



Congressional Budget Office

**Presentation to the
National Association for Business Economics**

**Fiscal Policy Choices
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Fiscal Policy Choices

- CBO projects that the deficit will shrink rapidly in the next two years under current law. The key choice for near-term policy is whether to enact additional tax cuts or spending increases to provide more stimulus to the economy.
- CBO projects that the debt is on a trajectory that poses significant economic risks and becomes unsustainable. The key choices for medium-term and long-term policy are how quickly and in what way to restrain federal borrowing.

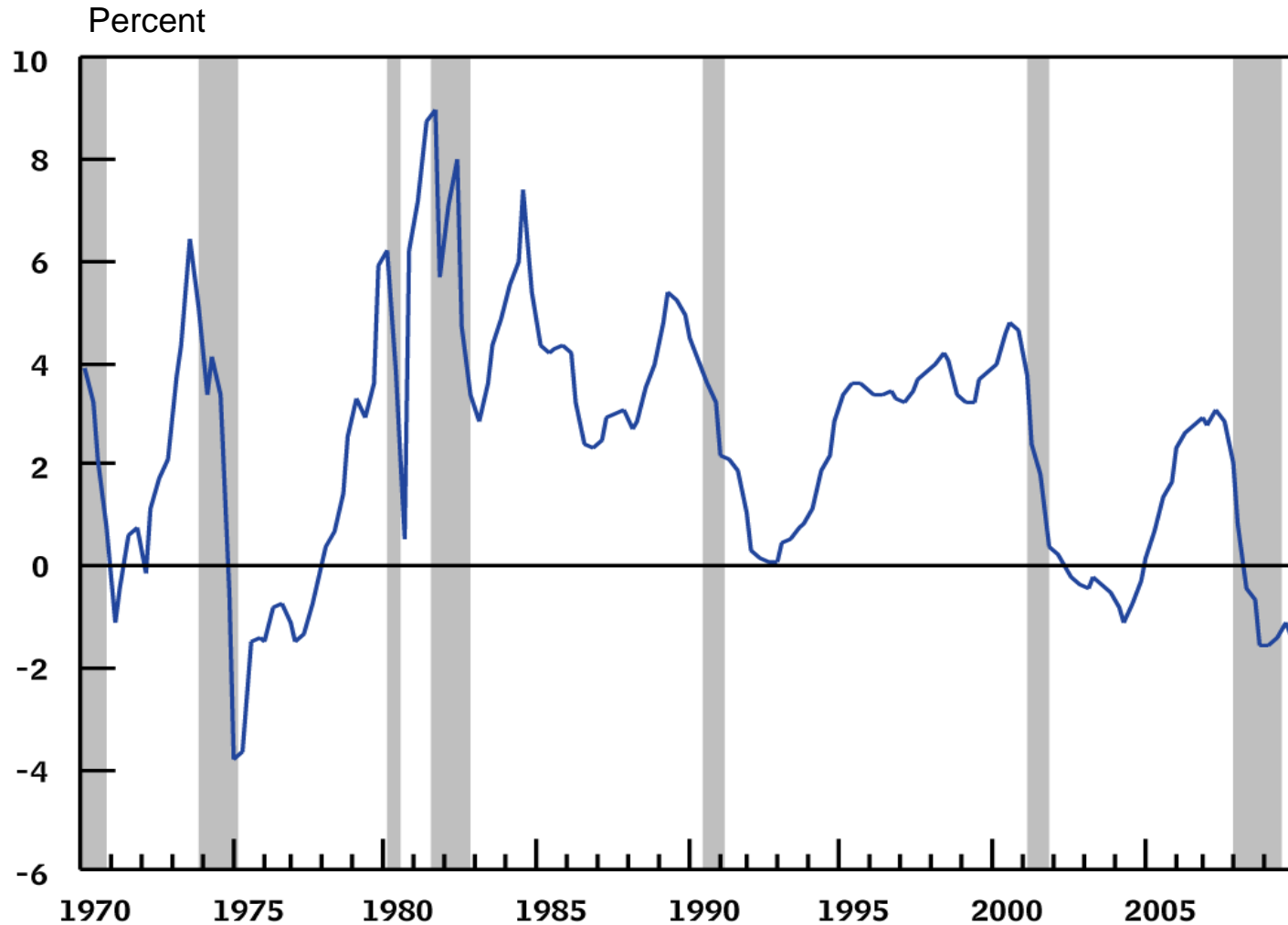


Forecast for a Slow Recovery

- Severe economic downturns often sow the seeds of robust recoveries:
 - During a slump in economic activity, consumers defer purchases, and businesses postpone capital spending.
 - Once demand picks up, spending and employment can accelerate rapidly.
- The current recovery will be dampened by several factors:
 - Continuing fragility of some financial markets and institutions.
 - Restrained increase in household spending.
 - Declining support from monetary and fiscal policy.



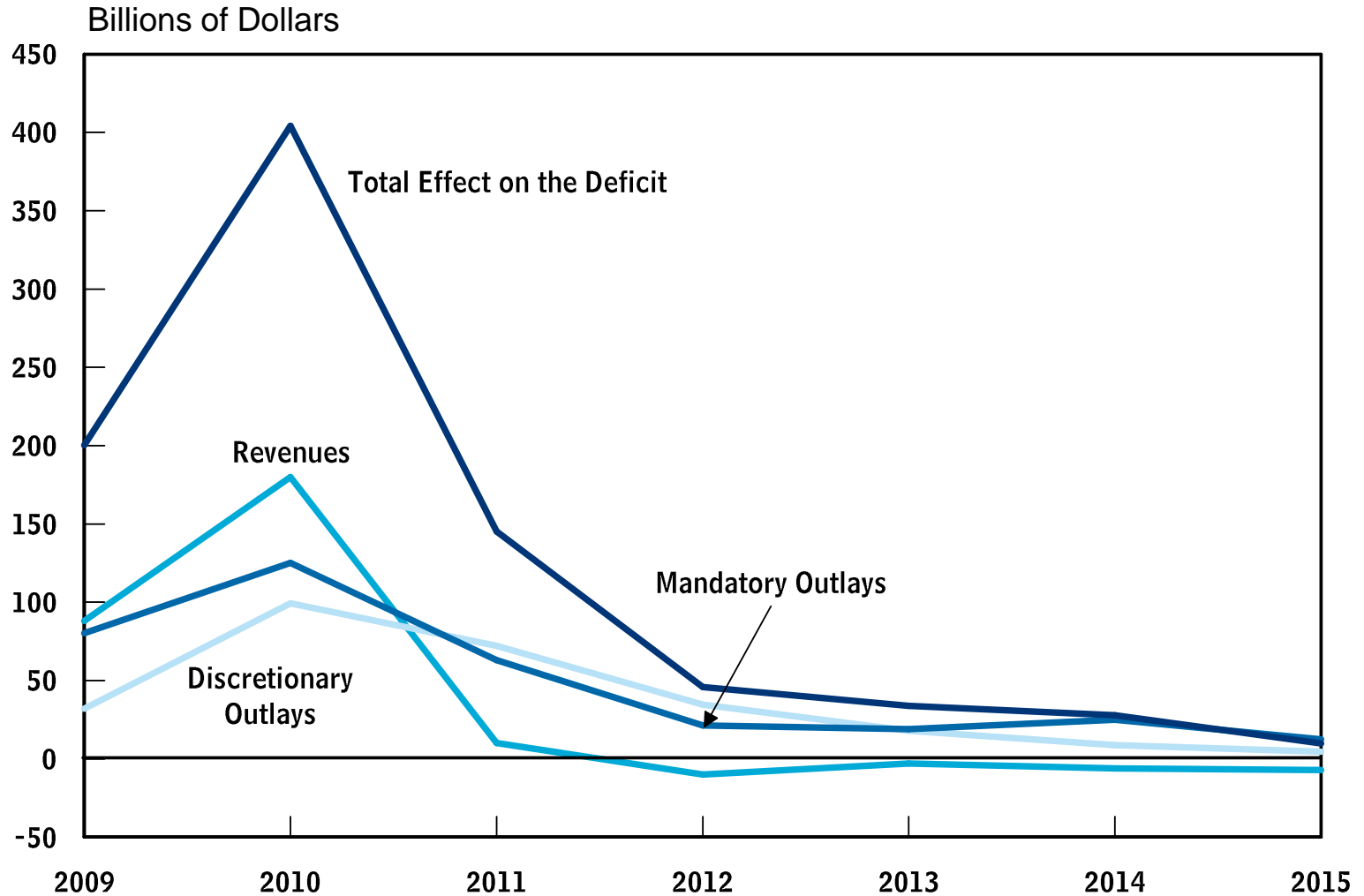
Real Federal Funds Rate



Note: The real federal funds rate is defined as the nominal rate less the year-over-year change in the core PCE price index.

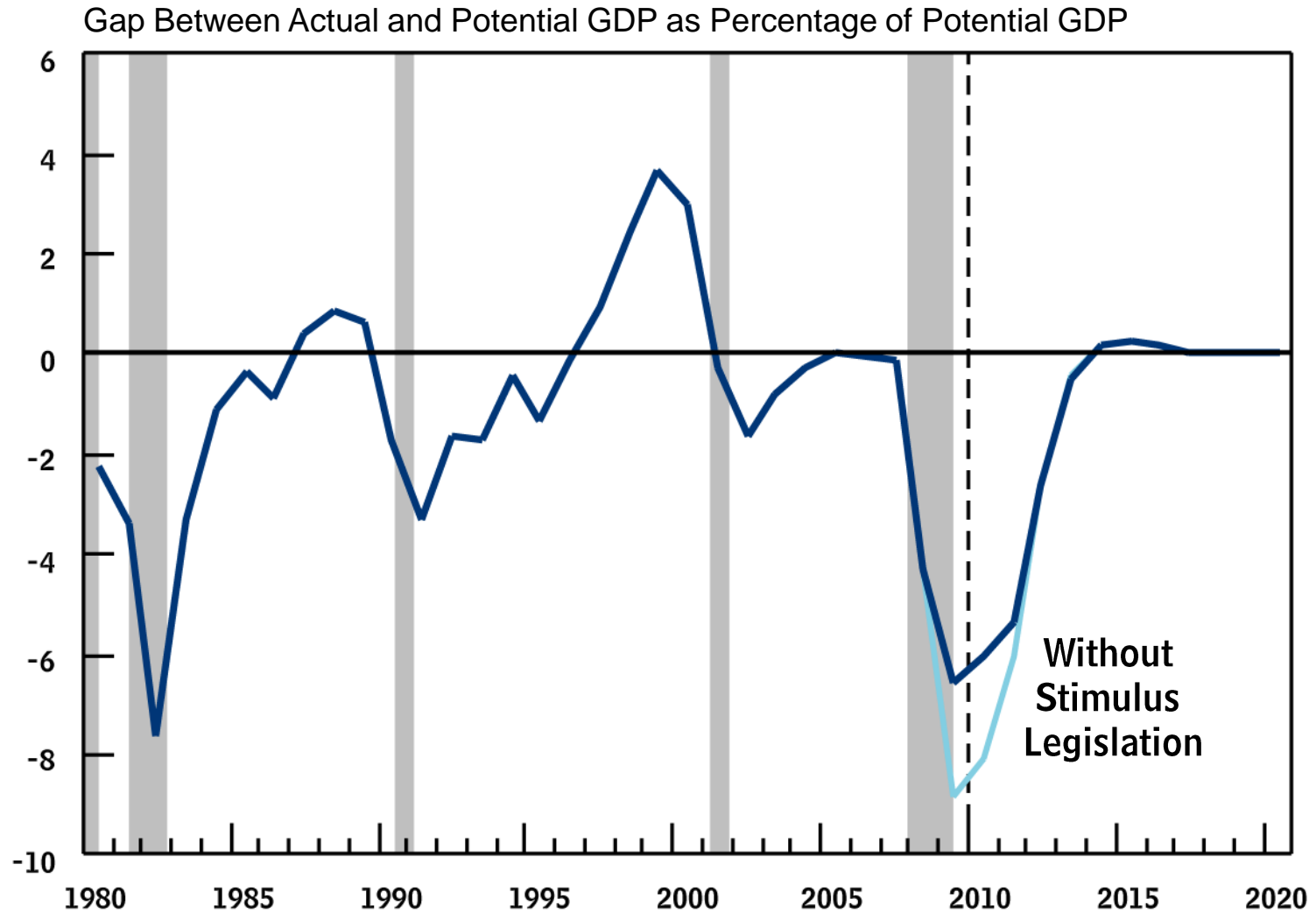


Estimated Budgetary Effects of ARRA



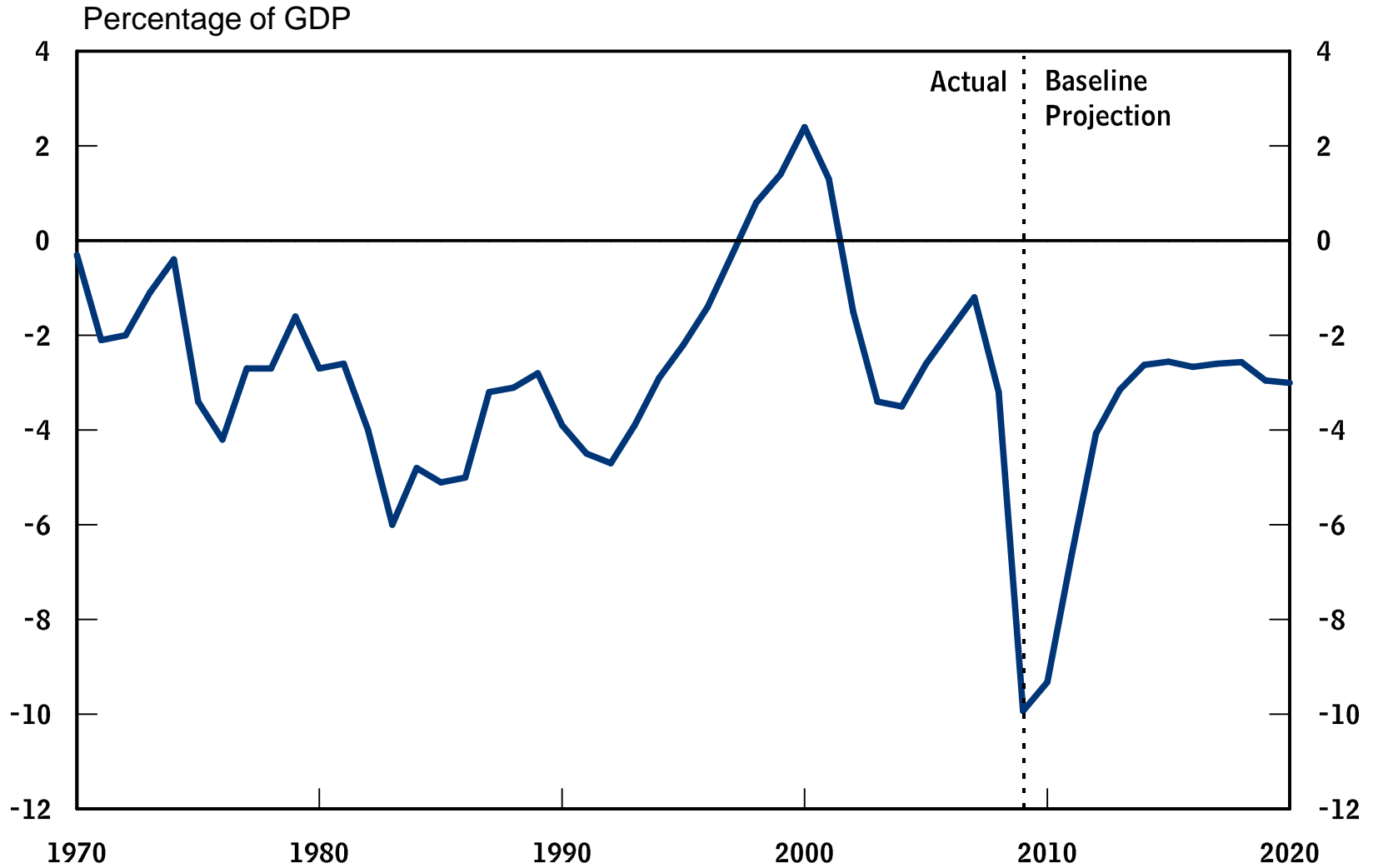


Effect of ARRA on the Output Gap



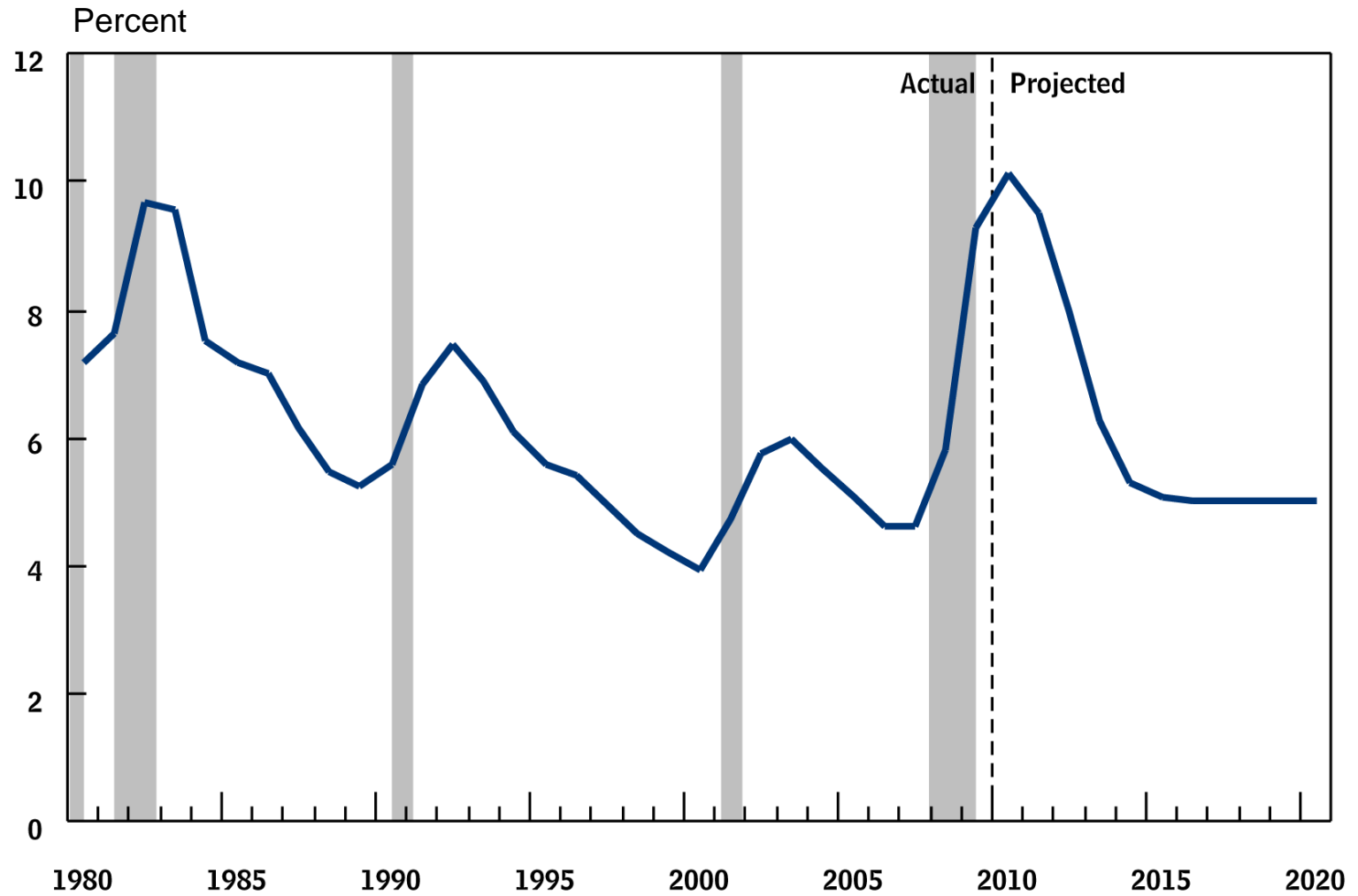


The Budget Deficit or Surplus



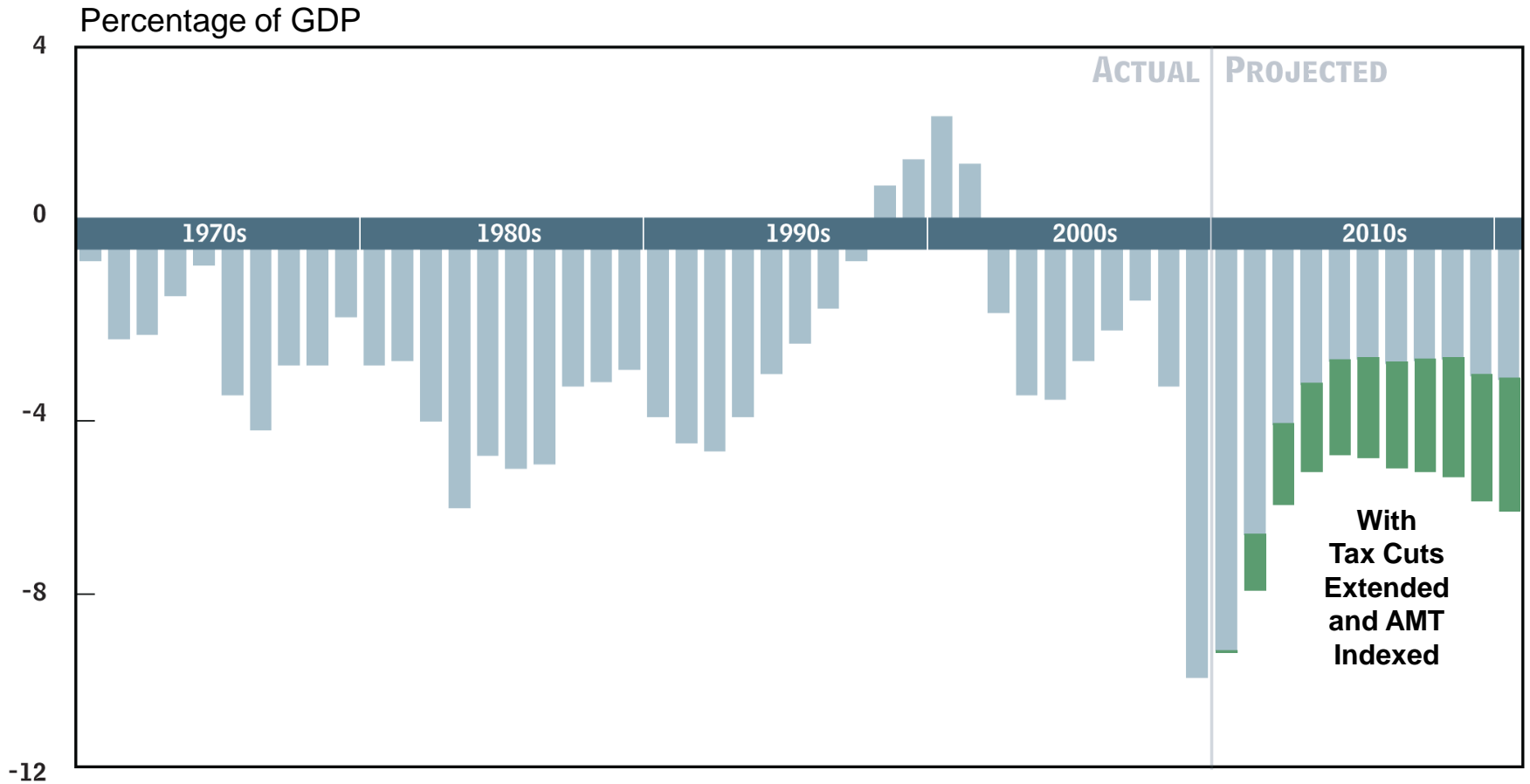


Unemployment Rate





Budget Deficit or Surplus





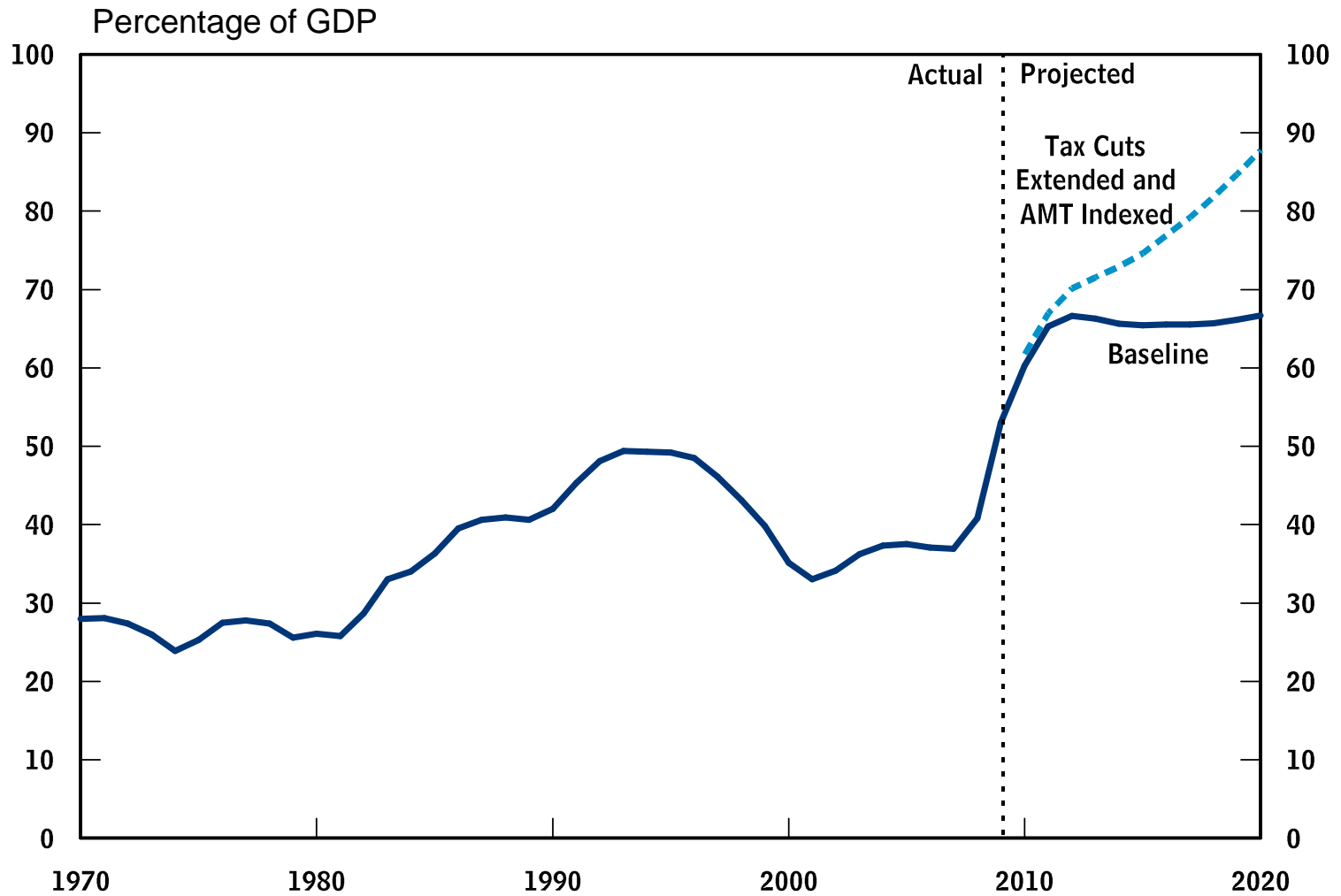
CBO's Estimate of the President's Budget, 2011-2020

	Trillions of Dollars
Deficit under current law baseline	6.0
Extension of most of 2001 and 2003 tax cuts and indexing of AMT (approximate, including debt service)	3.7
Other proposals (approximate, including debt service)	*
Deficit under the President's budget	9.8

Note: * = Less than \$0.05 trillion.



Rising Debt Burden



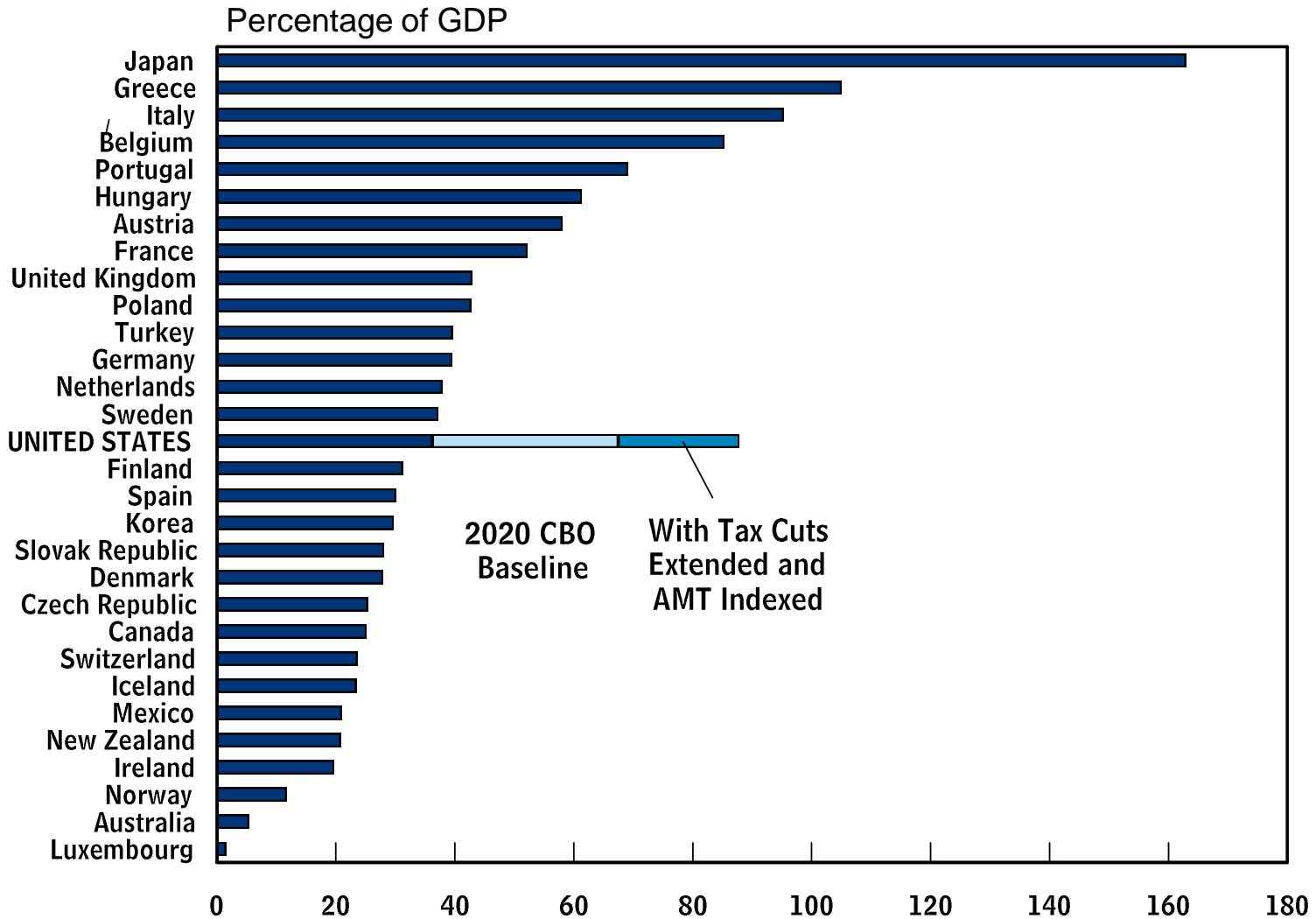


Why Does Rising Federal Debt Matter?

- Tax revenues are used to pay interest rather than finance current programs.
- Crowding out of saving and investment lowers future output and income relative to what would otherwise occur.
- The ability of the government to respond to future needs is reduced.
- The risk of a sharp jump in interest rates (perhaps related to flight from U.S. Treasuries or U.S. assets more generally) is heightened.



Debt Burden Across Countries in 2007



Source: OECD.

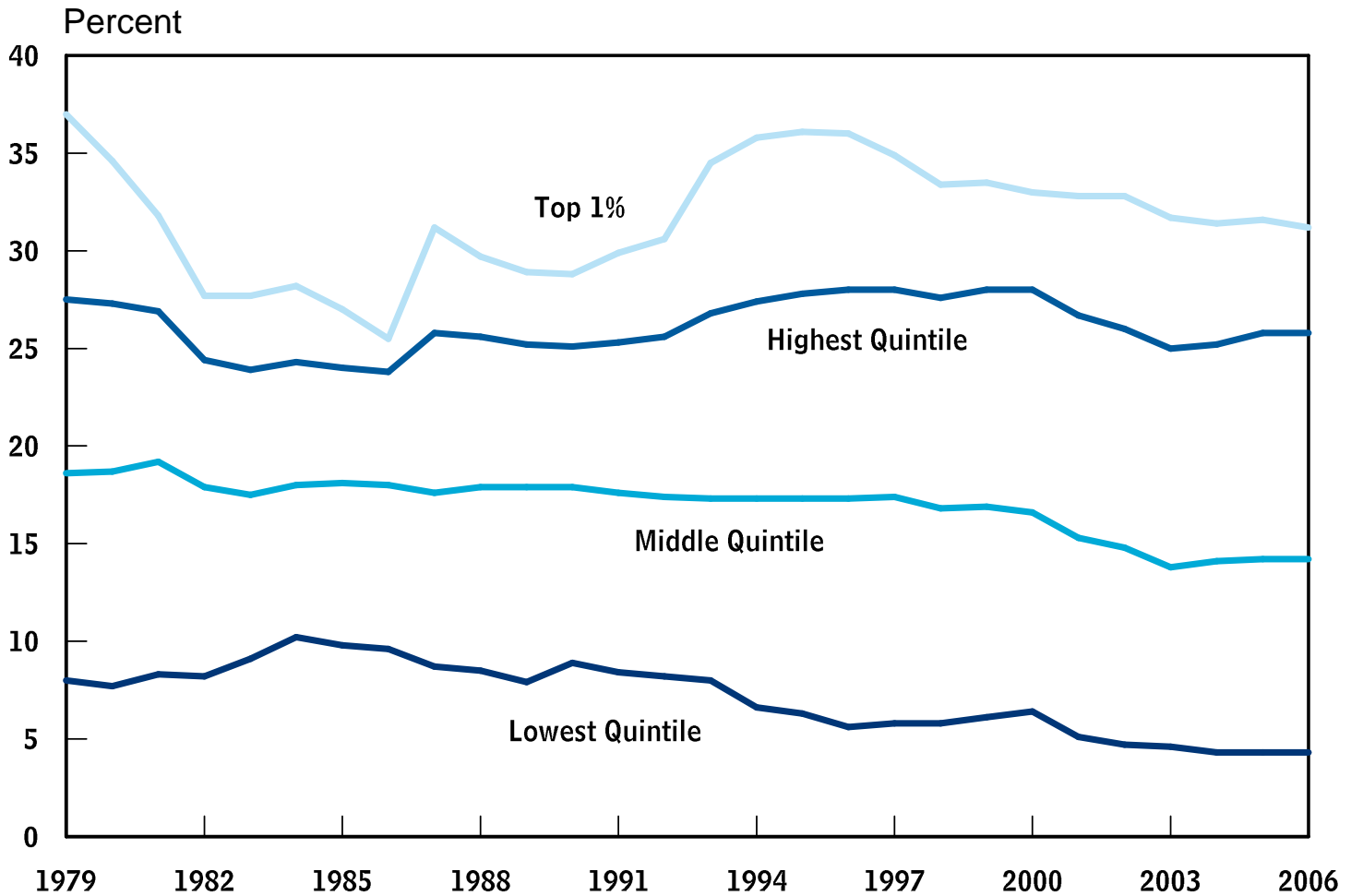


The Path of Fiscal Policy

- The problem with the federal budget deficit is not its level today when the economy is weak. The problem is its future path.
- Forecasts of budget and economic outcomes are highly uncertain. We believe that our projection balances the risks.
- The outlook for the budget under “current policy” is bleak. The key choices are not whether to change course on the federal budget, but how quickly and in what way.

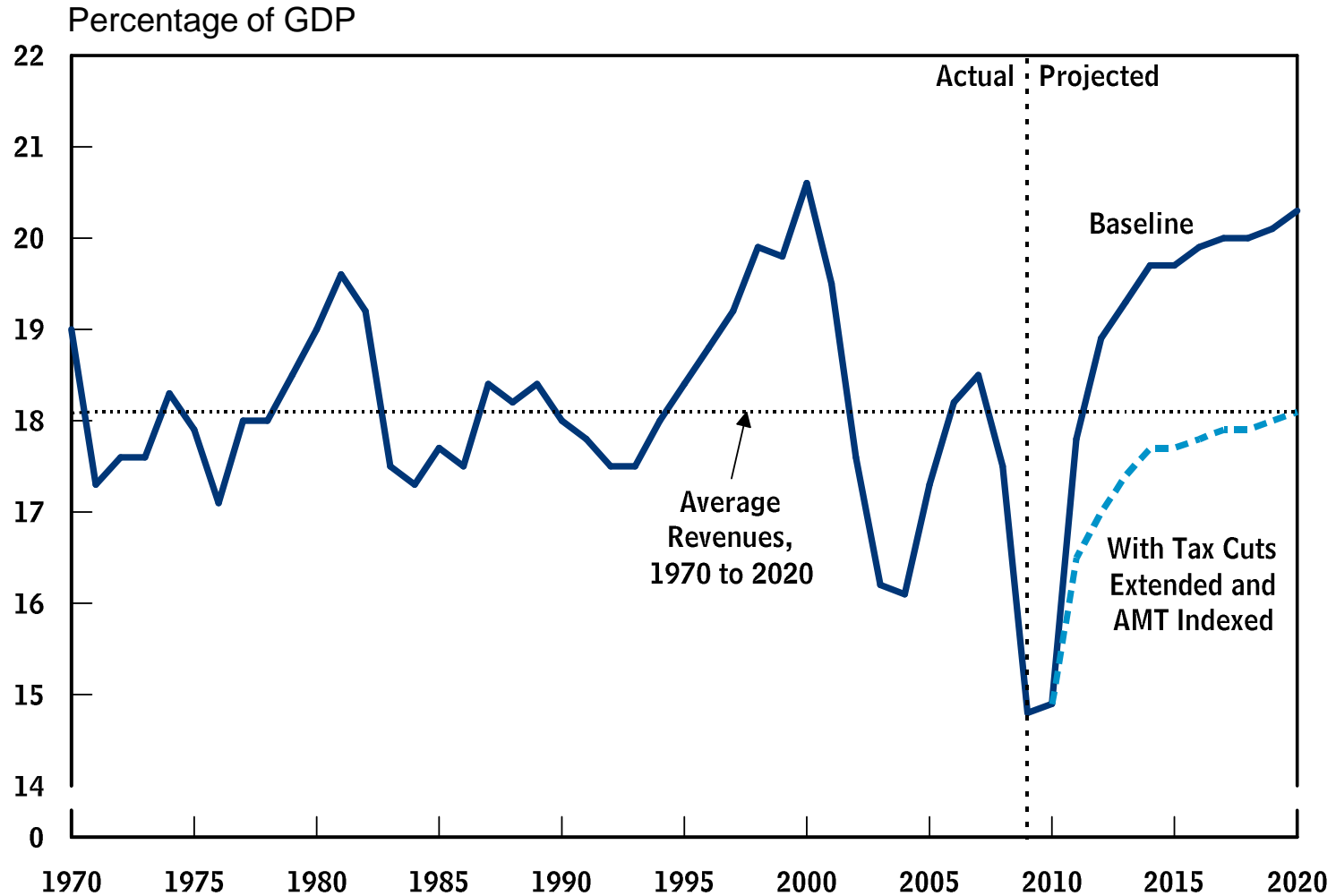


Effective Federal Tax Rates





Federal Revenues, 1970 to 2020



Note: Extending certain tax provisions enacted in 2001 and 2003 would also increase outlays for refundable tax credits. However, the outlay effect is shown here in the revenue line.



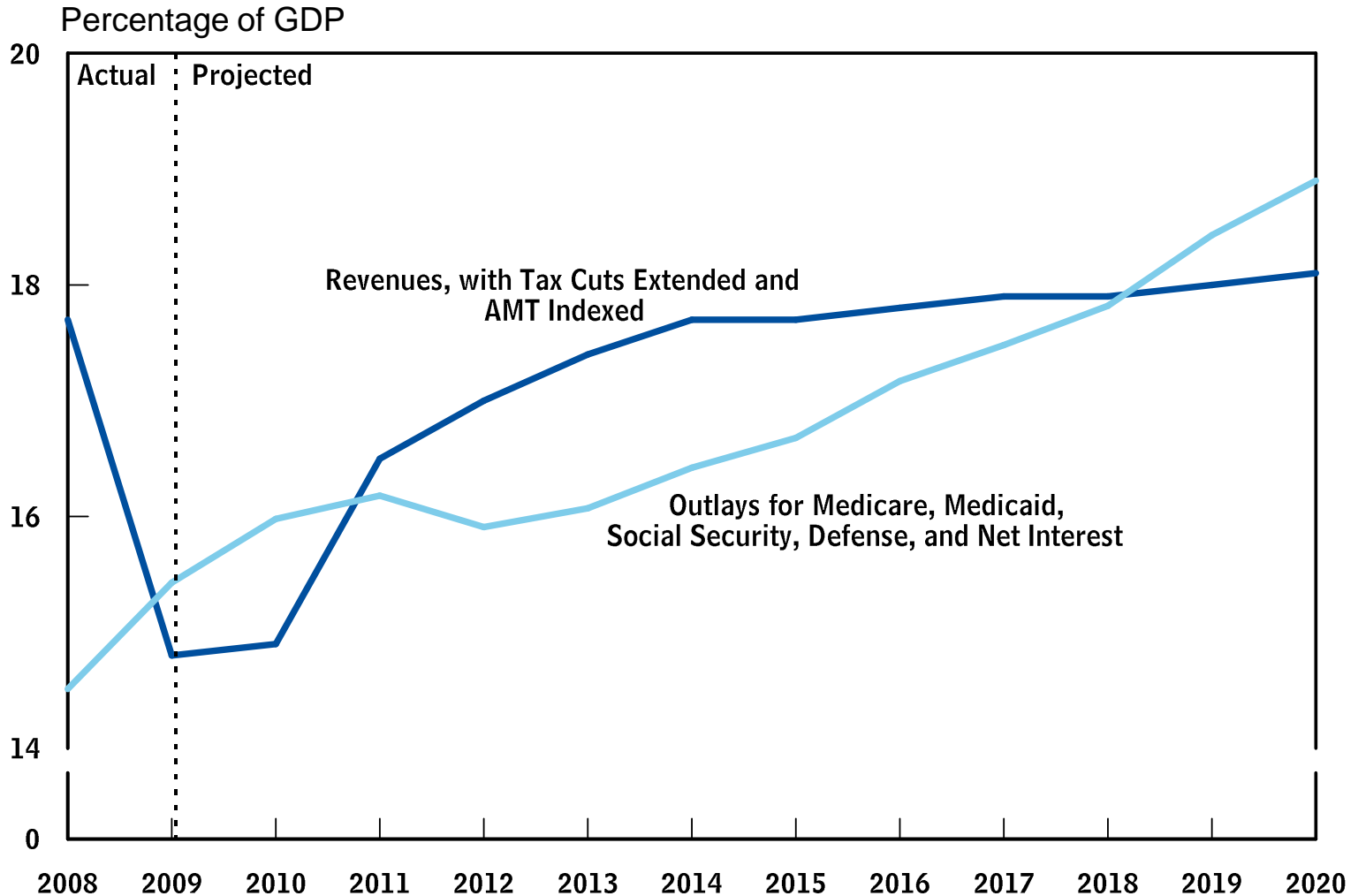
Components of the Federal Budget

	1970	2007	2020 March Baseline
	Percentage of GDP		
Revenues	19.0	18.5	20.3
Outlays	19.3	19.6	23.3
<i>Social Security, Medicare, and Medicaid</i>	3.8	8.2	11.1
<i>Defense</i>	8.1	3.9	3.6
<i>Other mandatory spending and nondefense discretionary spending</i>	6.0	5.8	5.3
<i>Net interest</i>	1.4	1.7	3.2
Deficit	0.3	1.2	3.0

Note: Figures are shown net of offsetting receipts where relevant.



Outlays for Some Key Federal Programs Will Exceed Total Federal Revenues Under “Current Policy”



Note: Extending certain tax provisions enacted in 2001 and 2003 would also increase outlays for refundable tax credits. However, the outlay effect is shown here in the revenue line.



If the Goal is to Balance the Budget in 2020

The Scale of The Problem		The Scale of Possible Solutions	
\$0.7 trillion	Baseline deficit	\$2.5 trillion	Social Security, Medicare, and Medicaid
\$1.4 trillion	Deficit if 2001 and 2003 tax rate cuts are extended and AMT is indexed	\$1.2 trillion	Other mandatory spending and nondefense discretionary spending
		\$0.8 trillion	Defense
		\$2.4 trillion	Individual income tax



Conclusion

- The problem posed by the federal budget deficit is not its current level, but its trajectory—especially if policymakers make changes to current law to maintain what many people view as current policy.
- In the past several decades, the country paid for increases in Social Security, Medicare, and Medicaid spending through cuts in defense spending relative to the size of the economy. That approach is not feasible in the future. Instead, significant changes will be needed in taxes or spending directly visible to many Americans.