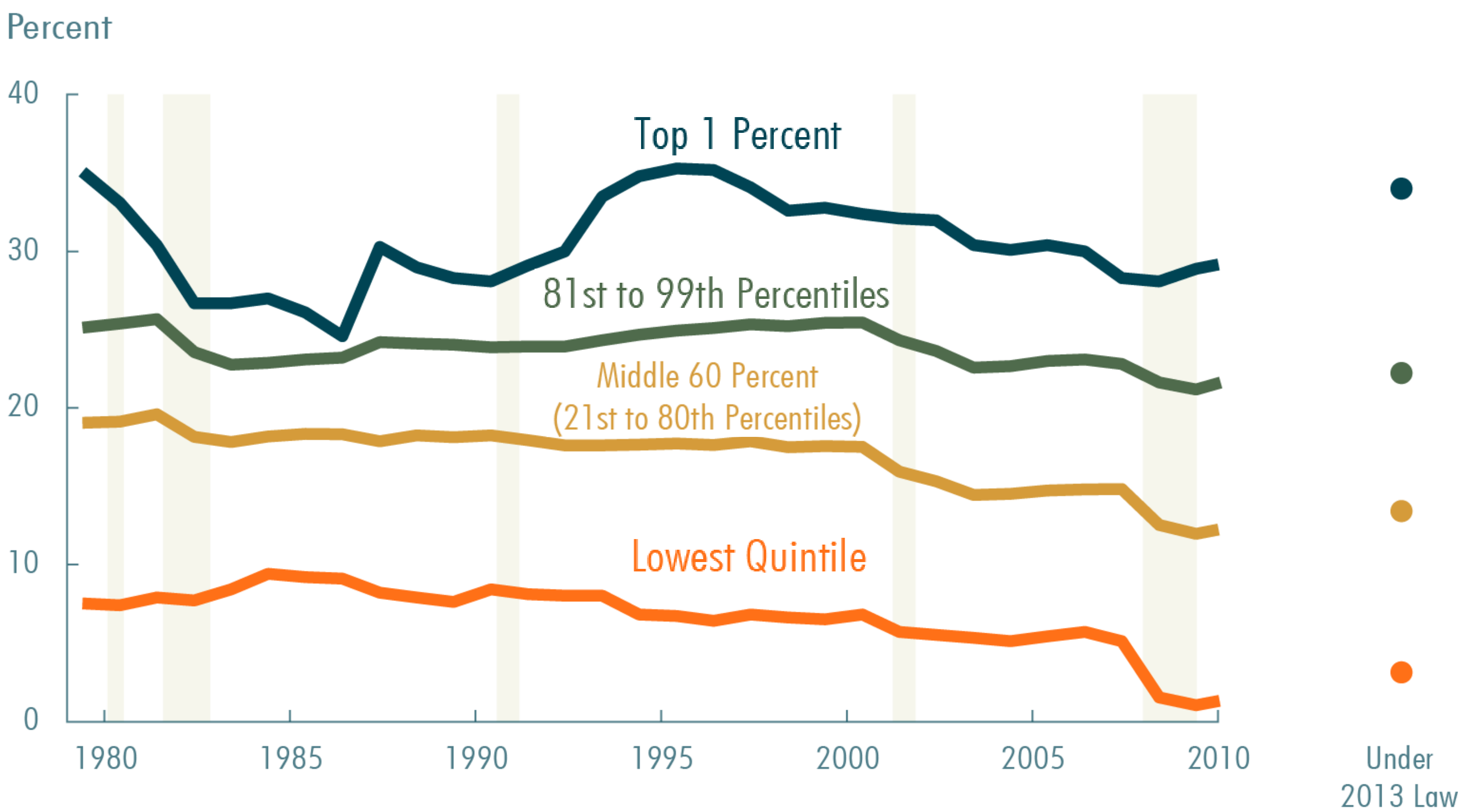
- Increasing federal spending for interest payments;
- Restraining economic growth in the long term;
- Giving policymakers less flexibility to respond to unexpected challenges; and
- Eventually increasing the risk of a fiscal crisis.

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

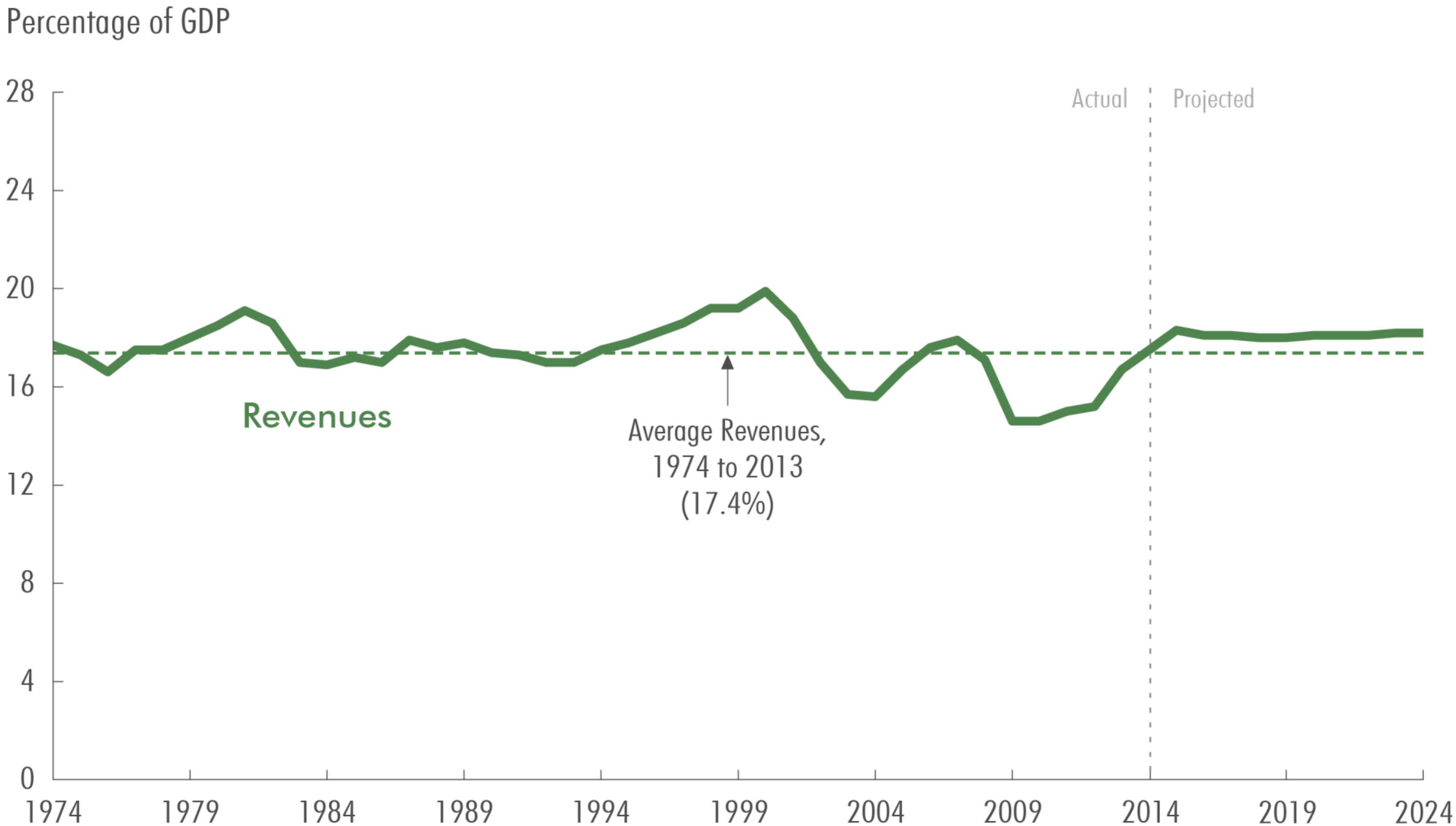
Individual Income Taxes Will Account for More Than 45 Percent of Total Revenues in 2014



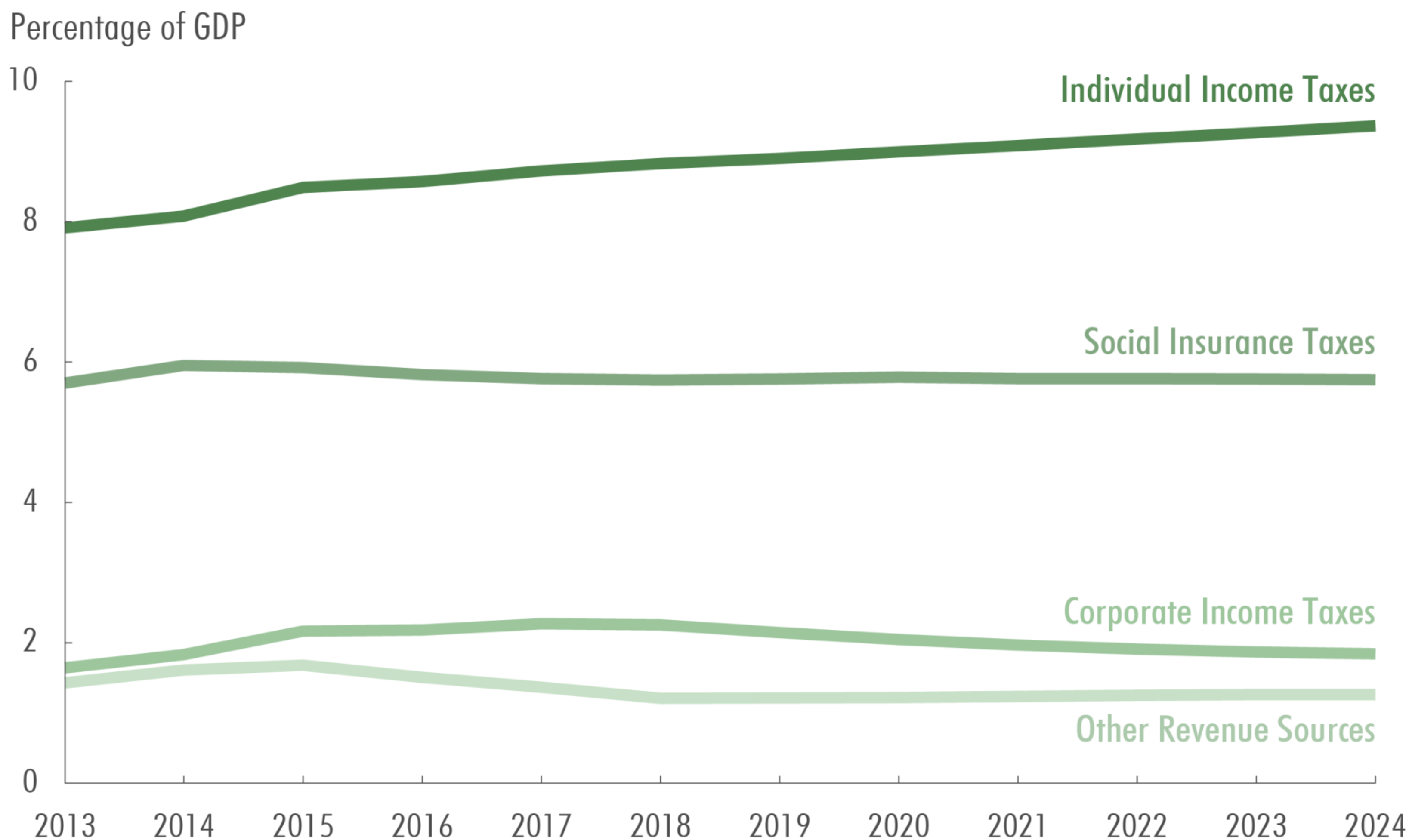
For Most Income Groups, Average Federal Tax Rates in 2013 Were Well Below Their Averages for the 1979–2010 Period



Total Revenues

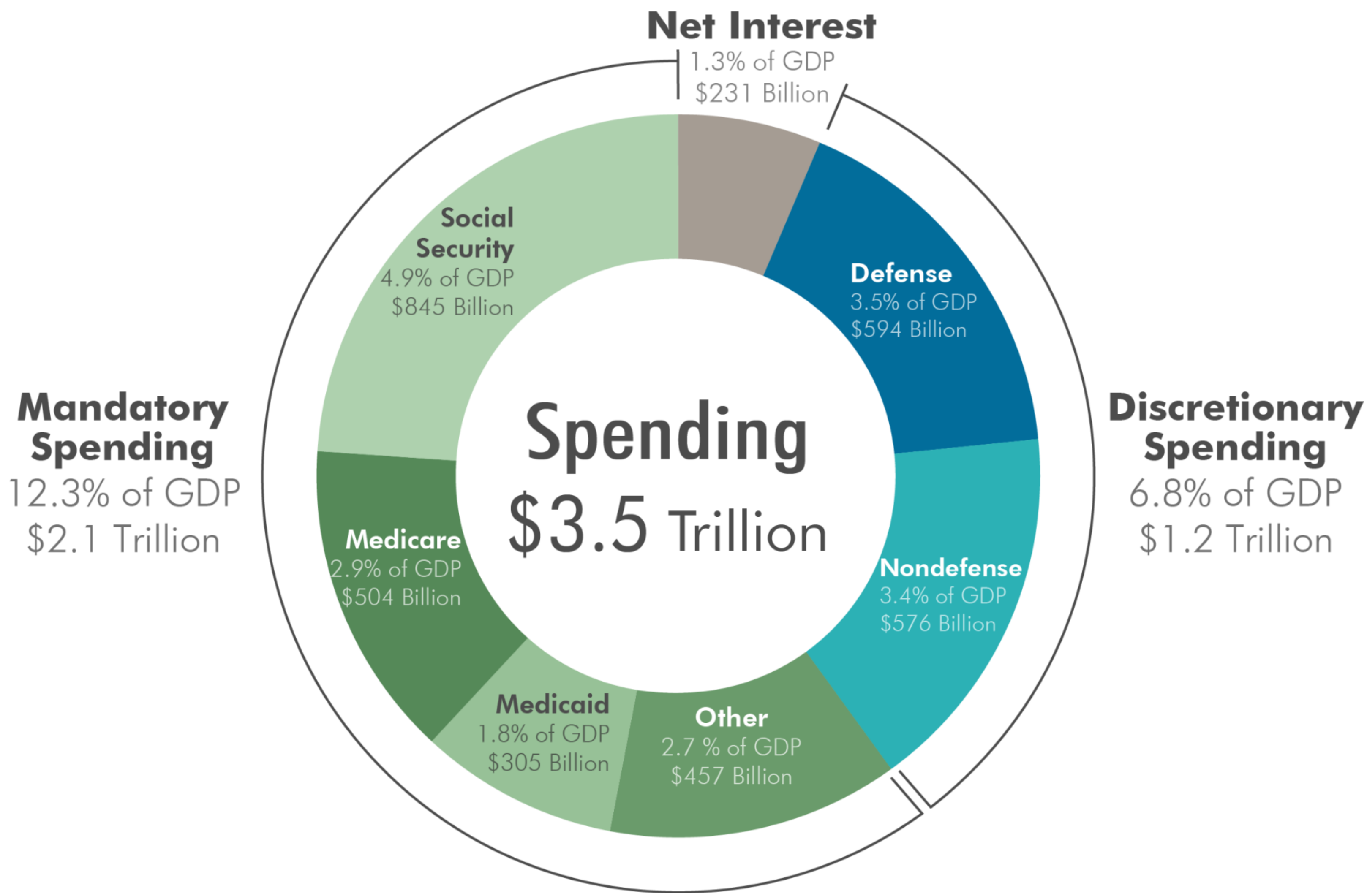


Growth in Federal Revenues Relative to the Size of the Economy Will Come From Individual Income Taxes

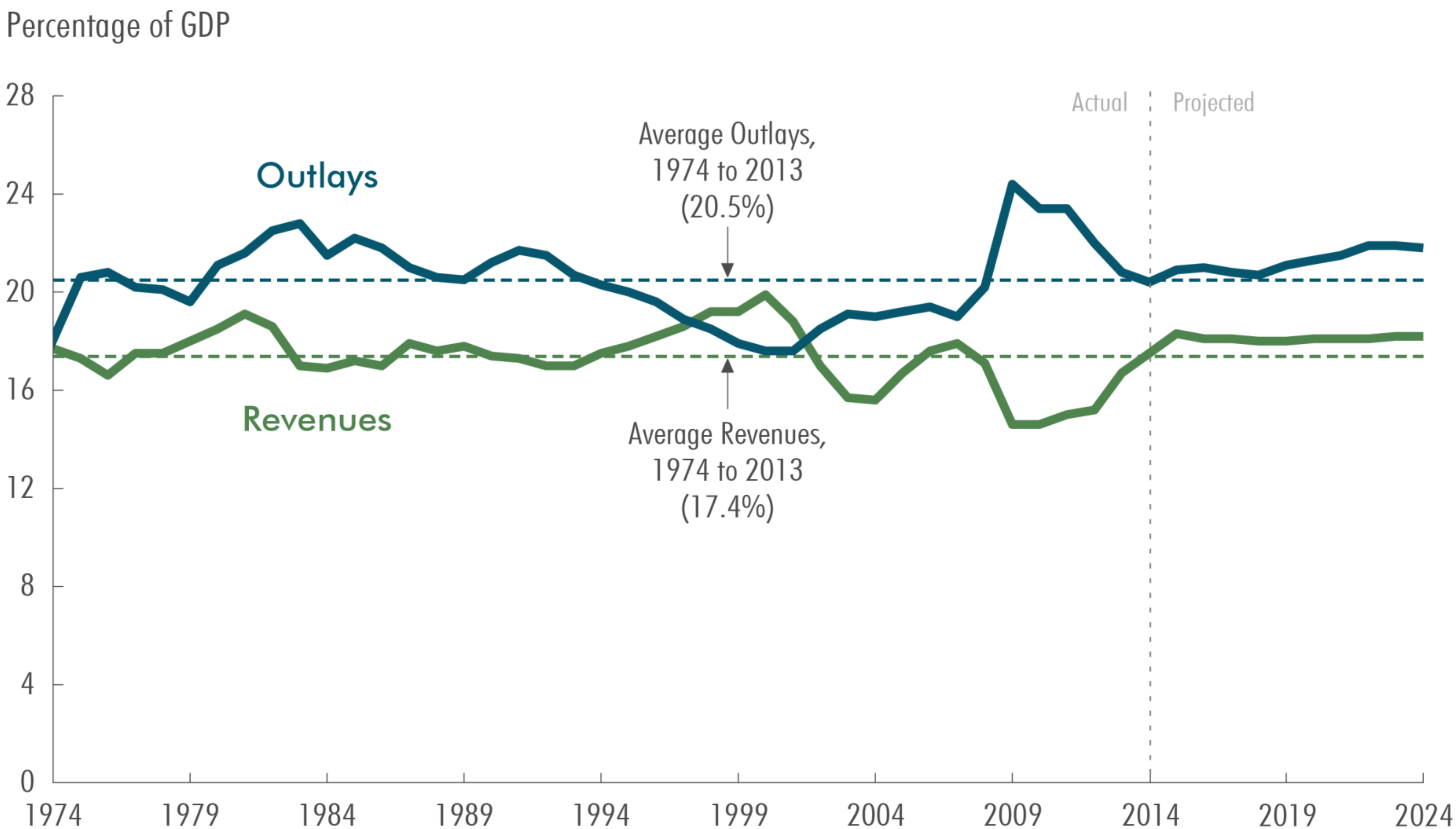


Under Current Law,
How Will the Composition of Federal Spending Change?

About 45 Percent of Federal Spending in 2014 Is Going for Social Security, Medicare, and Medicaid



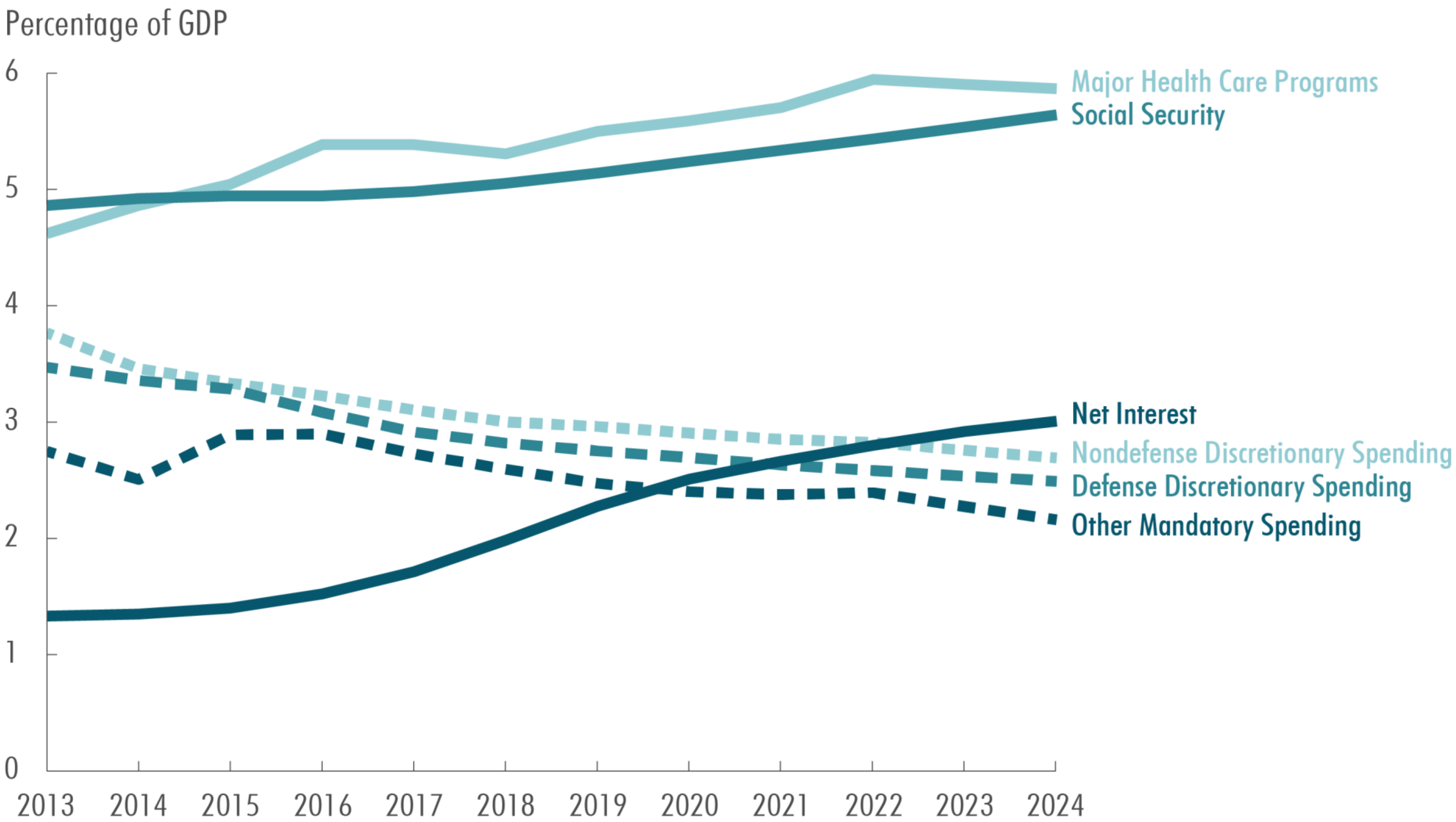
Total Outlays and Revenues



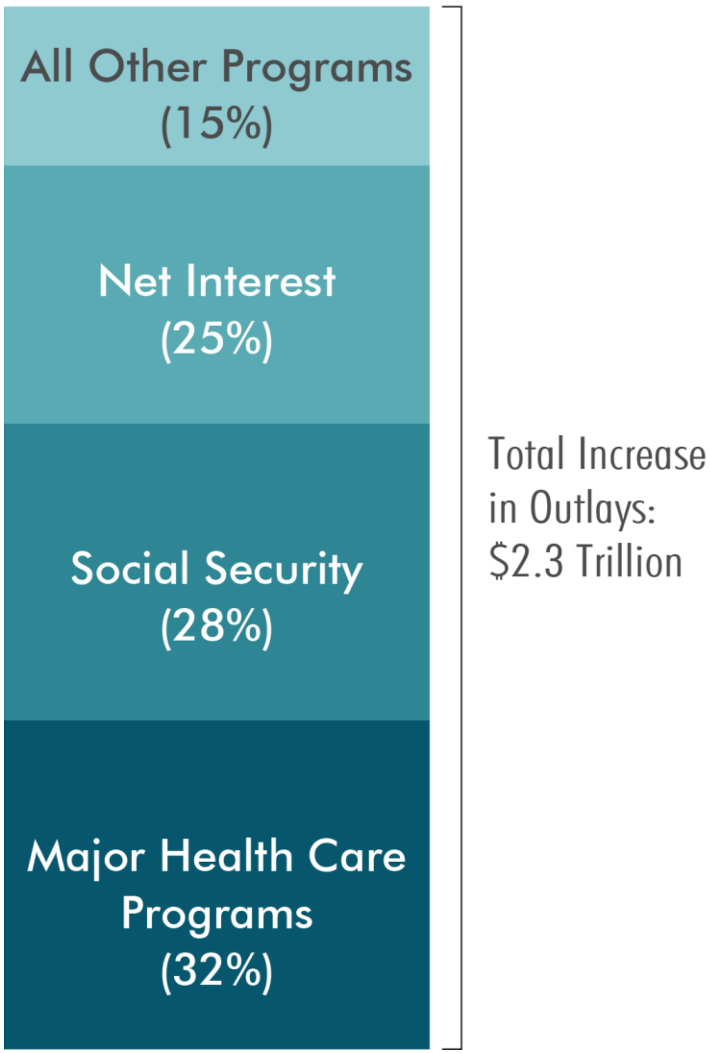
Federal spending will be boosted over the coming decade by four key factors:

- Retirement of the baby boomers,
- Expansion of federal subsidies for health insurance,
- Increasing health care costs per beneficiary, and
- Rising interest rates on federal debt.

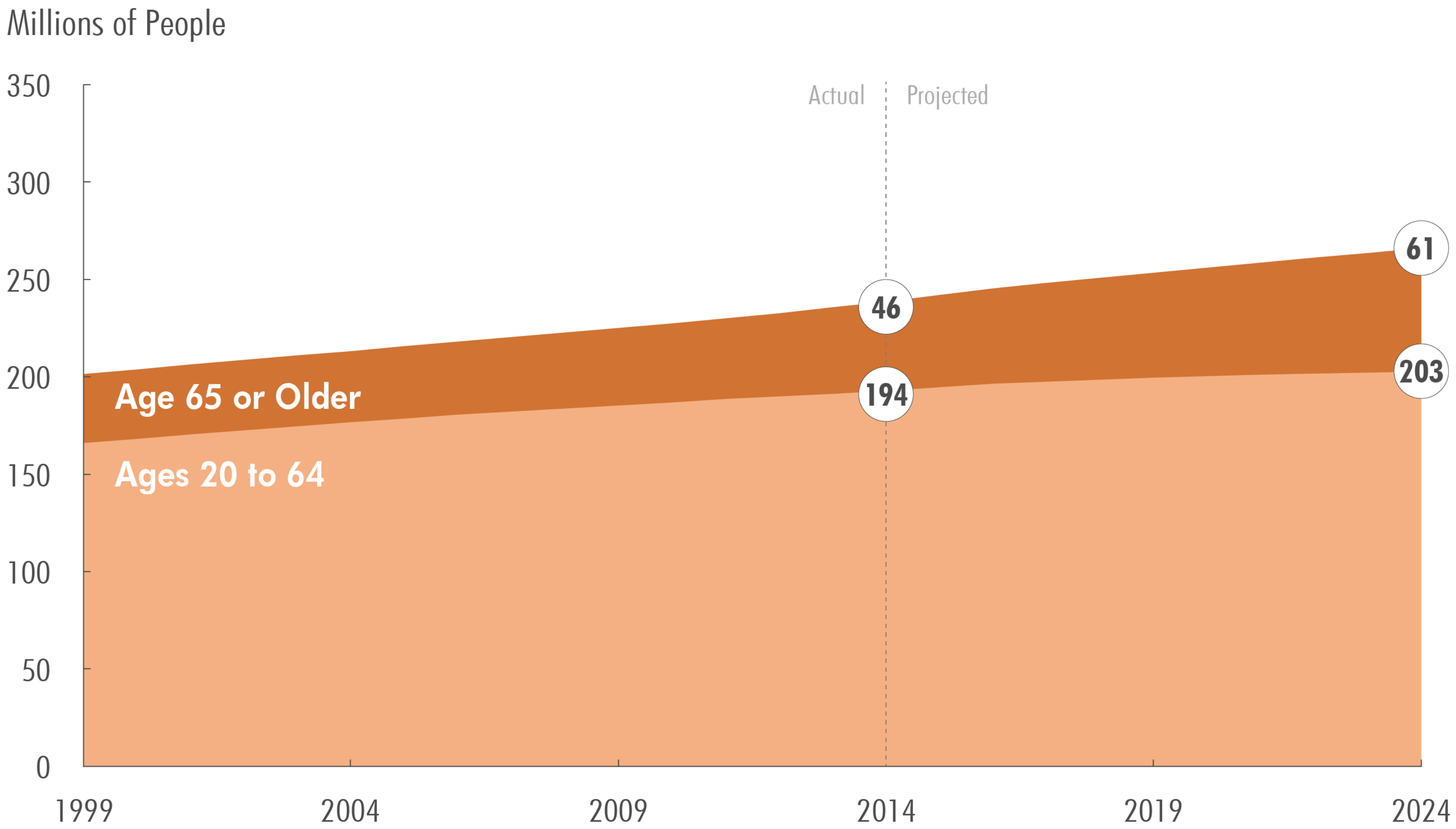
Federal Spending Will Shift Toward Social Security and Health Care Programs and Away from Other Activities



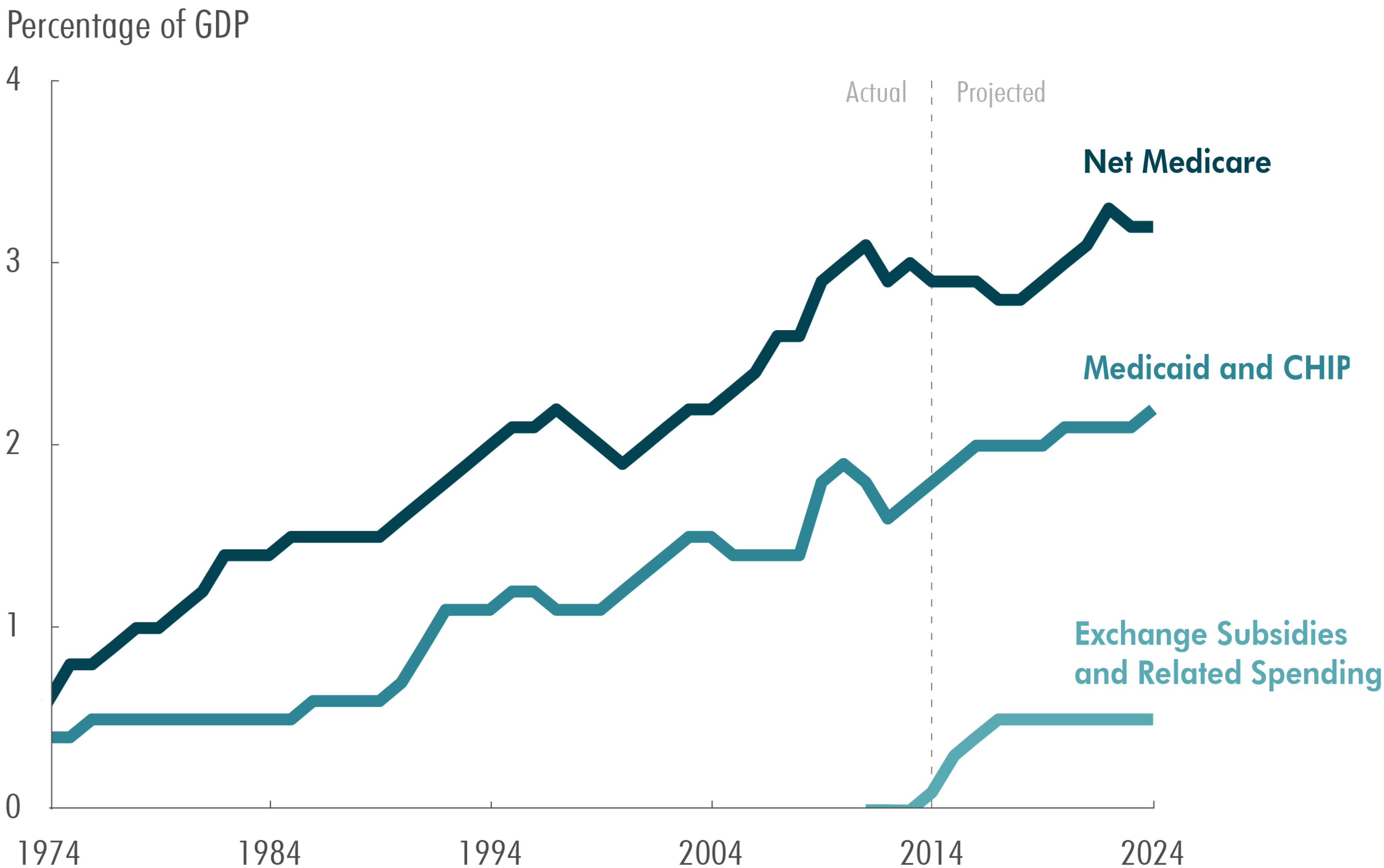
Three Types of Spending Account for 85 Percent of Total Projected Increase in Annual Spending Over Coming Decade



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



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



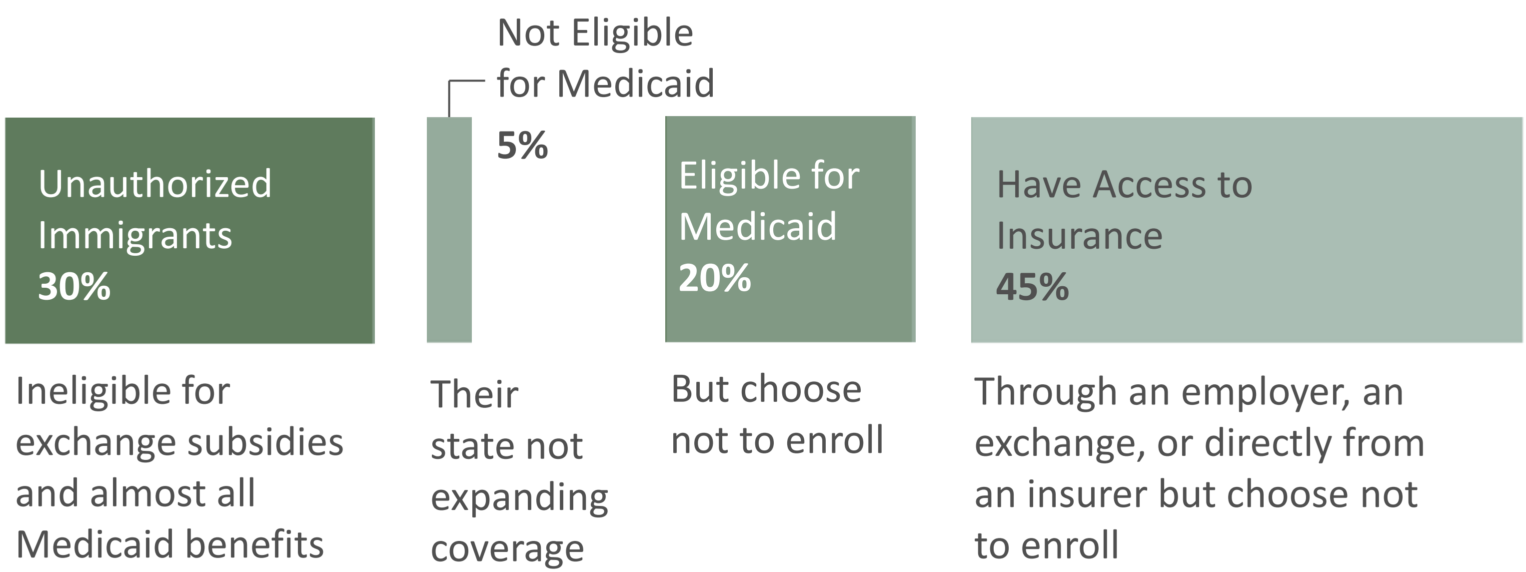
The Affordable Care Act Will Significantly Reduce the Number of People Without Health Insurance

Projections for 2024, People Under Age 65

Under Prior Law: **57 Million** Uninsured

Under the ACA: **31 Million** Uninsured

26 Million More Insured



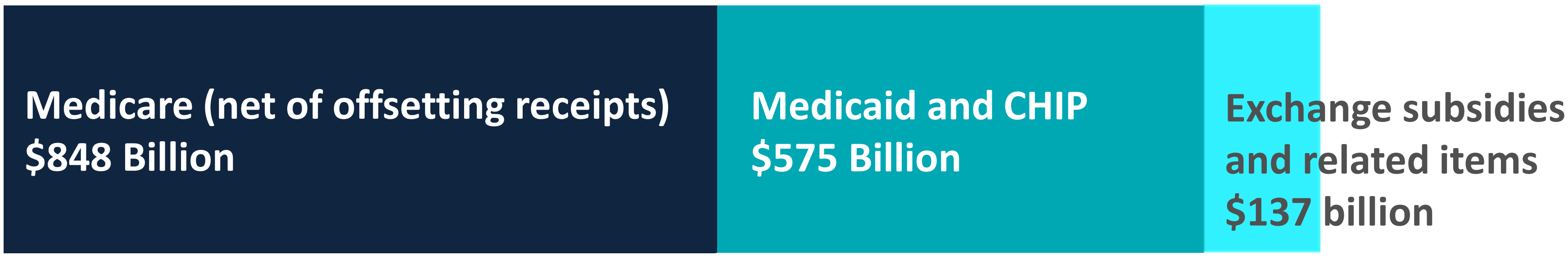
The Coverage Provisions of the ACA Will Have Little Effect on Health Insurance for Most Other People

Projections for 2024 for people under age 65 relative to prior law:

15 million	People who otherwise would have had employment-based health insurance will not.
8 million	People who otherwise would not have had employment-based insurance will.
10 million	People who otherwise would have bought nongroup insurance will face higher premiums before subsidies, on average—primarily because insurance will need to cover a larger share of health care costs. Some but not all of those people will receive subsidies in exchanges.
200 million	People who would have had employment-based health insurance, Medicaid, Medicare, or other coverage without the ACA will have the same source of coverage and similar costs (apart from any effect of the excise tax on high-premium plans).

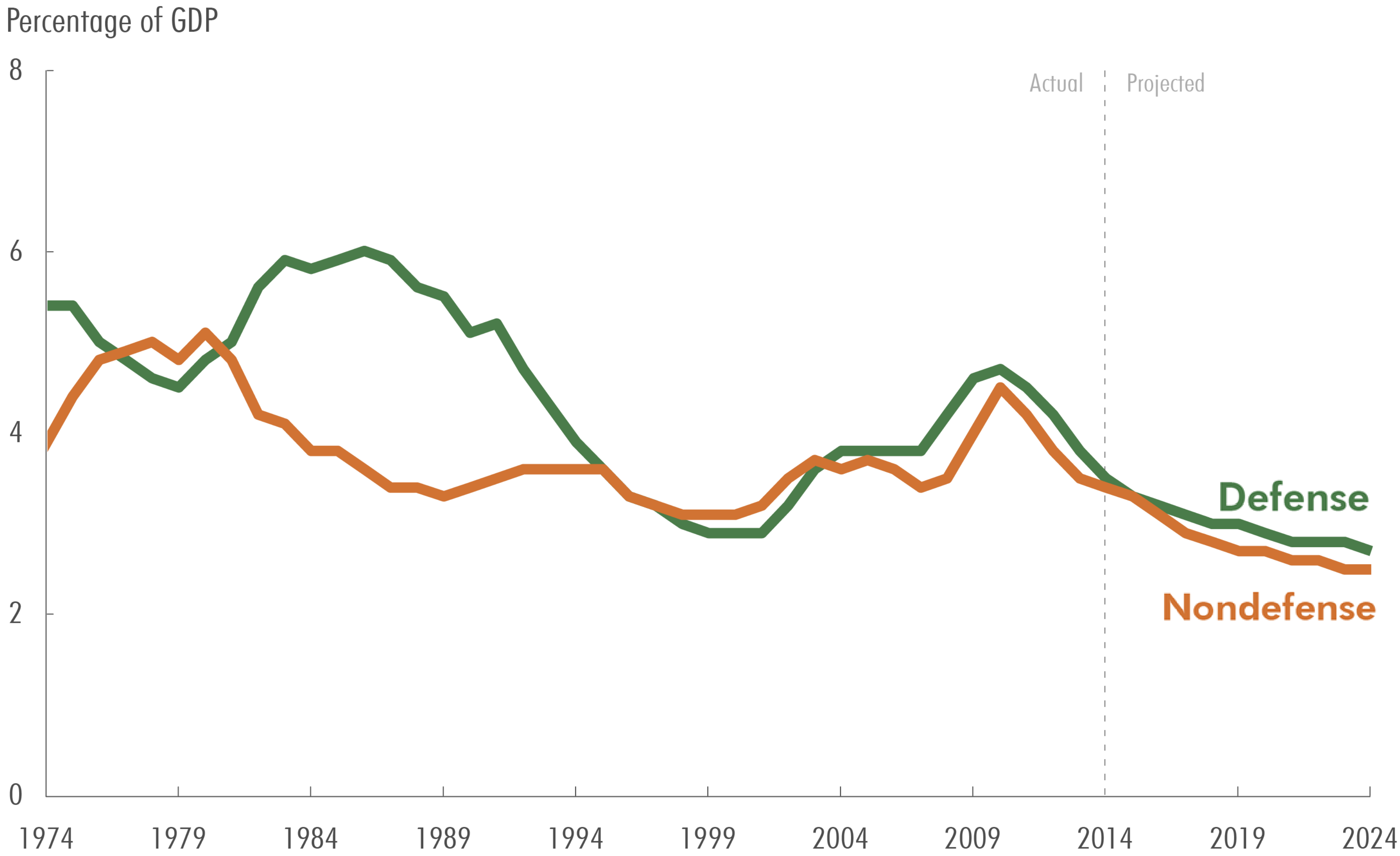
Even After the Affordable Care Act Is Fully Implemented, Most Federal Spending for Health Care Will Support Care for Older People

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 through 2021.

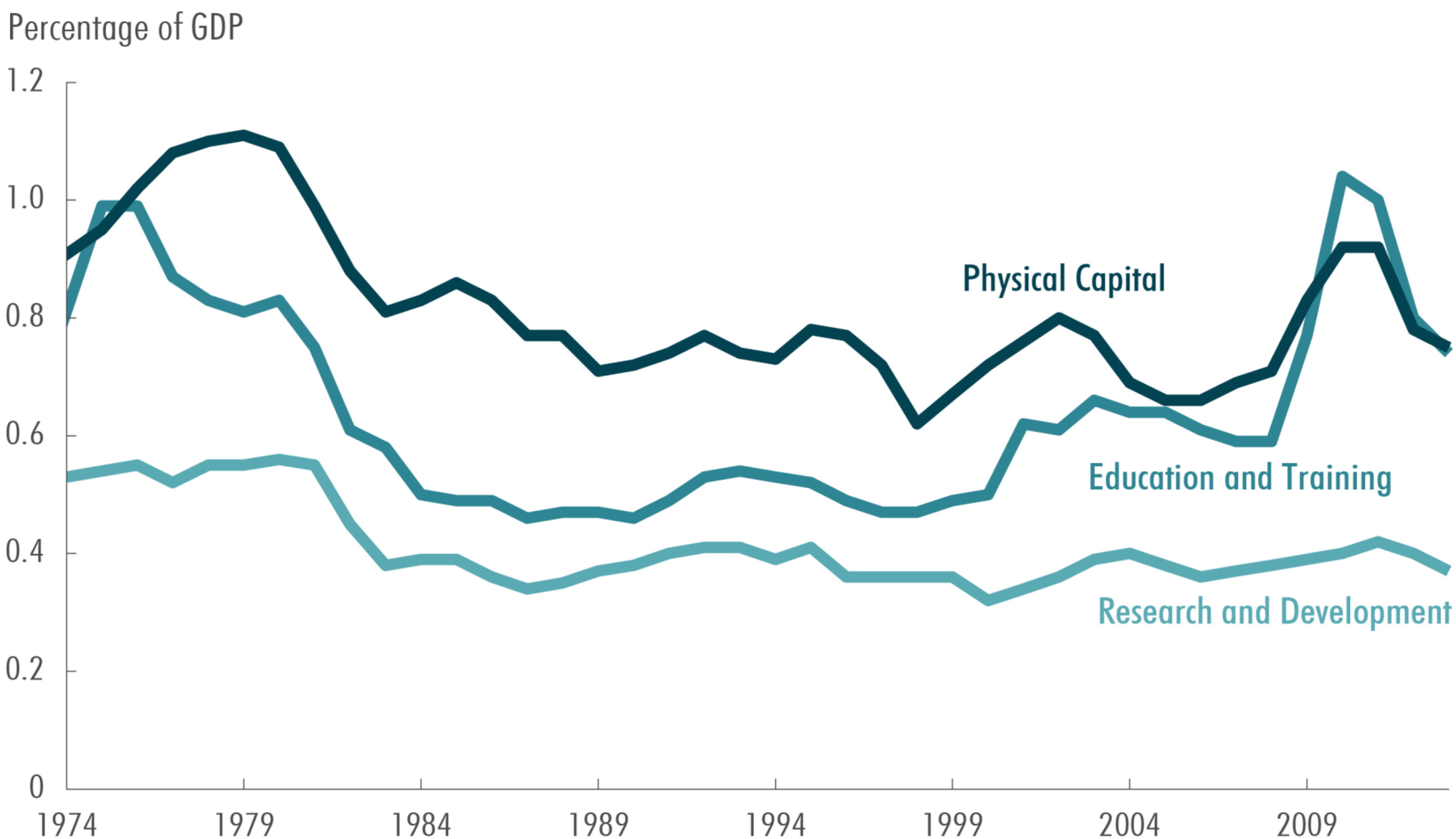
The difficult decisions about how large the appropriations will be for ***specific* programs and activities** will be made year-by-year in the future.

To keep defense spending within the caps, policymakers could:

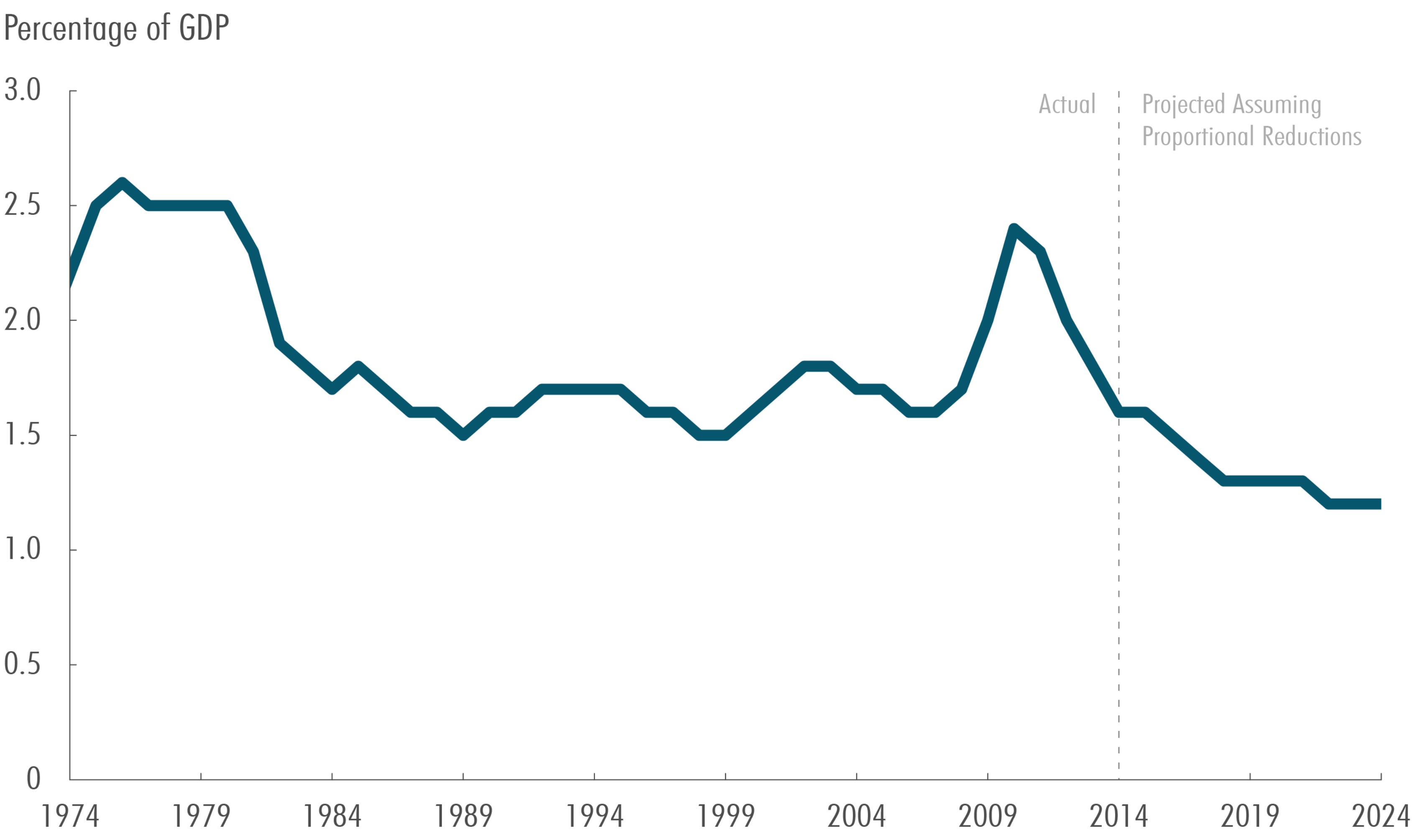
- Reduce the size of the military—for example, the number of brigade combat teams in the Army or major warships in the Navy;
- Decrease the per-unit costs of the military—for example, compensation per service member or operating expenses; or
- Both.

If changes occurred entirely through cutting the size of the military, the required cuts would be more than 20 percent.

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



If Investment Remained the Same Share of Nondefense Discretionary Spending as in the Past, It Would Reach Its Lowest Percentage of GDP in Decades



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).

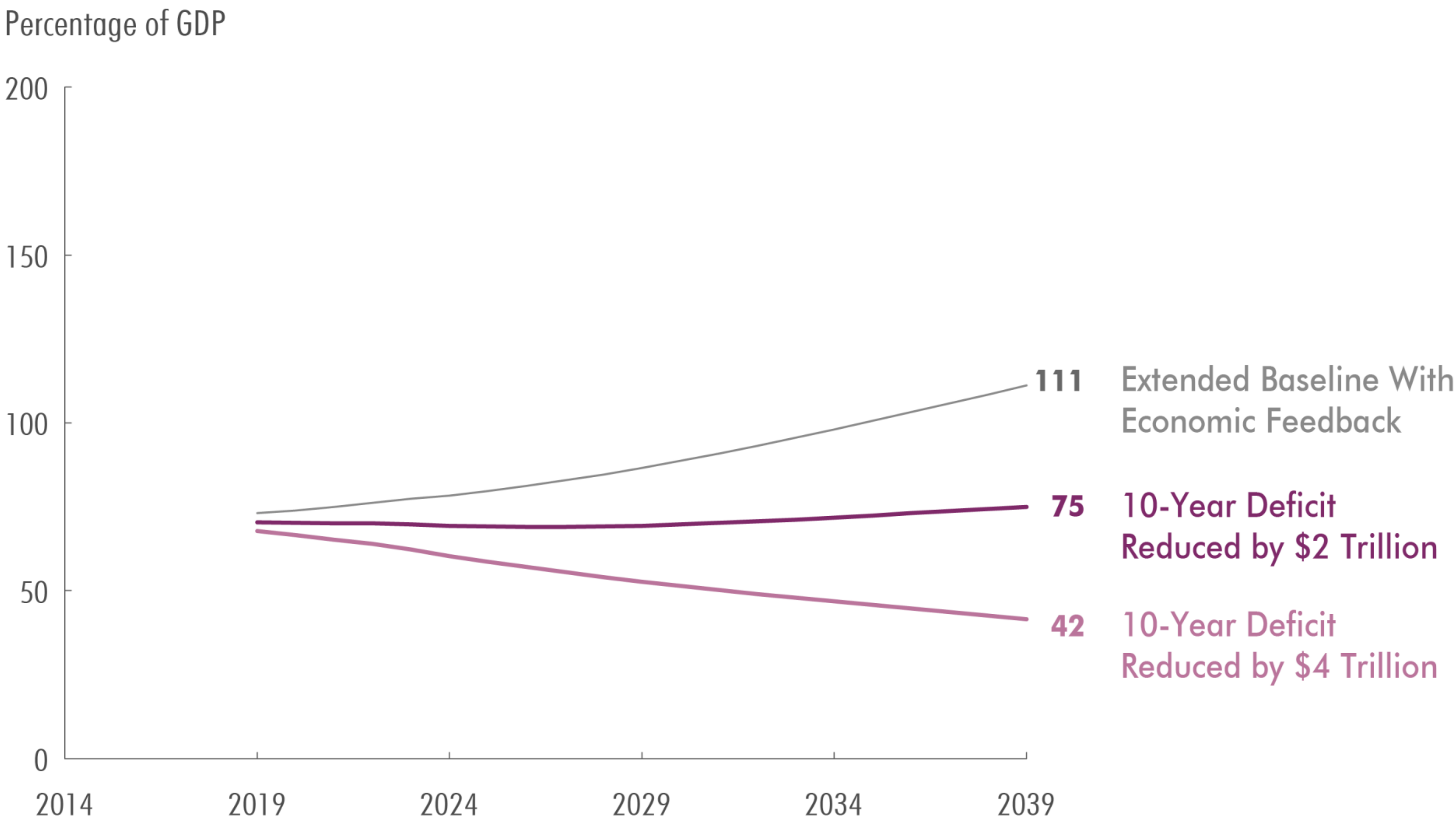
However, many observers worry that we have not explicitly *decided* as a society to make those changes. Rather, we seem to be drifting into the changes because spending for the largest benefit programs is determined by formulas for benefits per person that allow spending to grow without explicit action, whereas spending for many other federal activities is set through annual appropriations and requires explicit action each year.

What Choices Do Policymakers and Citizens Face?

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 since at least 1940, federal debt remains on an unsustainable path.

We will need to cut benefits from those large programs relative to current law, raise tax revenue above its historical percentage of GDP to pay for the rising cost of those programs, or do both.

Putting Federal Debt on a Sustainable Path Requires Significant Changes in Policy



A Few Illustrative Options for Reducing Deficits from CBO's *Options for Reducing the Deficit: 2014 to 2023*

	Approximate Estimated Savings Over 2014 to 2023
Reduce Social Security Benefits for New Beneficiaries by 15 Percent	**$200 B**
Increase Premiums for Parts B and D of Medicare	**$300 B**
Change the Cost-Sharing Rules for Medicare and Restrict Medigap Insurance	**$100 B**
Eliminate Exchange Subsidies for People With Income Over 300 Percent of the Federal Poverty Guidelines	**$100 B**
Convert Multiple Assistance Programs for Lower-Income People Into Smaller Block Grants to States	**$400 B**
Use an Alternative Measure of Inflation to Index Social Security and Other Mandatory Programs	**$150 B**

A Few Illustrative Options for Reducing Deficits from CBO's *Options for Reducing the Deficit: 2014 to 2023* (Cont.)

	Approximate Estimated Savings Over 2014 to 2023
Eliminate the Deduction for State and Local Taxes	**$950 B**
Use an Alternative Measure of Inflation to Index Some Parameters of the Tax Code	**$150 B**
Increase the Maximum Taxable Earnings for the Social Security Payroll Tax	**$450 B**
Increase Excise Taxes on Motor Fuels by 35 Cents and Index for Inflation	**$450 B**
Increase Corporate Income Tax Rates by 1 Percentage Point	**$100 B**

Moreover, if one wanted to raise federal spending for programs other than Social Security and health care closer to its historical percentage of GDP—while still reaching a chosen target for federal debt—the changes in taxes and benefits from those large programs would need to be even more significant.

Notes

Slides 5, 6, 10, 12, 13, 15, 16, 18, 19, 21, 24, and 25: For more information, see *An Update to the Budget and Economic Outlook: 2014 to 2024* (August 2014), www.cbo.gov/publication/45653. 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.

Slide 11: For more information, see *The Distribution of Household Income and Federal Taxes, 2010* (December 2013), www.cbo.gov/publication/44604.

Slides 7, 20, and 33: For more information, see *The 2014 Long-Term Budget Outlook* (July 2014), www.cbo.gov/publication/45471.

Slides 22 and 23: For more information, see *Updated Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act, April 2014* (April 2014), www.cbo.gov/publication/45231.

Slides 28 and 29: Figures are drawn from *Federal Investment* (December 2013), www.cbo.gov/publication/44974, and have been updated to reflect data in *An Update to the Budget and Economic Outlook: 2014 to 2024* (August 2014), www.cbo.gov/publication/45653.

Slides 34 and 35: For more information, see *Options for Reducing the Deficit: 2014 to 2023* (November 2013), ww.cbo.gov/publication/44715.