



Congressional Budget Office

American Association for Budget and Program Analysis

The Economic and Budget Outlook

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Director

November 24, 2009



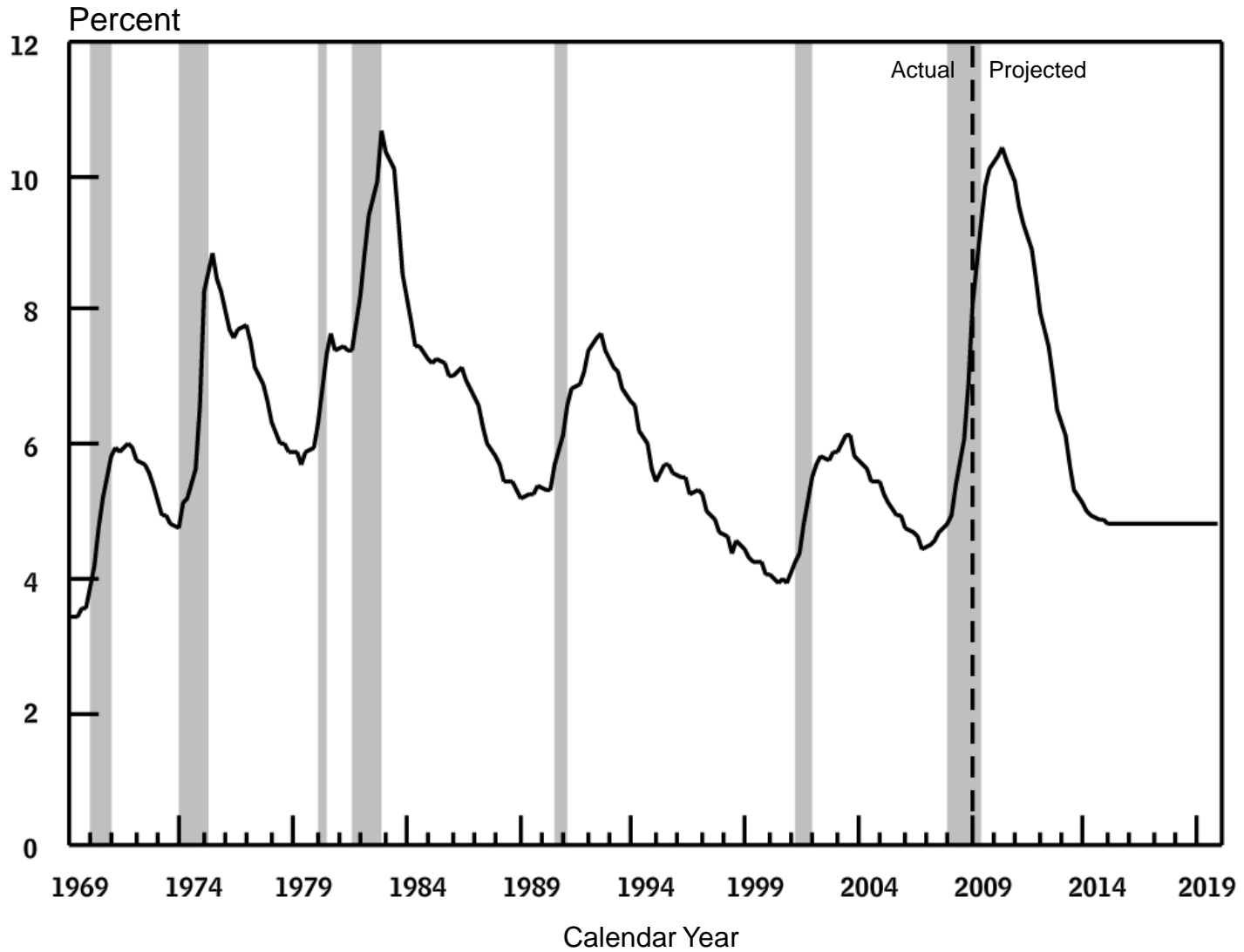
The Economic Outlook:

“CBO’s economic forecast anticipates a relatively slow and tentative recovery.”

— CBO, Summer Update
August 2009

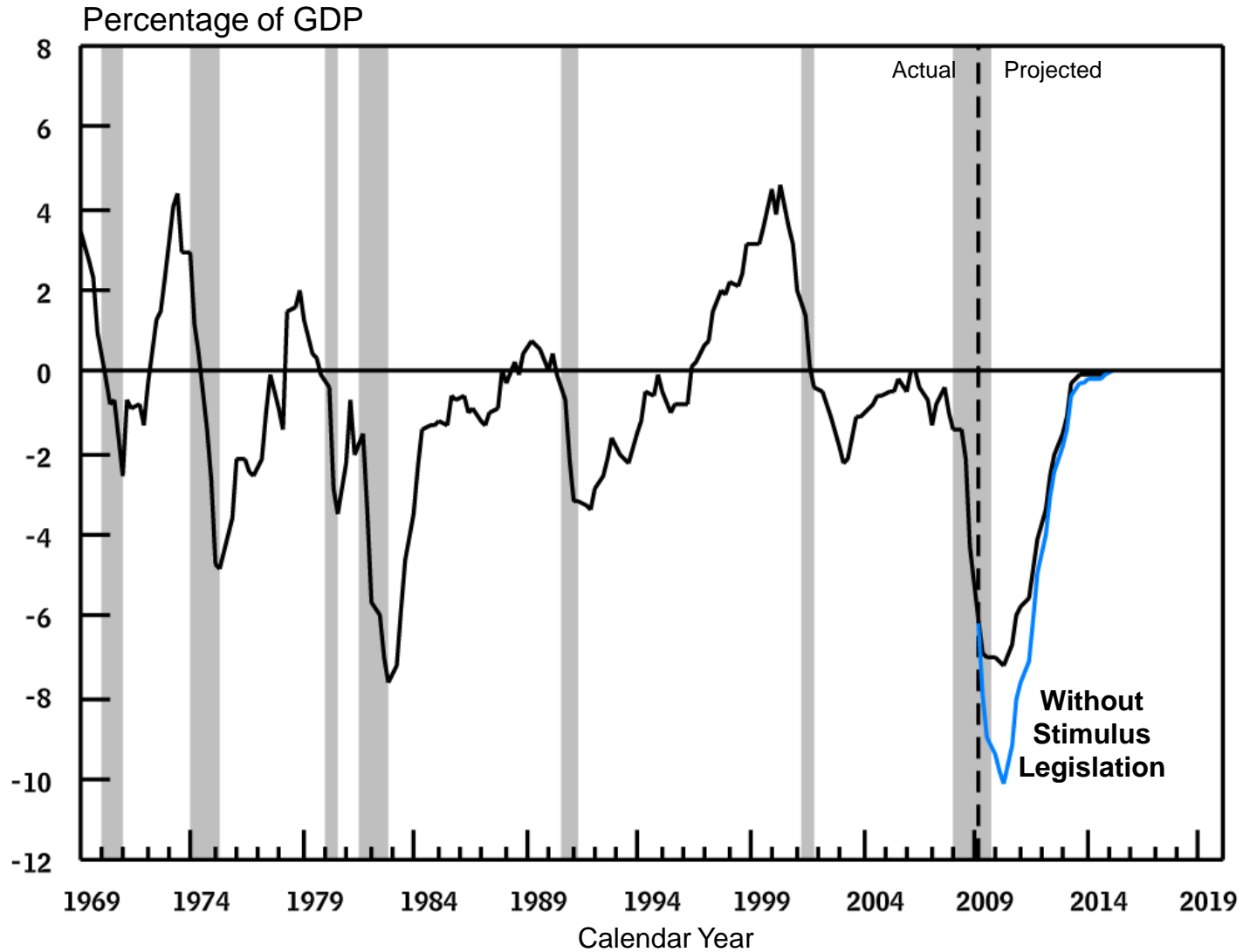


Unemployment Rate



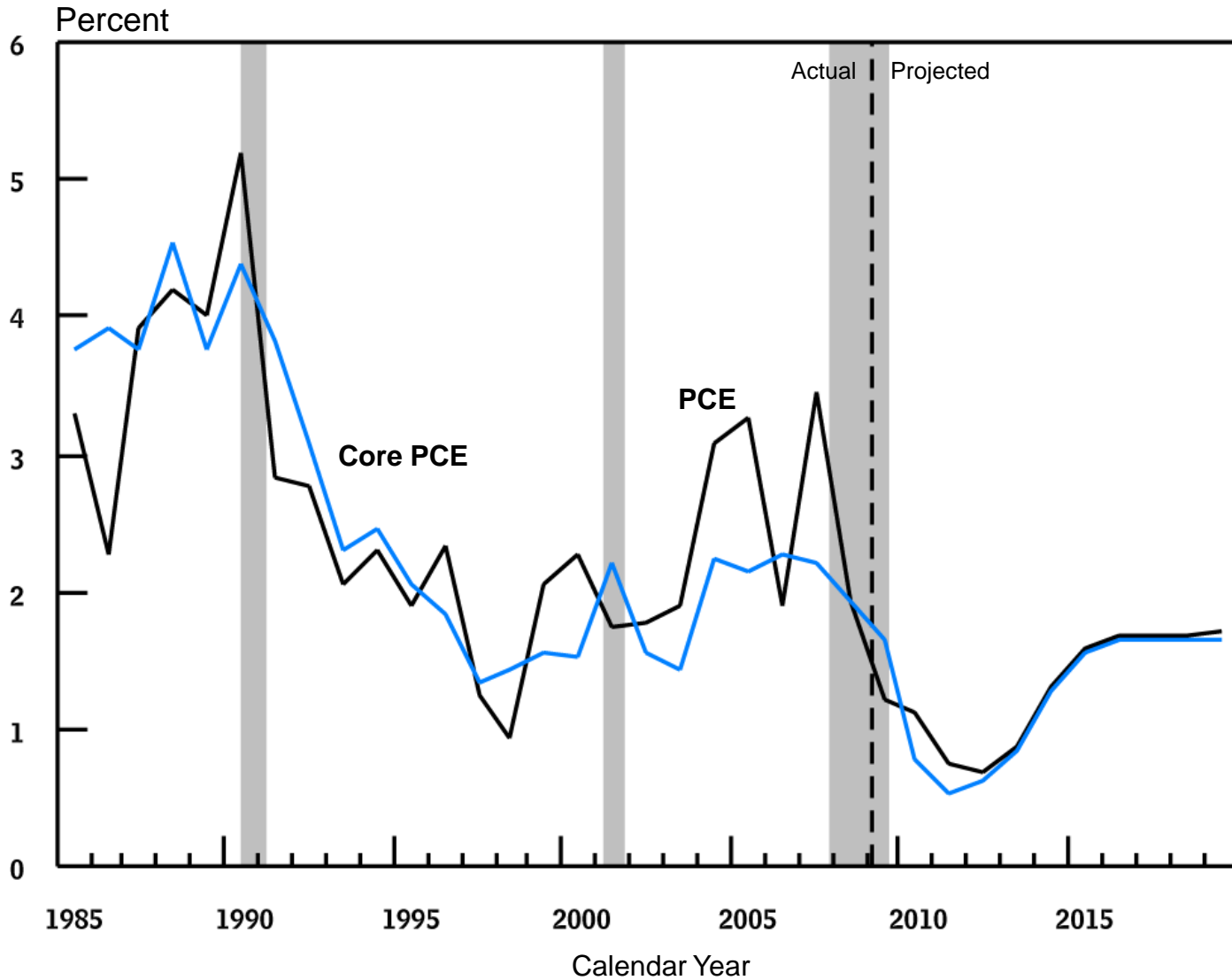


The GDP “Gap”





Inflation Rate





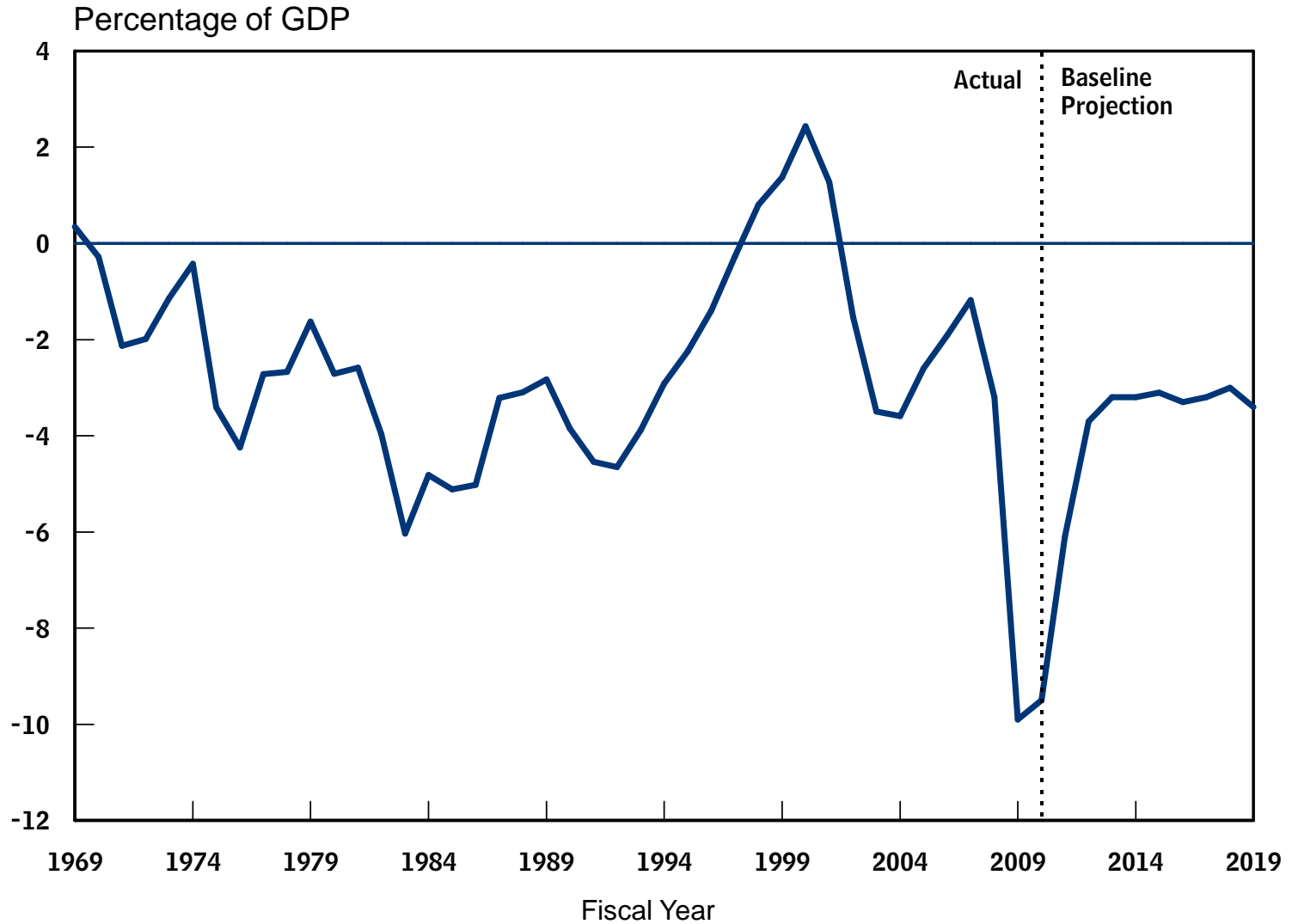
The Short-Term Budget Outlook:

“Over the coming years, as the economy improves and spending related to the financial rescue and the economic stimulus package abates, the deficit is projected to gradually shrink.”

— CBO, Summer Update
August 2009

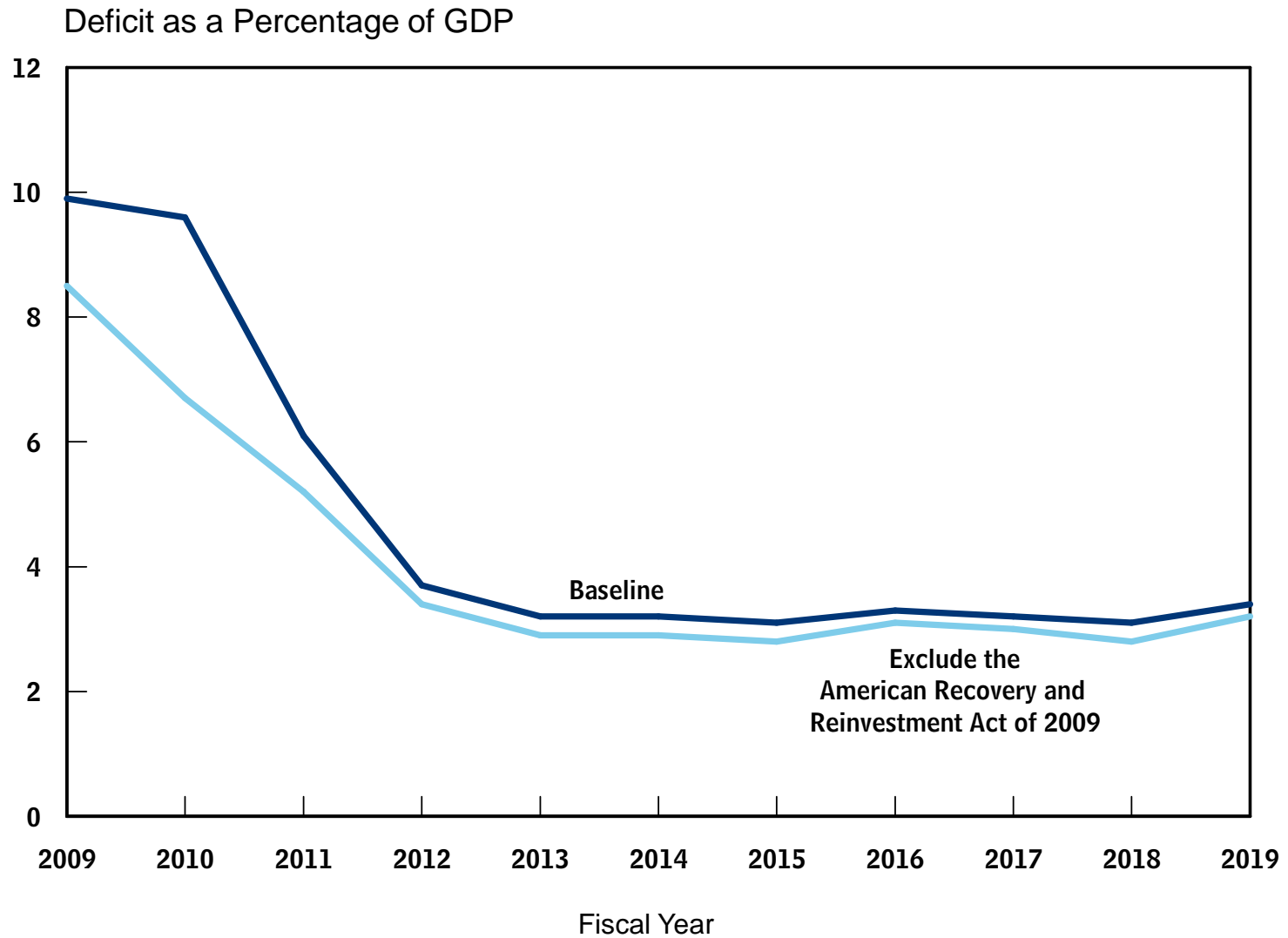


Federal Deficit or Surplus



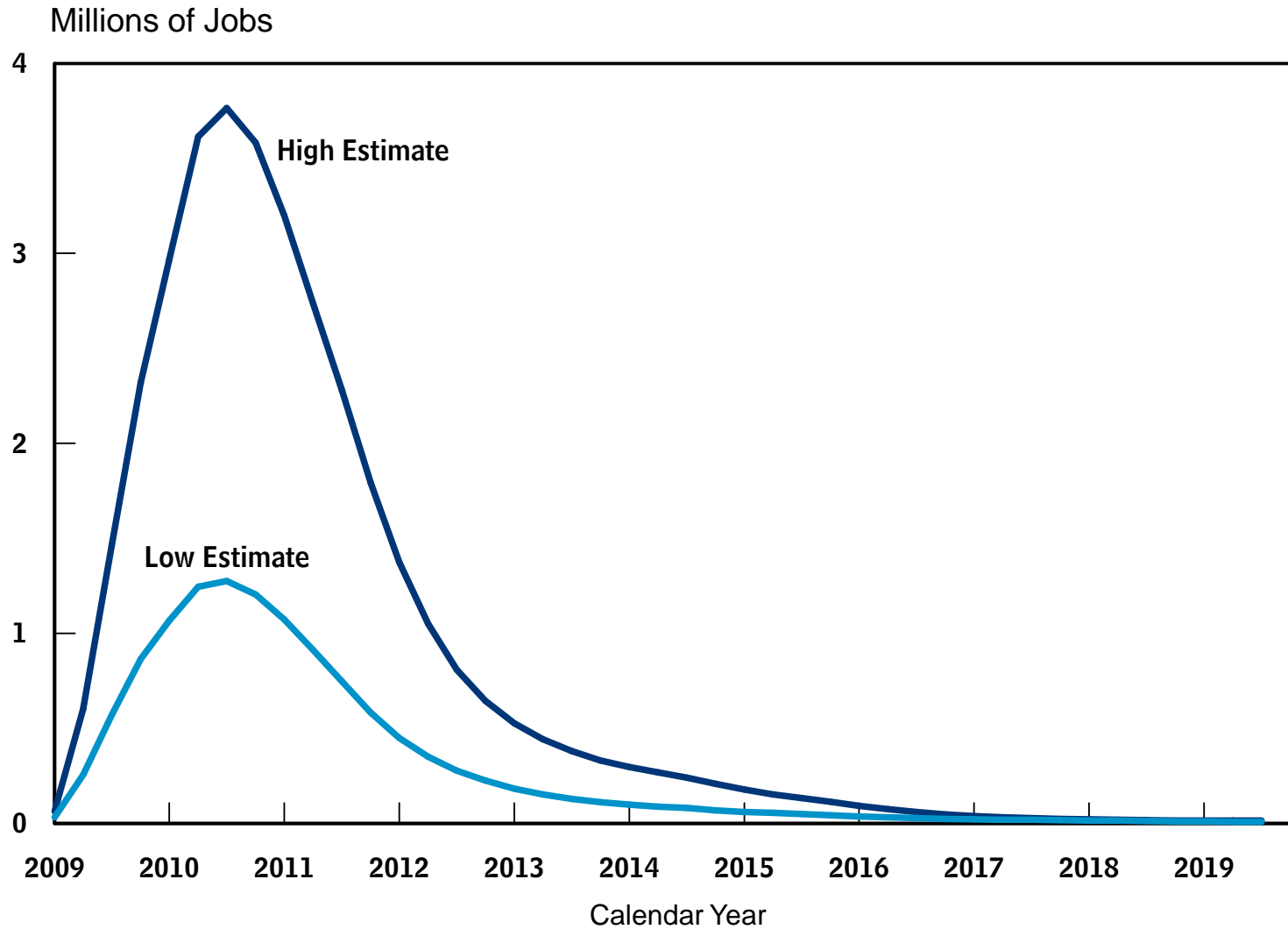


Withdrawal of Fiscal Stimulus





The Effect of ARRA on Employment



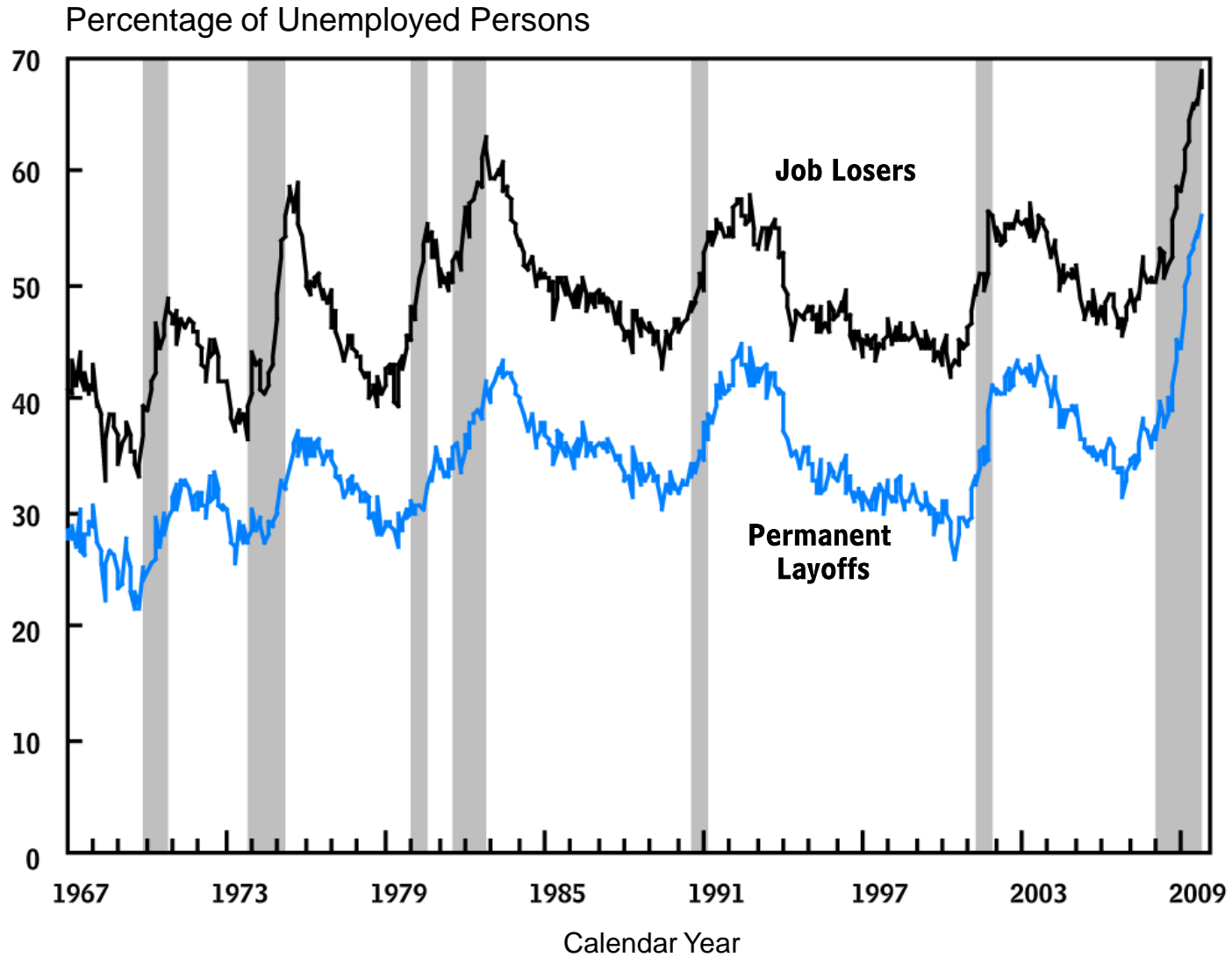


Options for Further Stimulus

- Create Jobs Directly
- Support Businesses
- Boost Demand
- Modify Mortgage and Housing Policy

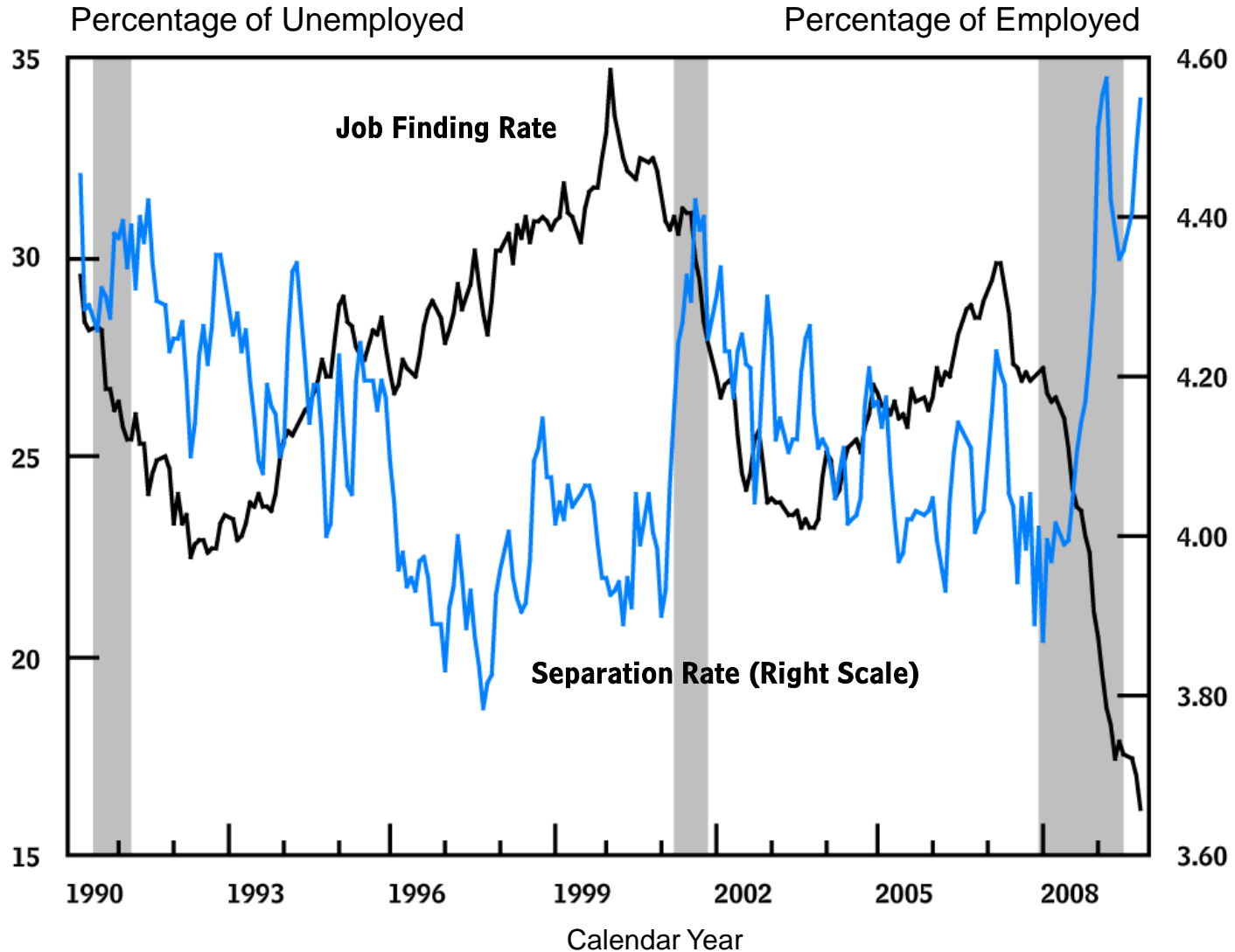


Reasons for Unemployment





Job Finding and Separation Probabilities





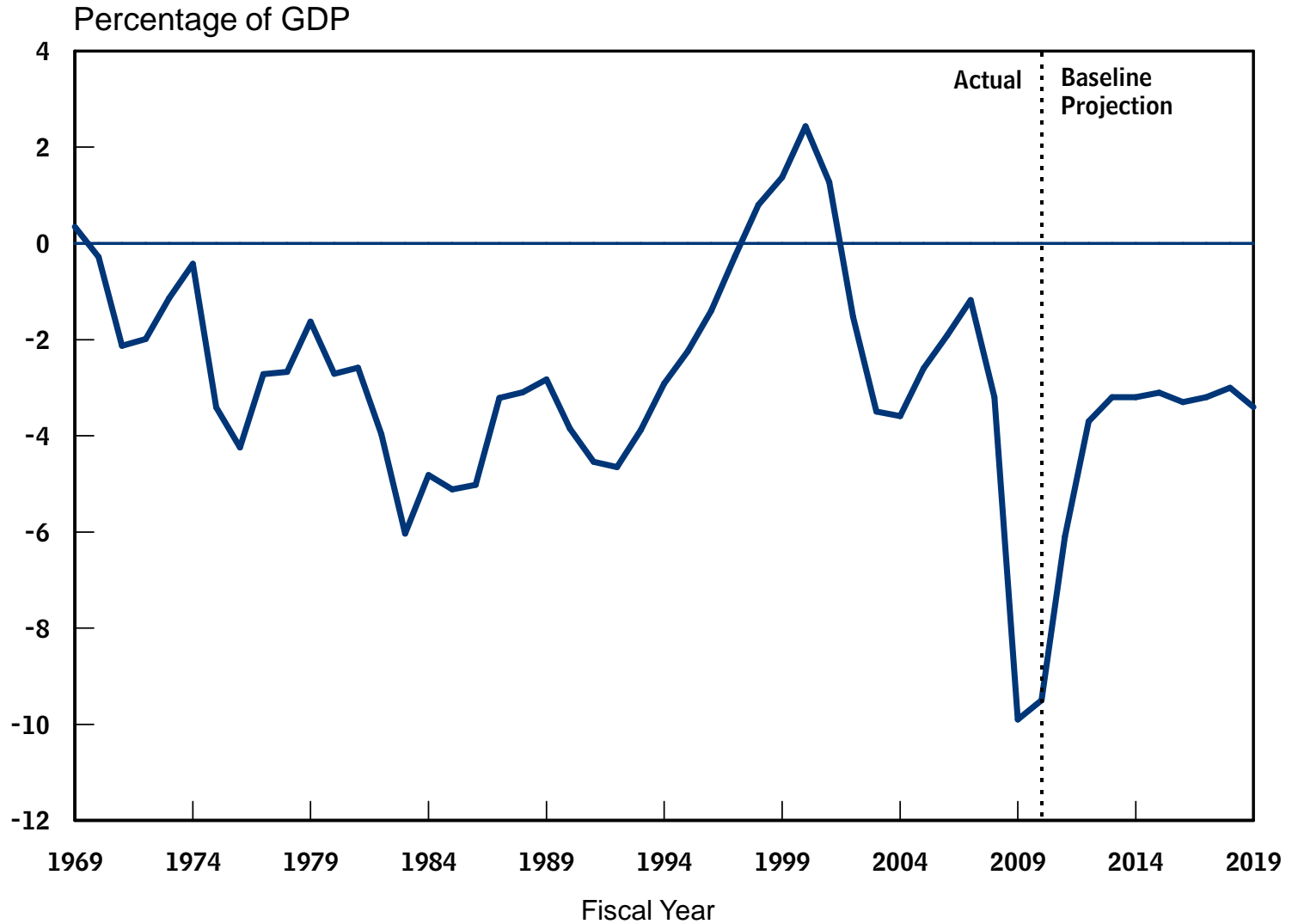
The Medium-Term and Long-Term Budget Outlook:

“The federal fiscal situation remains grim.”

-- CBO, Summer Update
August 2009



Federal Deficit or Surplus



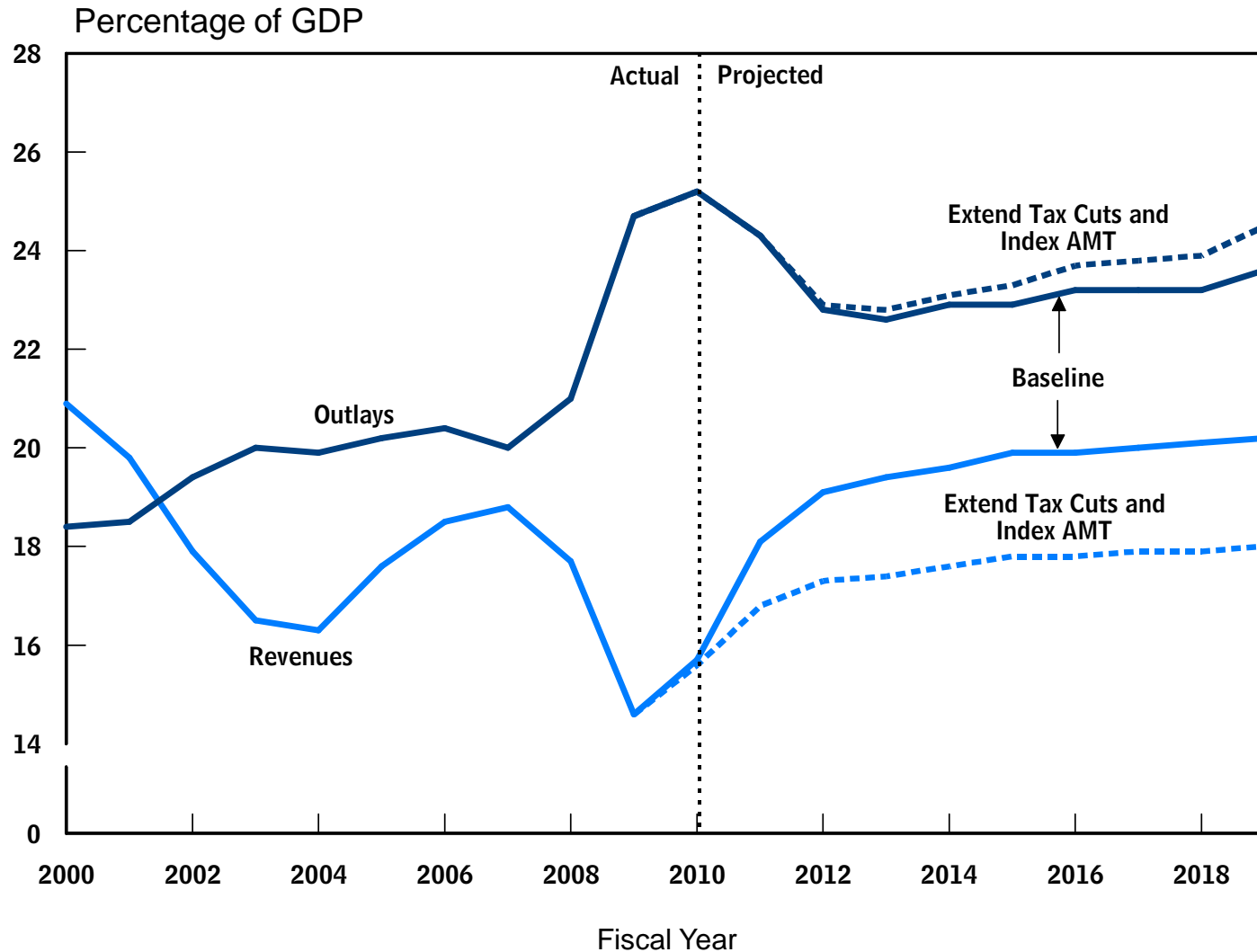


Three Reasons That the Fiscal Challenge Is Especially Acute

- **Current *policy* as perceived by many people would generate much larger deficits than current *law* as captured in CBO's baseline.**
- Federal debt is already very large relative to GDP by historical standards.
- Population aging and rising health spending will continue to push up federal spending under current law.



Revenues and Outlays Under Policy Alternative to Extend Tax Cuts and Index Alternative Minimum Tax



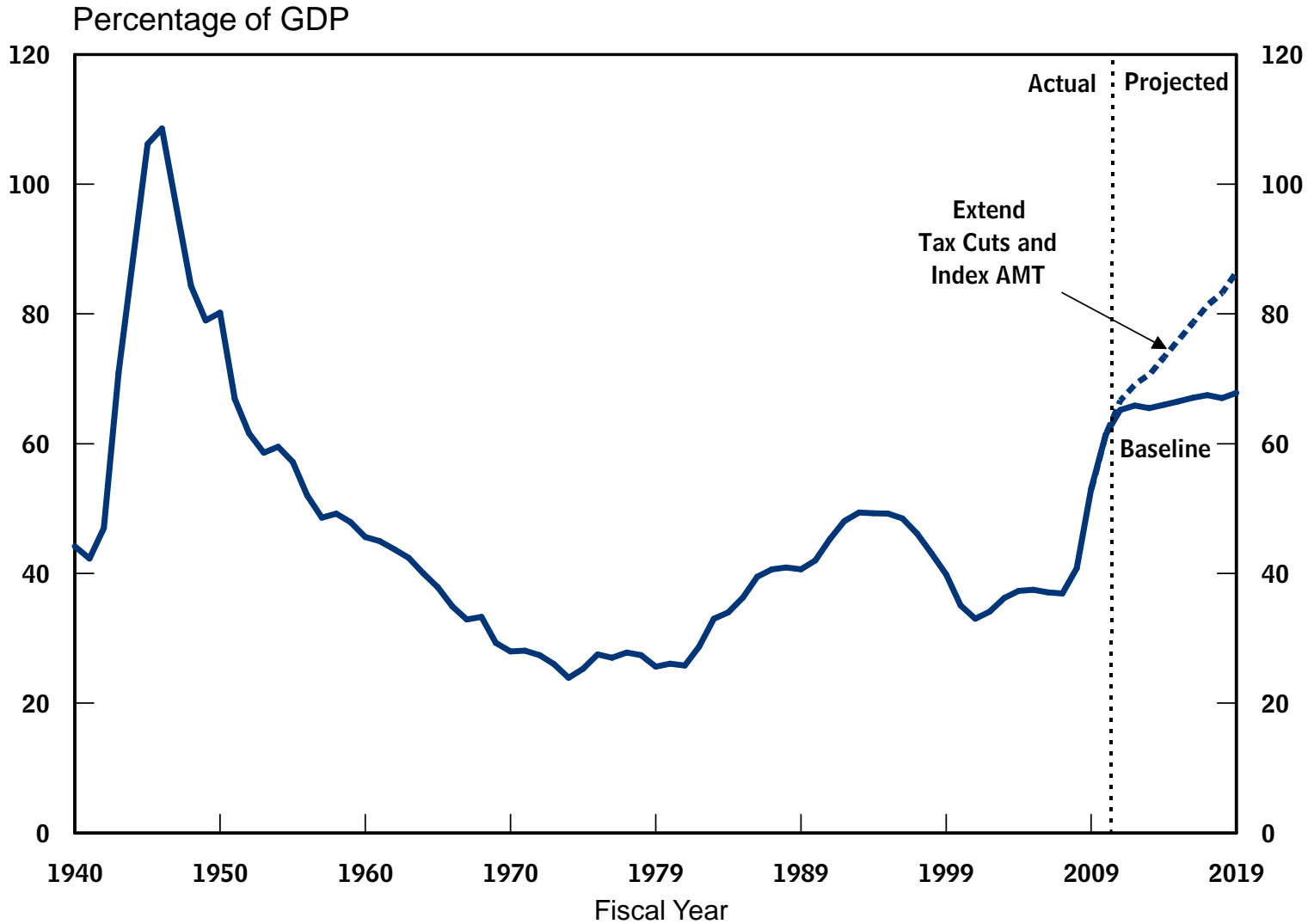


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Federal Debt Held by the Public





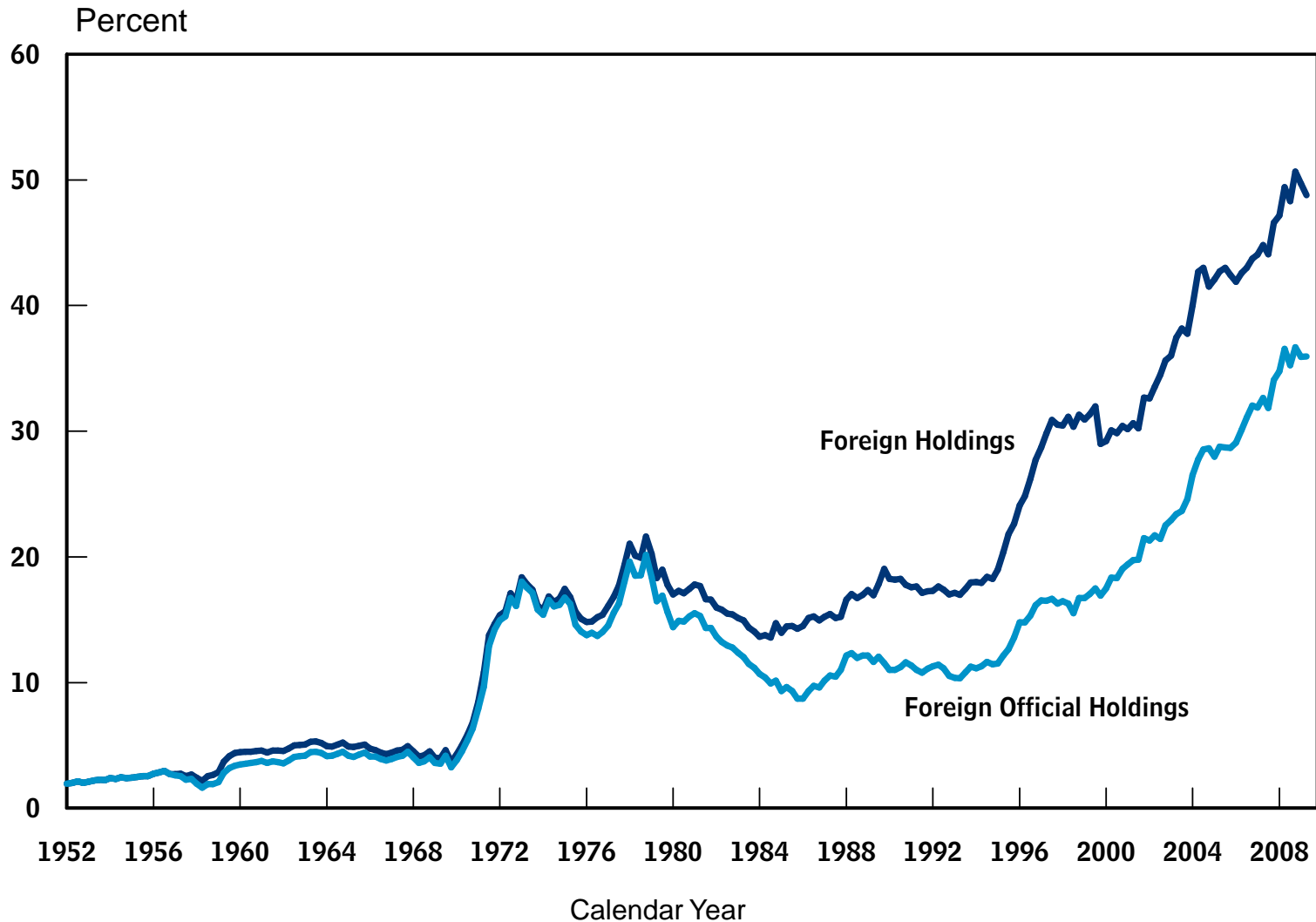
Why Does Rising Federal Debt Matter?

- Possible Crises Induced by Debt
 - Capital flight from United States and resulting drop in value of the dollar and jump in interest rates
 - Pressure on Federal Reserve to raise inflation

- Ongoing Costs of Debt
 - Tax revenues used to pay interest rather than to finance current programs
 - Reduction in saving, investment, output, wages, and incomes relative to what would occur otherwise

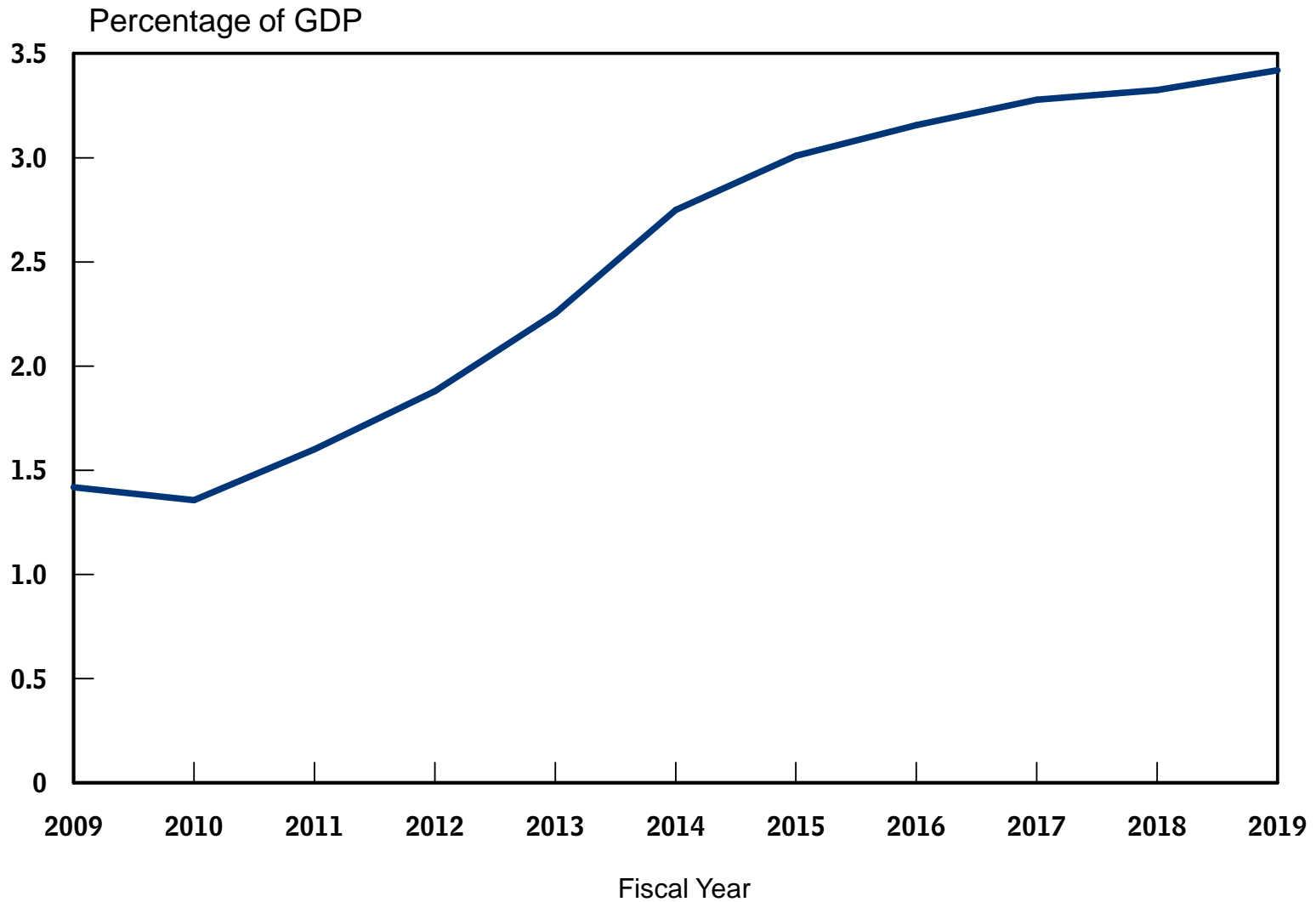


Foreign Holdings as a Share of U.S. Debt Held by the Public





Net Interest on the Debt



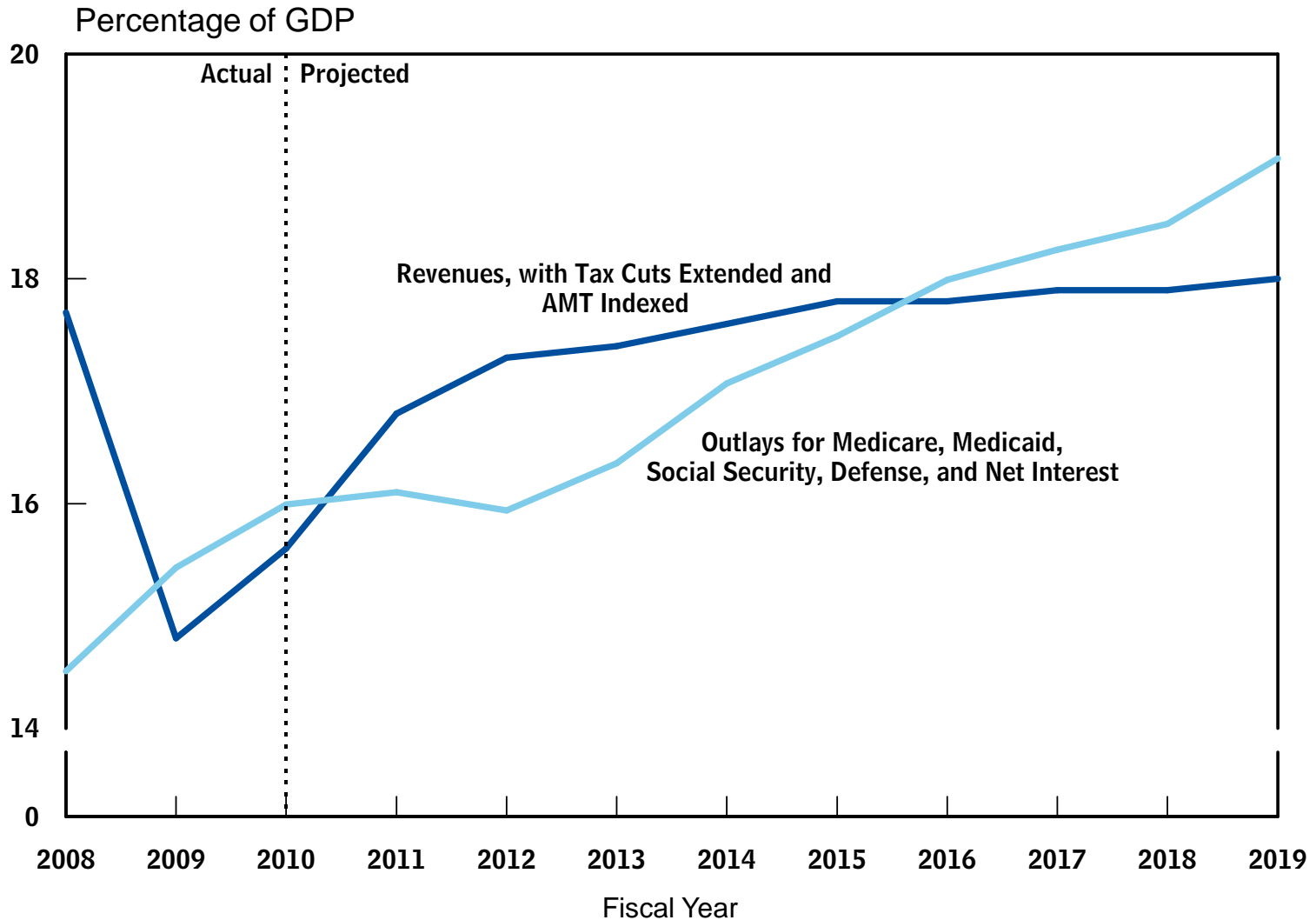


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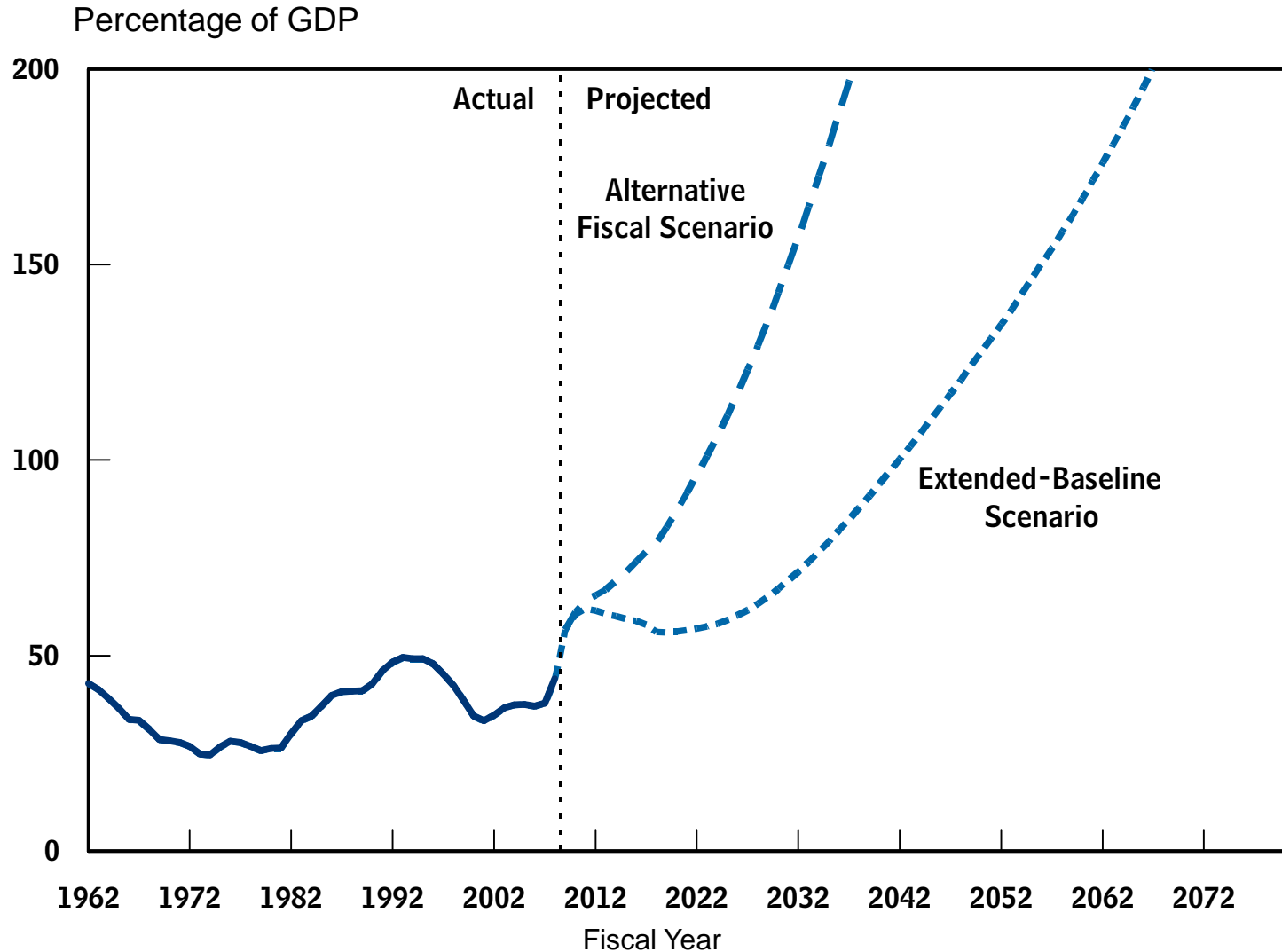


Revenues Relative to Outlays for Key Programs



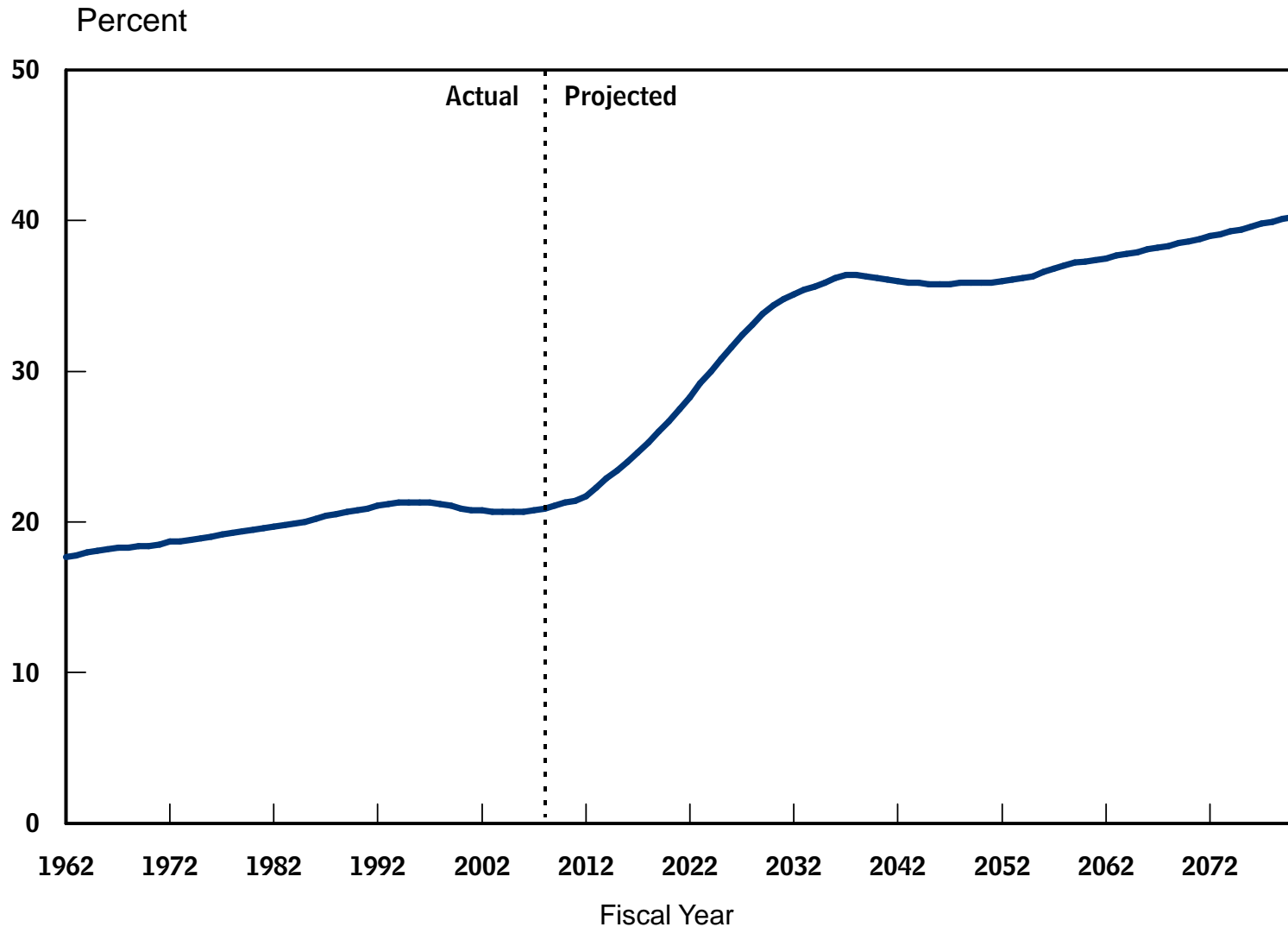


Federal Debt Under CBO's Long-Term Budget Scenarios



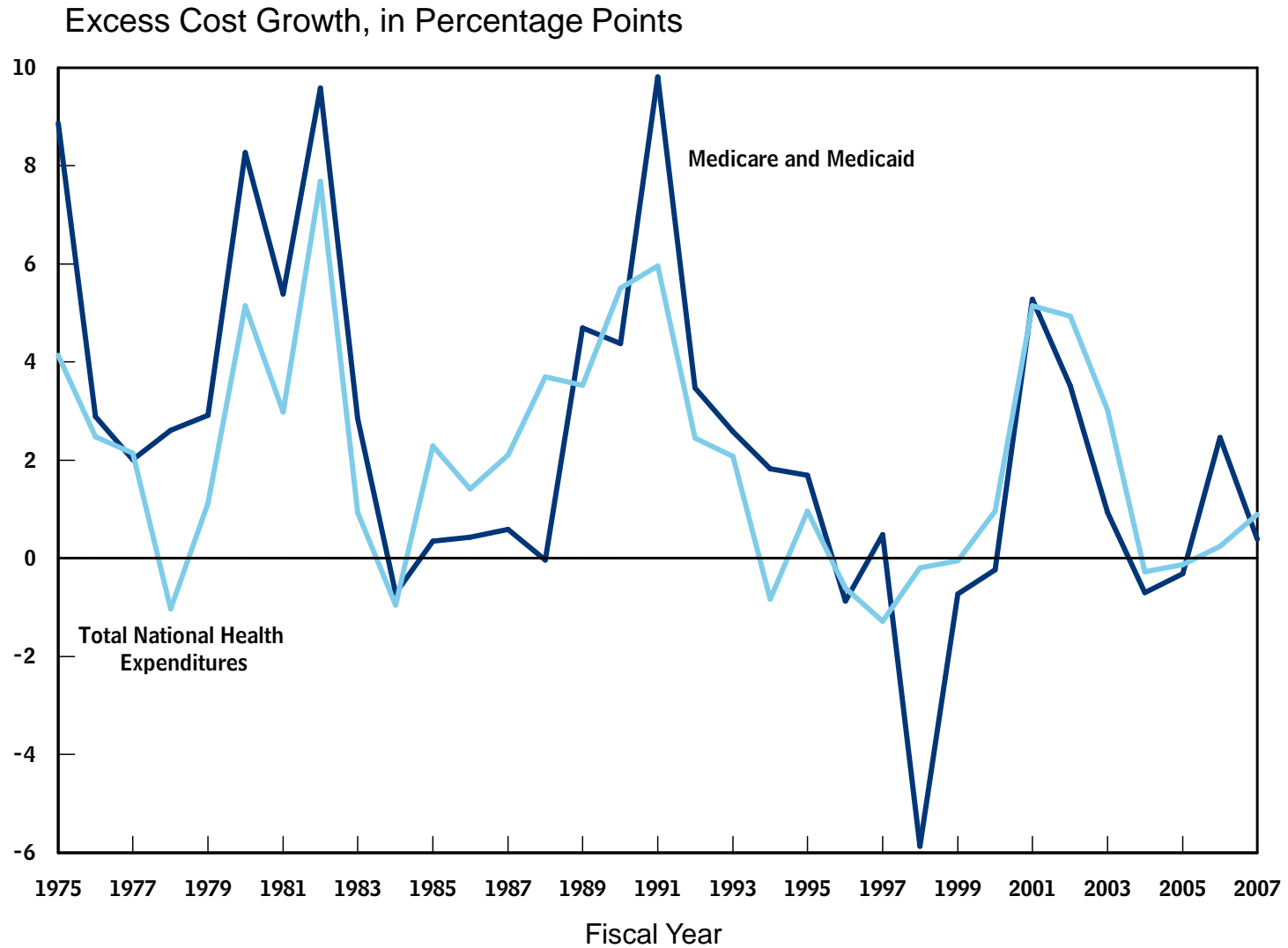


The Population Age 65 or Older as a Percentage of the Population Ages 20 to 64



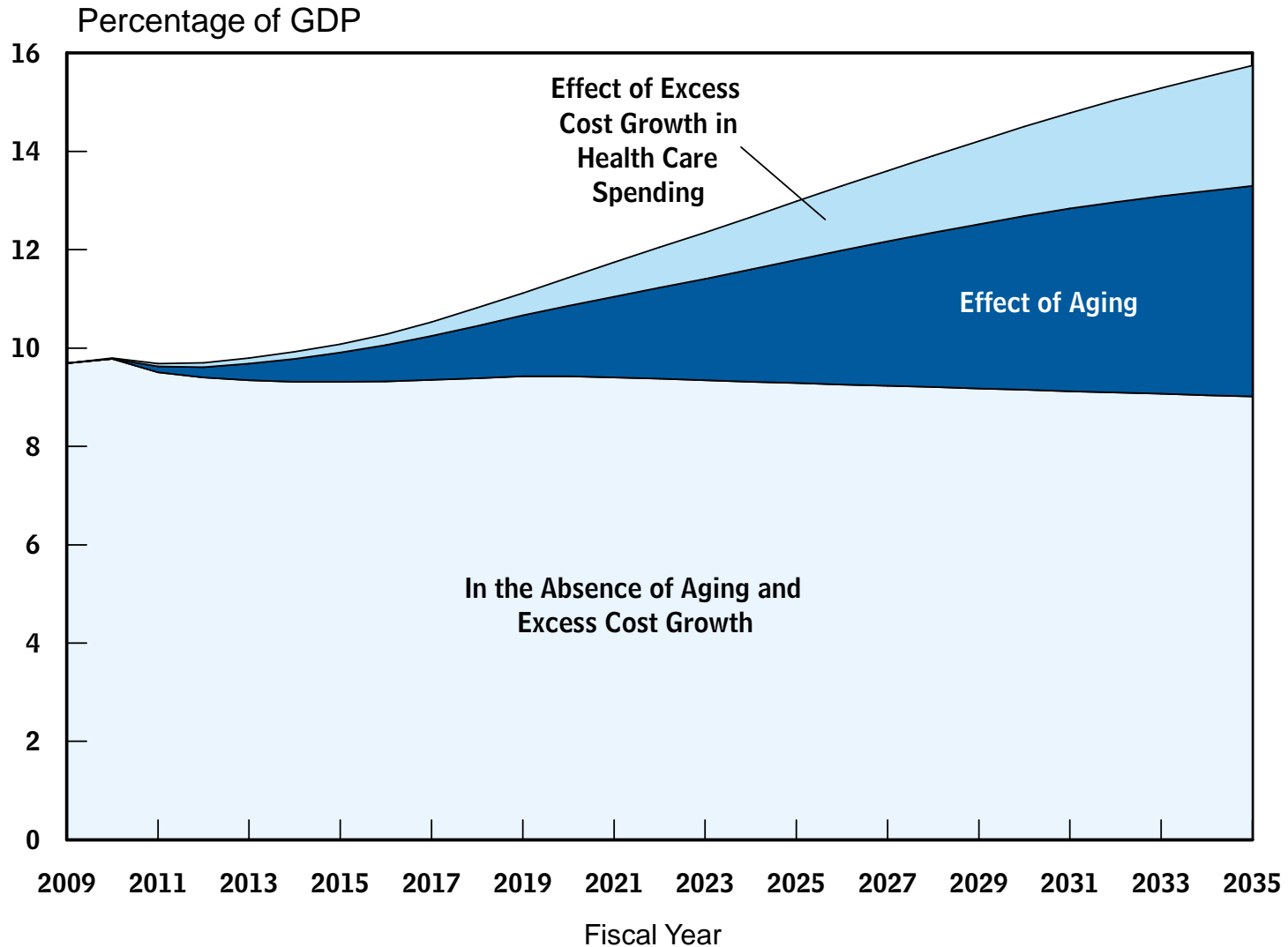


Rising Health Care Spending



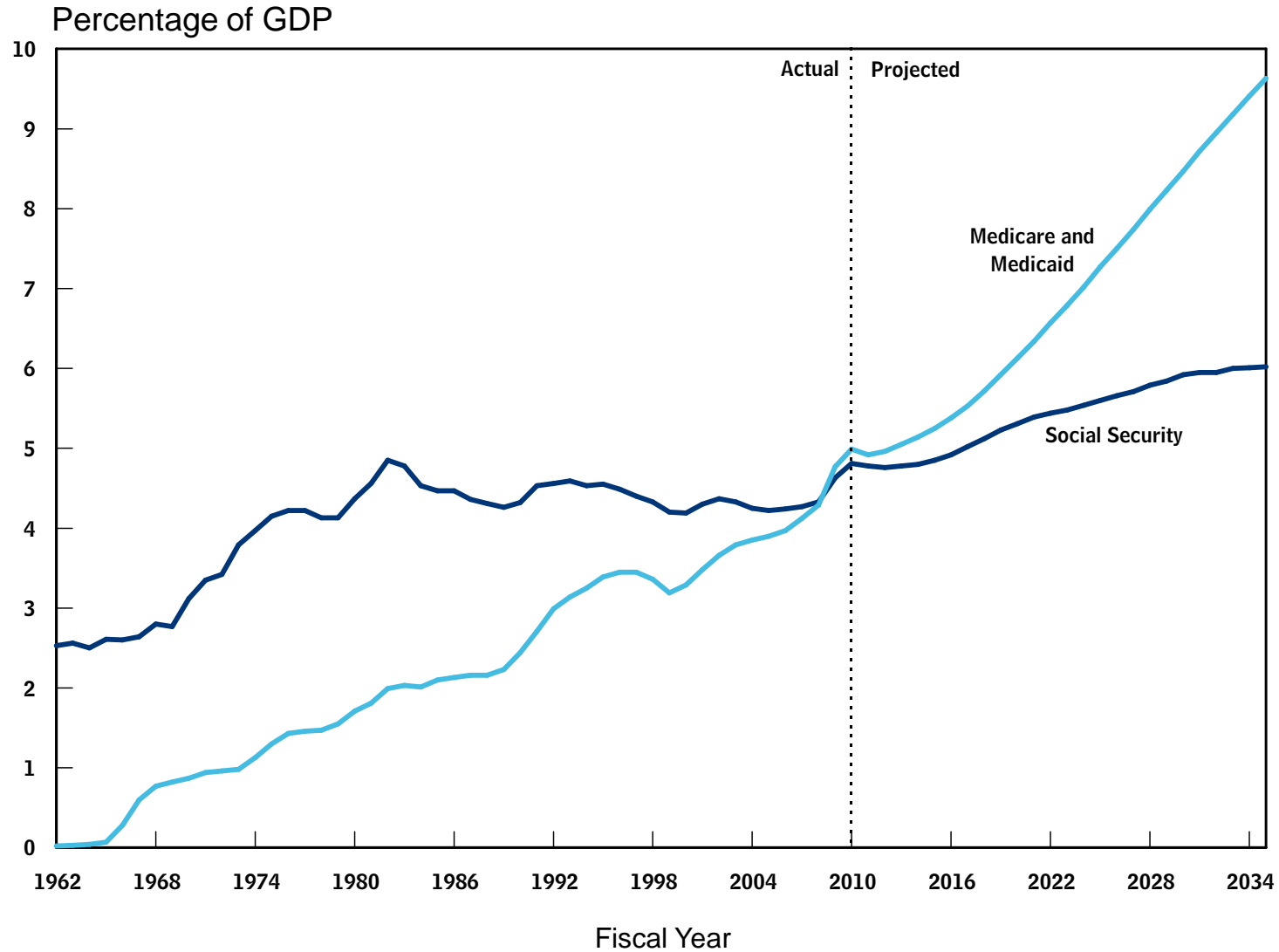


Factors Explaining Future Federal Spending on Medicare, Medicaid, and Social Security





Federal Spending for Social Security, Medicare, and Medicaid





Some Policy Options to Reduce Projected Spending for Social Security

- Increase the Retirement Age
 - Index to longevity?
 - Social Security alone or also Medicare?

- Decrease Benefits
 - Across-the-board?
 - Targeted at higher-income beneficiaries or other subgroups?



Some Policy Options to Reduce Projected Spending for Medicare and Medicaid

- **Decrease Payment per Health Care Service**
 - Reductions relative to current law play a significant role in current reform plans.
 - Will reductions lead to increased efficiency, lower income for providers, or reduced access to care or quality of care?

- **Decrease Number of Health Care Services Provided**
 - Could government policy improve people's health, and would that reduce demand for services?
 - What is the appropriate role of comparative effectiveness research?
 - Can payments to providers be restructured to reward value rather than the number of services provided?
 - Should beneficiaries pay more in copayments and deductibles?



Some Policy Options to Raise Revenues

- Increase Rates in Current Tax Structure
 - Personal taxes or corporate taxes?
 - Tax income or tax consumption?
 - Broader base?
 - Increase efficiency?
 - Change distribution of tax burden?
 - Reduce complexity?

- Raise Revenue in New Ways
 - Value-added tax?
 - Tax on carbon emissions or auction of emission allowances?



The Bottom Line

The country faces a fundamental disconnect between the services people expect the government to provide, particularly in the form of benefits for older Americans, and the tax revenues that people are willing to send to the government to finance those services. The fundamental disconnect will have to be addressed in some way if the budget is to be placed on a sustainable course.