The Budget and Economic Outlook: An Update

The Congressional Budget Office (CBO) estimates that the federal budget deficit for 2009 will total $1.6 trillion, which, at 11.2 percent of gross domestic product (GDP), will be the highest since World War II. That deficit figure results from a combination of weak revenues and elevated spending associated with the economic downturn and financial turmoil. The deficit has been boosted by various federal policies implemented in response, including the stimulus legislation and aid for the financial, housing, and automotive sectors.

Although various indicators suggest that the recession may have ended or is likely to end within the next few months, CBO's economic forecast anticipates a relatively slow and tentative recovery. A number of forces, including global economic weakness, continued strains in financial markets, and households' desire to rebuild their savings, are expected to restrain economic growth for the next few years.

CBO estimates that, as the economy recovers, if current laws and policies remained in place, the deficit would shrink but remain above $500 billion per year, or more than 3 percent of GDP, throughout the 2010–2019 period. As a result, debt held by the public would continue to grow as a percentage of GDP during that time. That debt, which was as low as 33 percent of GDP in 2001, would reach an estimated 54 percent of GDP this year and grow to 68 percent of GDP by 2019.

Those baseline projections, which are similar in many respects to the projections CBO prepared in March, reflect spending and revenue assumptions that may underestimate potential deficits. Because they presume no changes in current tax laws, the projections assume the expiration of tax reductions enacted earlier in this decade and provisions that have kept the alternative minimum tax (AMT) from affecting many more taxpayers. Consequently, those assumptions result in projected revenues that, as a percentage of GDP, would be high by historical standards. They also assume that future annual appropriations are held constant in real (inflation-adjusted) terms, resulting in projections of discretionary spending that would be low, relative to GDP, by historical standards. Many other policy outcomes are possible, however. If, for example, those tax reductions were assumed to continue (along with the indexing of the AMT for inflation) and future annual appropriations were assumed to remain at their 2009 share of GDP, the deficit in 2019 would equal 8.5 percent of GDP.

Beyond the 10-year budget window, the nation will face further significant fiscal challenges posed by rising health care costs and the aging of the population. Continued large deficits and the resulting increases in federal debt would, over time, reduce economic growth. Putting the nation on a sustainable fiscal course will require some combination of lower spending and higher revenues than the amounts now projected.

The Budget Outlook from 2009 to 2019

The dramatic expansion of the deficit in 2009 (up from 3.2 percent of GDP in 2008) results from a projected rise in outlays of 24 percent (the largest percentage increase since 1952) and a drop in revenues of 17 percent from last year's levels (the largest percentage drop since 1932). Those changes have largely been the result of the severe economic downturn and the fiscal impact of federal policies enacted in response.

Summary Table 1.

CBO's Baseline Budget Outlook

	Actual 2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total, 2010-2014	Total, 2010-2019
							In Billions of Dollars							
Total Revenues	2,524	2,100	2,264	2,717	3,010	3,221	3,403	3,577	3,737	3,908	4,081	4,260	14,614	34,177
Total Outlays	2,983	3,688	3,644	3,638	3,600	3,759	3,961	4,135	4,358	4,534	4,703	4,982	18,602	41,314
Total Deficit (-) or Surplus	**-459**	**-1,587**	**-1,381**	**-921**	**-590**	**-538**	**-558**	**-558**	**-620**	**-626**	**-622**	**-722**	**-3,988**	**-7,137**
On-budget	-642	-1,720	-1,485	-1,029	-721	-684	-711	-710	-765	-761	-747	-834	-4,630	-8,446
Off-budget[a]	183	133	104	108	131	146	152	151	145	136	125	111	642	1,310
Debt Held by the Public at the End of the Year	5,803	7,612	8,868	9,782	10,382	10,870	11,439	11,986	12,581	13,174	13,611	14,324	n.a.	n.a.
							As a Percentage of Gross Domestic Product							
Total Revenues	17.7	14.9	15.7	18.1	19.1	19.4	19.6	19.9	19.9	20.0	20.1	20.2	18.5	19.3
Total Outlays	21.0	26.1	25.2	24.3	22.8	22.6	22.9	22.9	23.2	23.2	23.2	23.6	23.5	23.4
Total Deficit	**-3.2**	**-11.2**	**-9.6**	**-6.1**	**-3.7**	**-3.2**	**-3.2**	**-3.1**	**-3.3**	**-3.2**	**-3.1**	**-3.4**	**-5.0**	**-4.0**
Debt Held by the Public at the End of the Year	40.8	53.8	61.4	65.2	65.9	65.5	66.0	66.5	67.1	67.5	67.0	67.8	n.a.	n.a.
Memorandum:														
Gross Domestic Product (Billions of dollars)	14,222	14,140	14,439	14,993	15,754	16,598	17,319	18,019	18,760	19,524	20,308	21,114	79,103	176,828

Source: Congressional Budget Office.

Note: n.a. = not applicable.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds and the net cash flow of the Postal Service.

On the basis of tax collections through July 2009, CBO expects federal revenues to decline by more than $400 billion from last year's total. Revenues are projected to be 14.9 percent of GDP, nearly 3 percentage points below the 2008 level (see Summary Table 1). Although CBO anticipates declines in almost all sources of revenue, the decrease is largely attributable to the drop in receipts from individual income taxes (which are expected to fall from 8.1 percent of GDP to 6.5 percent) and corporate income taxes (which are estimated to decline from 2.1 percent of GDP to 1.0 percent).

Outlays will rise by about $700 billion this year, in CBO's estimation. Much of that increase results from legislation enacted in calendar year 2008 in response to turmoil in the housing and financial markets—in particular, $133 billion for the Troubled Asset Relief Program (TARP) and $291 billion for the estimated costs of placing Fannie Mae and Freddie Mac into conservatorship.

CBO expects that total spending in 2009 from funding provided by the American Recovery and Reinvestment Act (ARRA, Public Law 111-5) will reach about $115 billion.

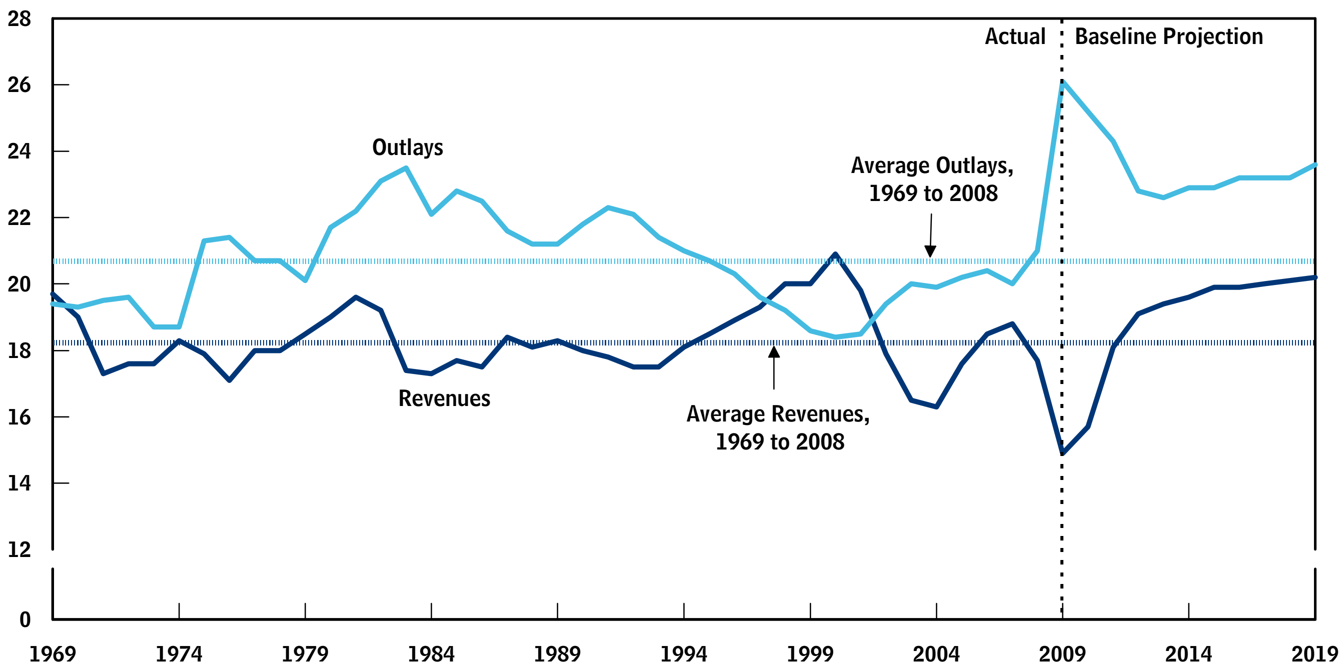
Since it last issued baseline projections in March, CBO has reduced its estimate of the deficit for 2009 by $80 billion. Both outlays and revenues are now expected to be lower in the current year than previously estimated, by $165 billion and $85 billion, respectively. A large drop (of $203 billion) in the estimated subsidy cost of the TARP dominates the change in projected outlays for 2009; other changes (mostly in revenues) offset much of that decrease.

CBO has also updated its baseline projections for the coming decade. In accordance with long-standing procedures, CBO's projections assume that current laws and

Summary Figure 1.

Total Revenues and Outlays

(Percentage of gross domestic product)



Source: Congressional Budget Office based on data from the Office of Management and Budget.

policies remain in place.[1] The resulting baseline is therefore not intended to be a prediction of future budgetary outcomes; rather, it serves as a benchmark that lawmakers can use to measure the effects of spending or revenue proposals.

As the economy improves and spending related to the financial rescue and the economic stimulus package tails off, the deficit is projected to gradually diminish; by 2013, it would amount to 3.2 percent of GDP (about the same level as in 2008), under the assumption that various tax provisions expire as scheduled and that discretionary spending rises at the rate of inflation. Between 2013 and 2019, deficits are projected to range from 3.1 percent to 3.4 percent of GDP, well above the 2.4 percent of GDP that they have averaged over the past 40 years.

Outlays are projected to inch down each year from 2010 to 2012 as spending under ARRA concludes and as the anticipated economic recovery allows payments for unemployment compensation and other benefit programs to return to more typical levels. Total spending is projected to head up again beginning in 2013, with outlays for Medicare, Medicaid, and Social Security contributing significantly to that growth. Over the 2010–2019 period, under the assumptions for CBO's baseline, total outlays would average 23.4 percent of GDP—higher than the 20.7 percent of GDP that federal spending has averaged over the past 40 years (see Summary Figure 1).

Revenues are projected to rise from 14.9 percent of GDP this year to 15.7 percent in 2010. Then, in CBO's baseline, projected revenues increase sharply with the expiration of provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001, the Jobs and Growth Tax Relief Reconciliation Act of 2003, and ARRA. By 2012, revenues in the baseline reach 19.1 percent of GDP. Because of the structure of the individual income tax, projected revenues rise slowly thereafter relative to the size of the economy, reaching 20.2 percent of GDP by 2019. By comparison, federal

1. Exceptions exist for discretionary funding provided in ARRA, as well as for certain mandatory programs—primarily those established on or before the date the Balanced Budget Act of 1997 was enacted—and for expiring excise taxes that are dedicated to trust funds.

revenues have averaged 18.3 percent of GDP over the past 40 years.

Debt held by the public is projected to exceed 61 percent of GDP by the end of next year, which is the highest level since 1952, and reach 68 percent by the end of 2019. That accumulating federal debt, coupled with rising interest rates, would lead to a near tripling of net interest payments (relative to the size of the economy) between 2009 and 2019.

Since March, projected deficits over the 2010–2019 period have risen by $2.7 trillion. About half of the increase is the result of assuming that appropriations in each year include an additional $106 billion (with adjustments for inflation) to reflect the supplemental appropriations that were enacted in June (mostly to finance military operations in Iraq and Afghanistan); that approach is in accordance with rules governing projections of discretionary spending in the baseline. Reductions in projected revenues and increases in interest costs account for most of the remaining difference.

The Economic Outlook

CBO anticipates that economic activity will begin to rebound in the second half of 2009, largely the result of fiscal stimulus provided under ARRA, improving conditions in the financial markets, slower declines in both residential and business investment, and a slowing in the rate at which inventories are being drawn down. However, a number of forces are expected to restrain growth for some time: Economies worldwide remain weak, financial markets continue to be strained, and households will want to restrain spending in order to rebuild their savings. Moreover, experience suggests that recovery from recessions triggered by financial crises and sharp drops in the value of assets tends to be protracted; CBO's forecast reflects that experience.

Specifically, CBO estimates positive economic growth during the second half of calendar year 2009, at an annual rate of 1.6 percent, following declines at an annual rate of 6.4 percent in the first quarter and 1.0 percent in the second quarter. In CBO's forecast, real GDP grows by 2.8 percent between the fourth quarter of 2009 and the fourth quarter of 2010, by 3.8 percent in 2011, and by an average of 4.5 percent in 2012 and 2013 (see Summary Table 2). With the economy functioning well below its potential level, inflation is projected to remain very low; the consumer price index for all urban consumers (CPI-U), with food and energy prices excluded, is expected to increase by 1.6 percent this year, by 1.1 percent in 2010, and by 1.0 percent in 2011 (as measured by the change in the index from the fourth quarter of one year to the fourth quarter of the next year).

Despite the anticipated turnaround in economic growth, at least several more months of declines in employment are anticipated, albeit at a slower pace than in the first half of this year. Hiring usually lags behind the initial stages of a recovery because firms tend to increase output by first boosting the number of hours that existing employees work, and their productivity, and only later by adding employees. In addition, the unemployment rate tends to lag behind the turning point because the number of people seeking work tends to rebound faster than employment. In CBO's forecast, the unemployment rate continues to rise, climbing from 9.3 percent this year to an average of 10.2 percent next year (peaking at 10.4 percent around the middle of the year), and then falls to 9.1 percent in 2011.

Interest rates are expected to remain at historically low levels for the next few years. In CBO's forecast, the interest rate on 3-month Treasury bills averages 0.2 percent in 2009 and 0.6 percent and 1.7 percent in 2010 and 2011, respectively; the rate on 10-year Treasury notes averages 3.3 percent in 2009, 4.1 percent in 2010, and 4.4 percent in 2011.

Between 2014 and 2019, CBO's projections indicate real growth that averages 2.4 percent and CPI-U inflation that averages 1.9 percent. By the agency's estimates, the unemployment rate will average 4.8 percent during the 2014–2019 period, and the interest rate on 3-month Treasury bills will average 4.7 percent and the rate on 10-year Treasury notes will average 5.5 percent.

The Long-Term Budget Outlook

Over the long term (beyond the 10-year baseline projection period), the budget remains on an unsustainable path. Unless changes are made to current policies, the nation will face a growing demand for budgetary resources caused by rising health care costs and the aging of the population. Continued large deficits and the resulting increases in federal debt over time would reduce long-term economic growth by lowering national saving

Summary Table 2.

CBO's Economic Projections for Calendar Years 2009 to 2019

	Forecast			Projected Annual Average	
	2009	2010	2011	2012–2013	2014–2019
	Fourth Quarter to Fourth Quarter (Percentage change)				
Real GDP	-1.0	2.8	3.8	4.5	2.4
GDP Price Index	1.6	0.9	0.3	0.7	1.6
PCE Price Index	1.2	1.1	0.8	0.8	1.6
Core PCE Price Index[a]	1.7	0.8	0.5	0.7	1.6
Consumer Price Index[b]	0.8	1.5	1.2	1.1	1.9
Core Consumer Price Index[a]	1.6	1.1	1.0	1.2	1.9
	Calendar Years				
Nominal GDP					
Billions of dollars	14,163	14,570	15,146	16,799 [c]	21,320 [d]
Percentage change	-0.7	2.9	4.0	5.3	4.1
Unemployment Rate (Percent)	9.3	10.2	9.1	6.4	4.8
Interest Rates (Percent)					
Three-month Treasury bills	0.2	0.6	1.7	3.6	4.7
Ten-year Treasury notes	3.3	4.1	4.4	4.8	5.5

Source: Congressional Budget Office.

Notes: GDP = gross domestic product; PCE = personal consumption expenditure.

The dollar values for nominal GDP and the tax bases are derived from data from the national income and product accounts that were available at the end of June 2009 and do not reflect the July revisions. Economic projections for each year from 2009 to 2019 are available at www.cbo.gov/spreadsheets.shtml.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Level in 2013.

d. Level in 2019.

and investment relative to what would otherwise occur, causing productivity and wage growth to gradually slow.

Last year, outlays for Social Security, Medicare, and Medicaid combined accounted for about 9 percent of GDP. Outstripping the growth of GDP, spending for those programs is expected to rise rapidly over the next 10 years, totaling nearly 12 percent of GDP by 2019. Under long-term projections recently published by CBO, such spending would continue to rise under current laws and policies and could total 17 percent of GDP by 2035.[2]

If outlays for those programs reached that level, federal spending would be well above its historical percentage of GDP. Unless revenues were increased correspondingly, annual deficits would climb and federal debt would grow significantly, posing a threat to the economy. Alternatively, if taxes were raised to finance the rising spending, tax rates would have to reach levels never seen in the United States. Some combination of significant changes in benefit programs and other spending and tax policies will be necessary in order to attain long-term fiscal balance.

2. See Congressional Budget Office, *The Long-Term Budget Outlook* (June 2009).