

Budget Outlook for the US Federal Government



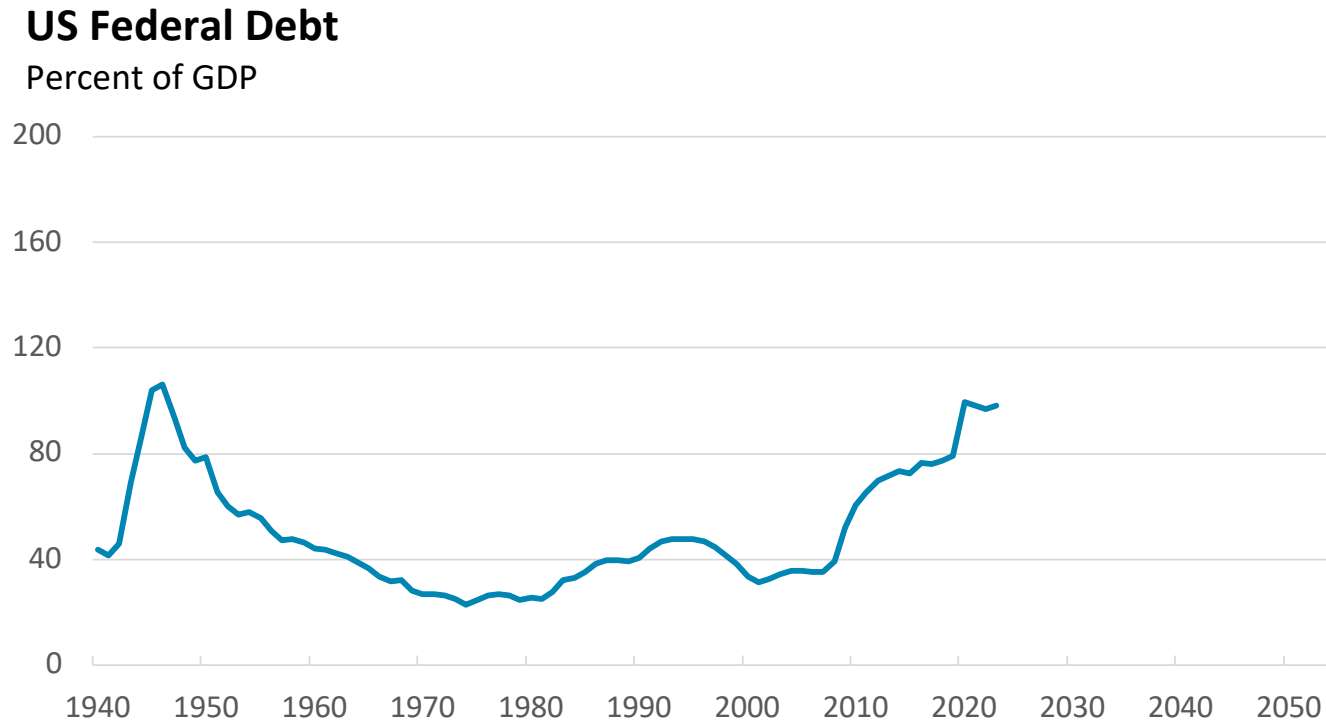
HARVARD Kennedy School

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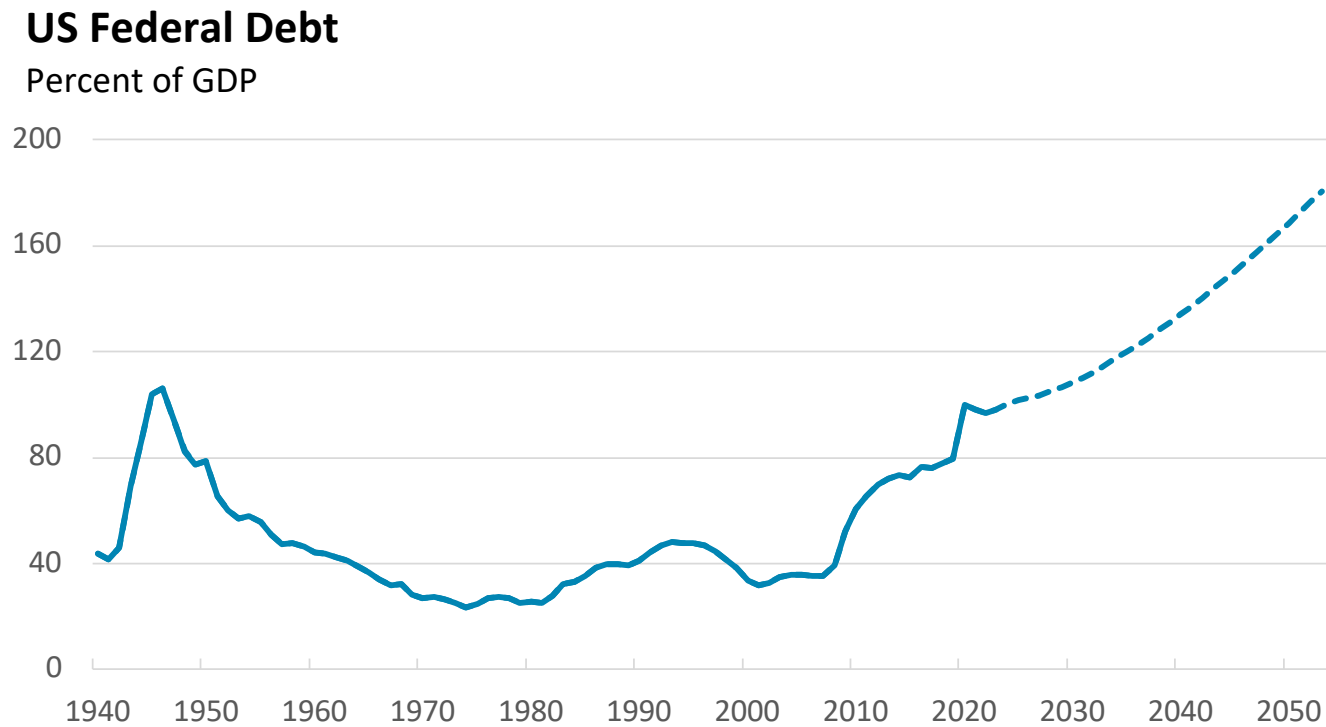
Douglas Elmendorf
Harvard Kennedy School

Current US fiscal policy is unsustainable



Source: CBO Long-term Budget Outlook (2023).

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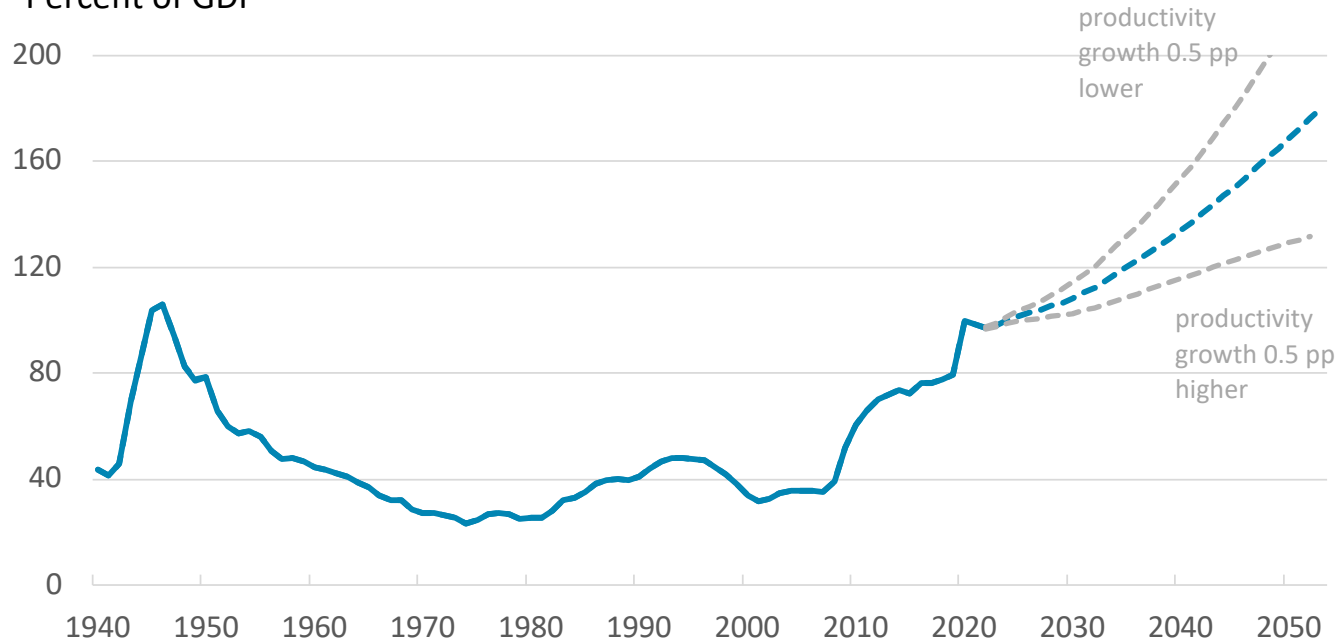


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US Federal Debt

Percent of GDP

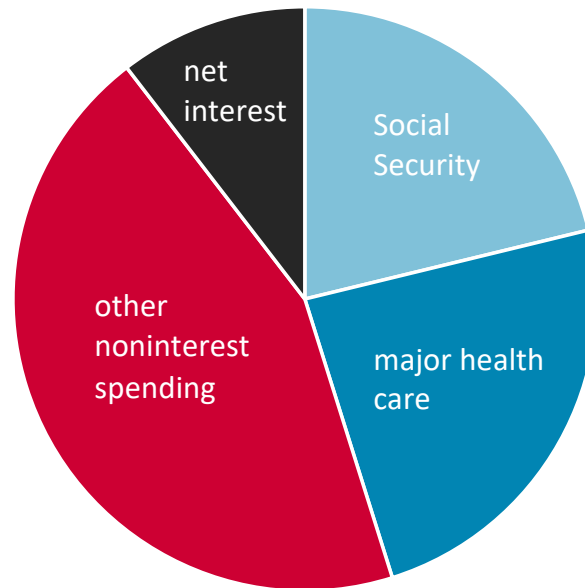


Source: CBO Long-term Budget Outlook (2022 and 2023).

There is a large gap between spending and revenue today

Federal Spending by Category in 2024

Share of total spending

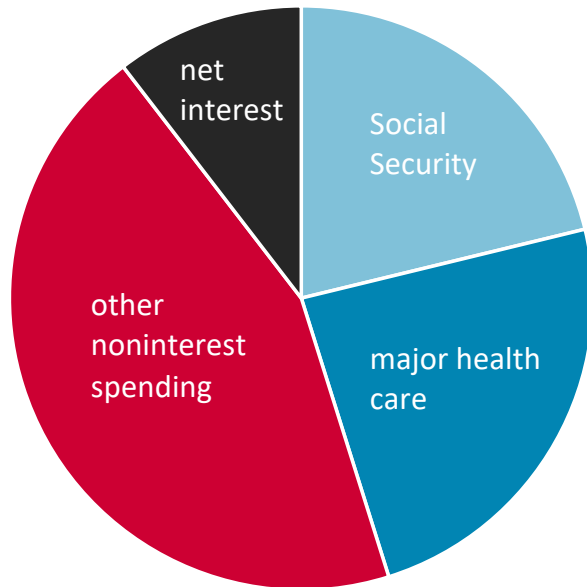


Source: CBO Long-term Budget Outlook (2023)

There is a large gap between spending and revenue today

Federal Spending by Category in 2024

Share of total spending



Federal Revenues by Category in 2024

Share of total revenue

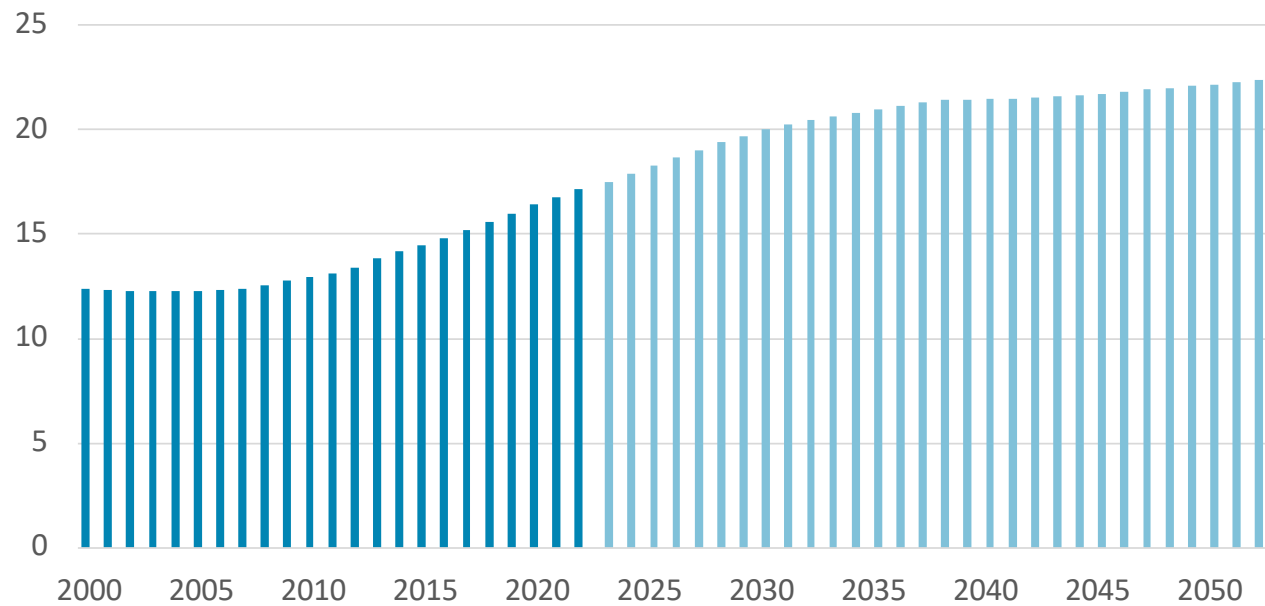


Source: CBO Long-term Budget Outlook (2023)

The main causes of unsustainability over time are population aging and rising health care spending

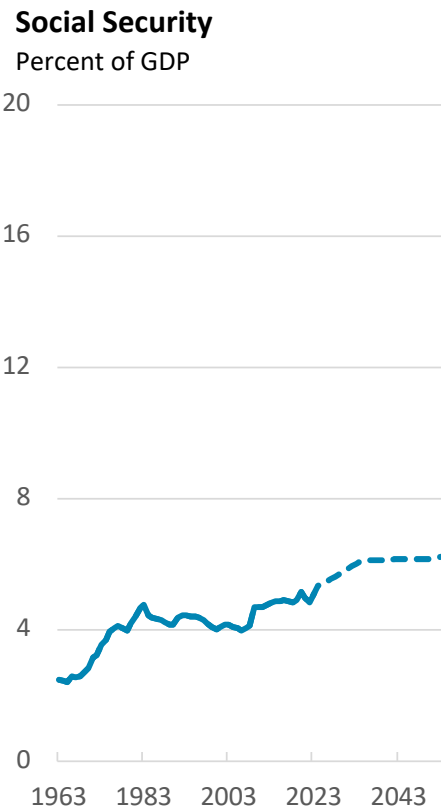
Share of US Population 65 and Older

Percent

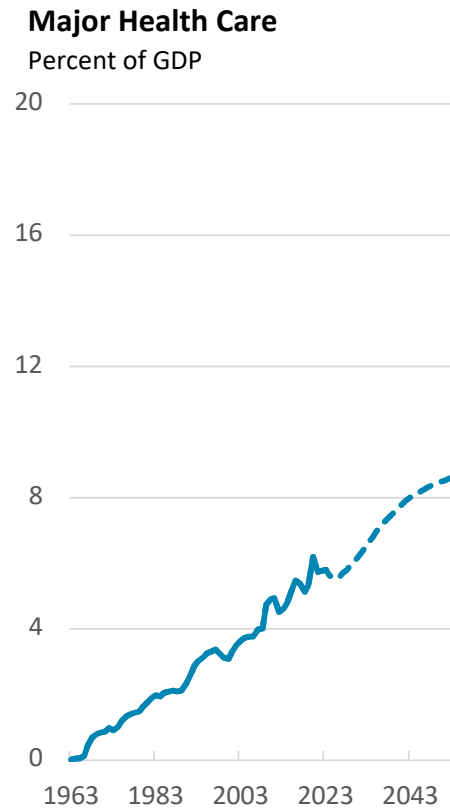
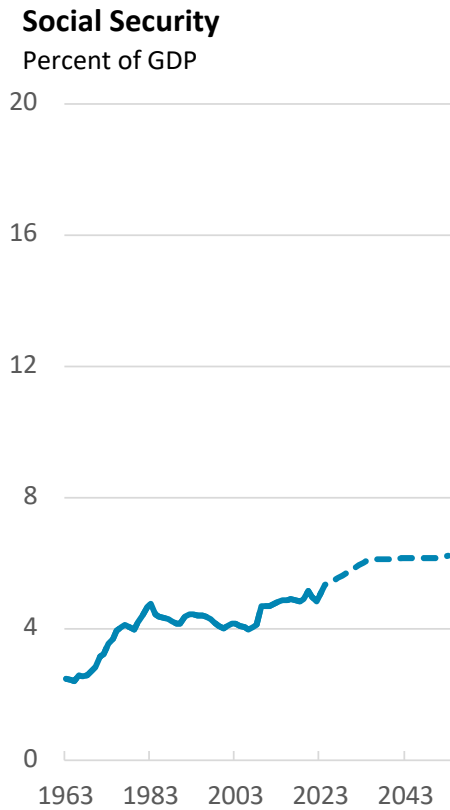


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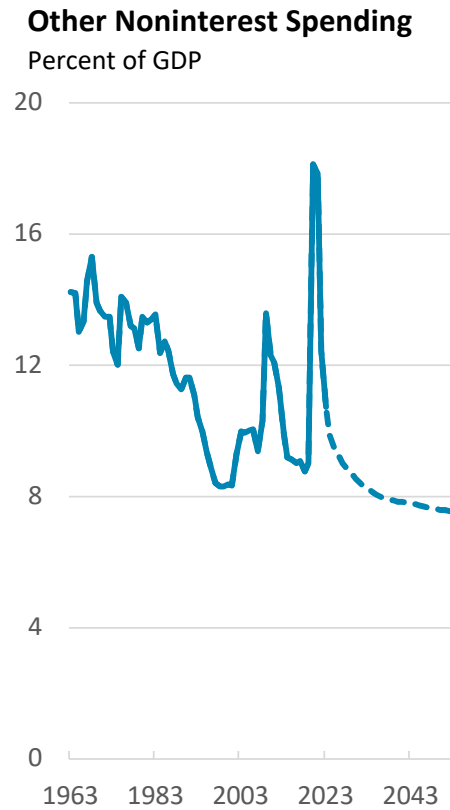
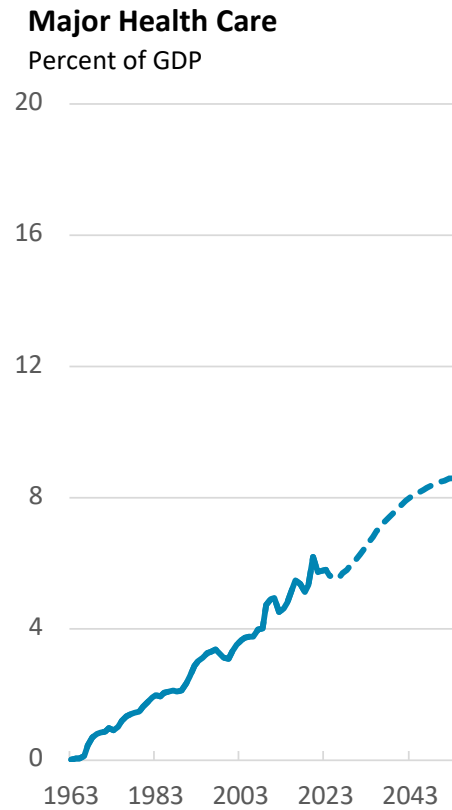
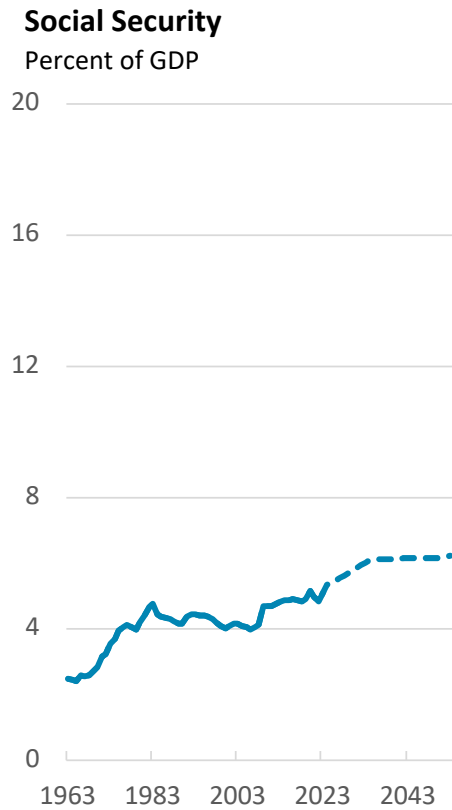
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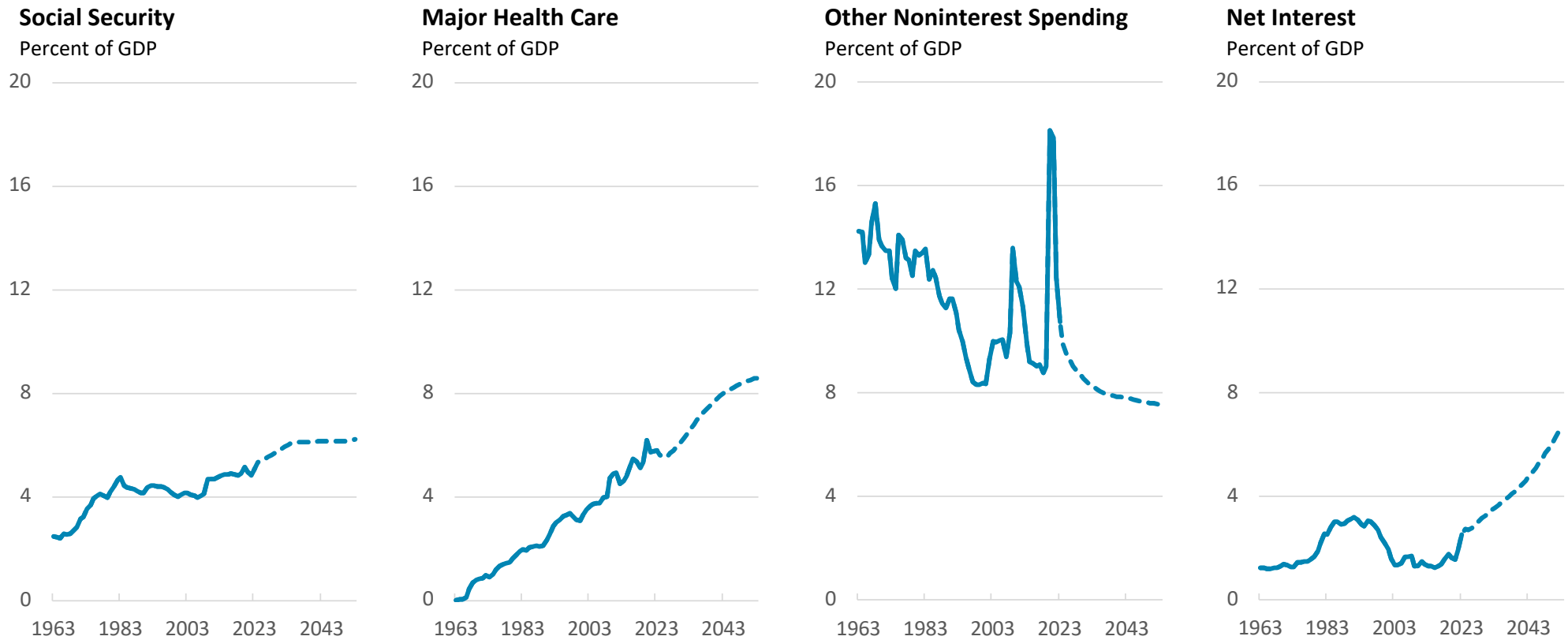


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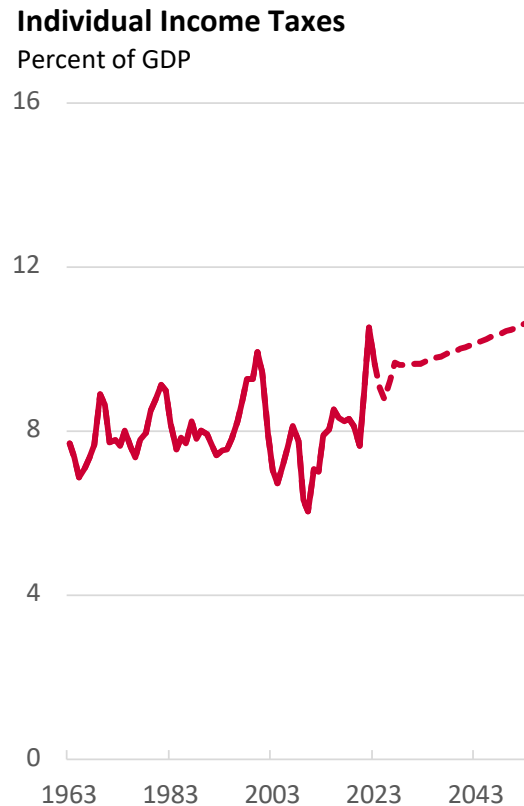
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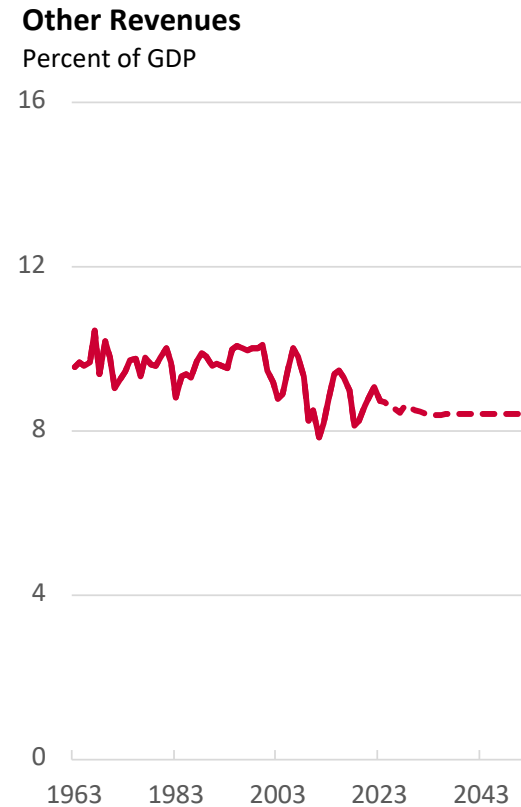
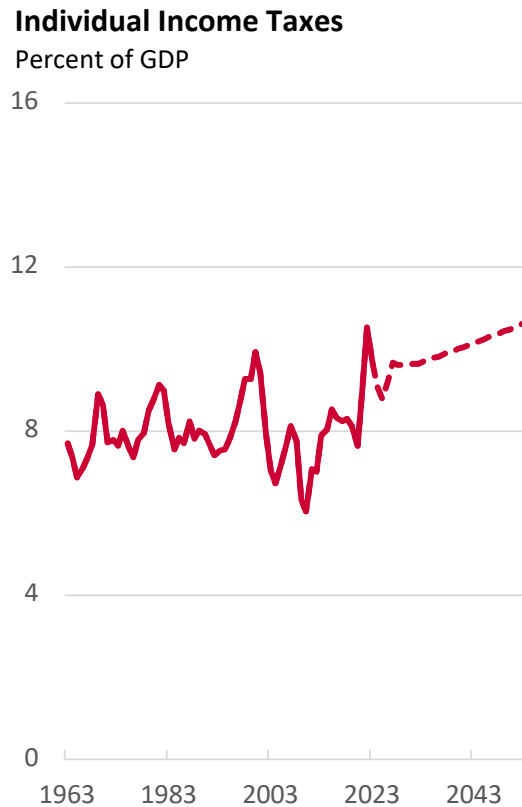
Source: CBO Long-term Budget Outlook (2023)

Revenue will rise relative to GDP under current law—but that would be an historical anomaly



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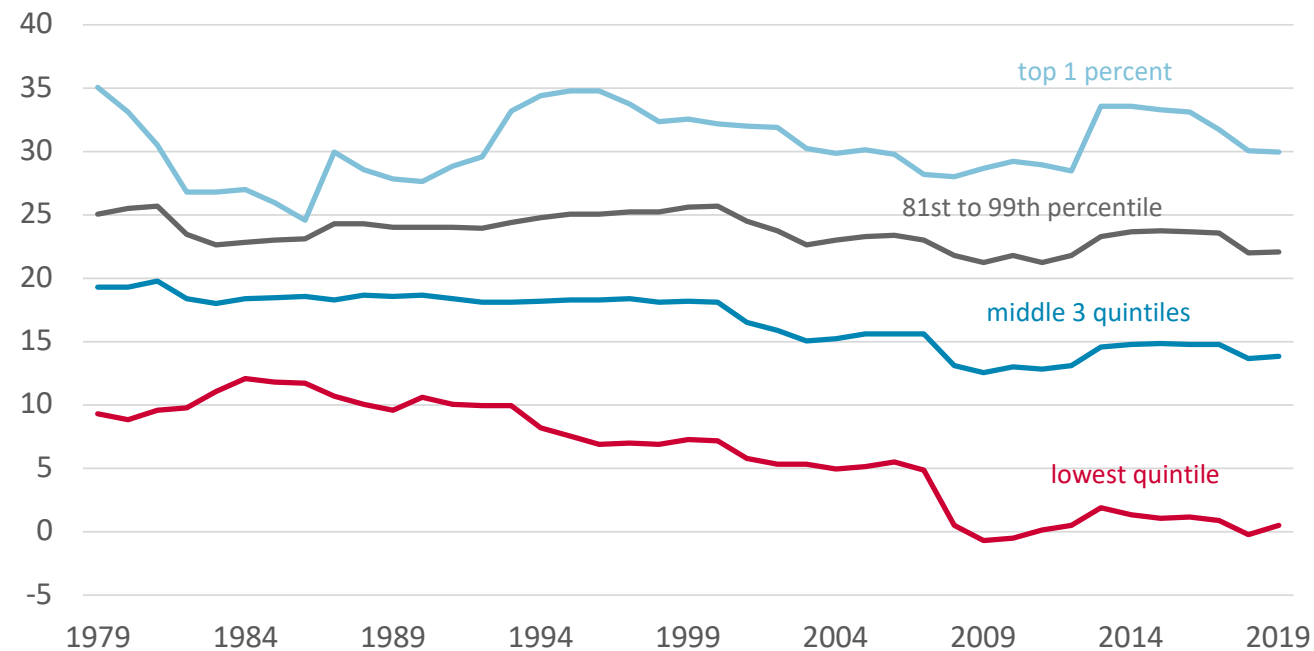


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Average Federal Tax Rates

Percent

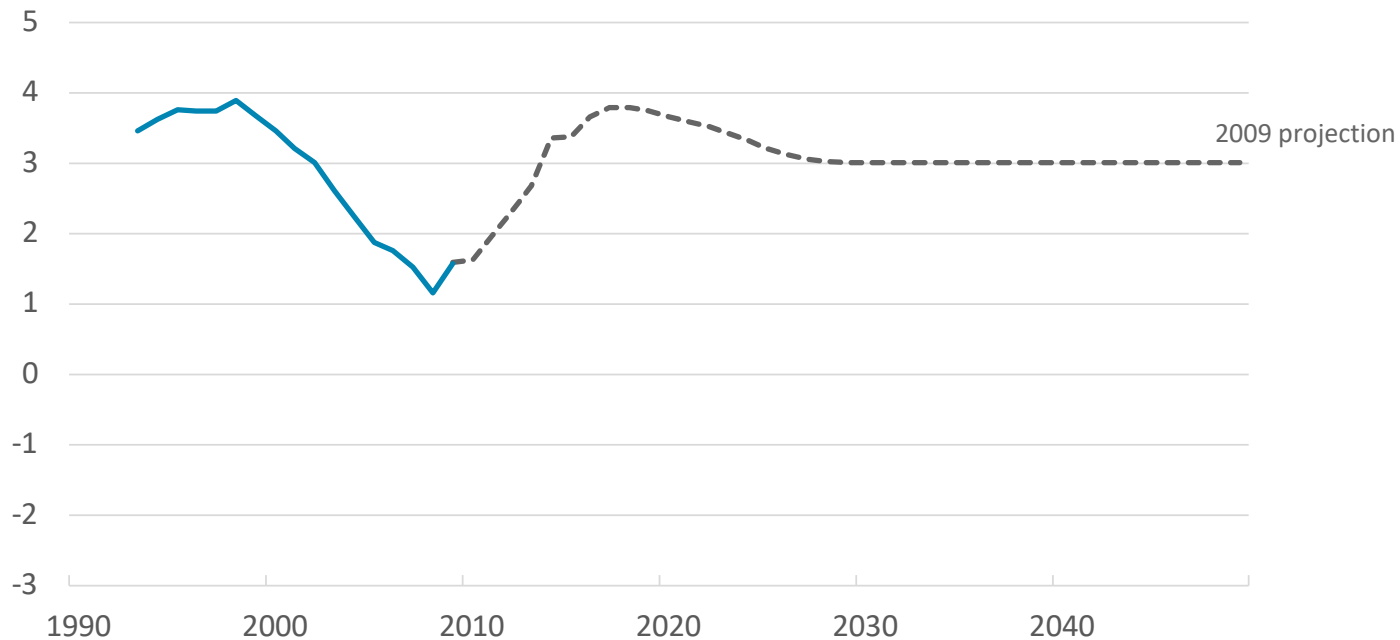


Source: CBO Distribution of Household Income, 2019 (2022).

Interest rates on Treasury debt probably will be below their historical levels

Real Interest Rate on 10-Year Treasury Note

Percent (5-year lagged moving average)

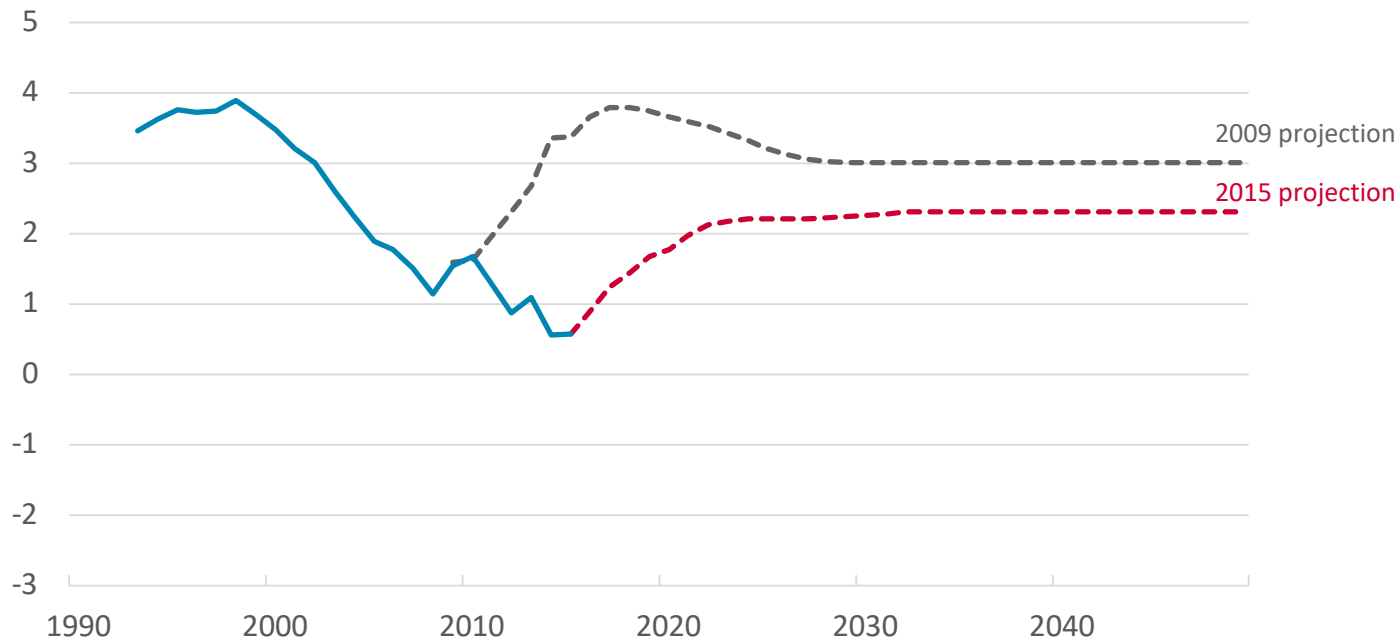


Source: CBO Long-Term Budget Outlook (2023 and earlier versions).

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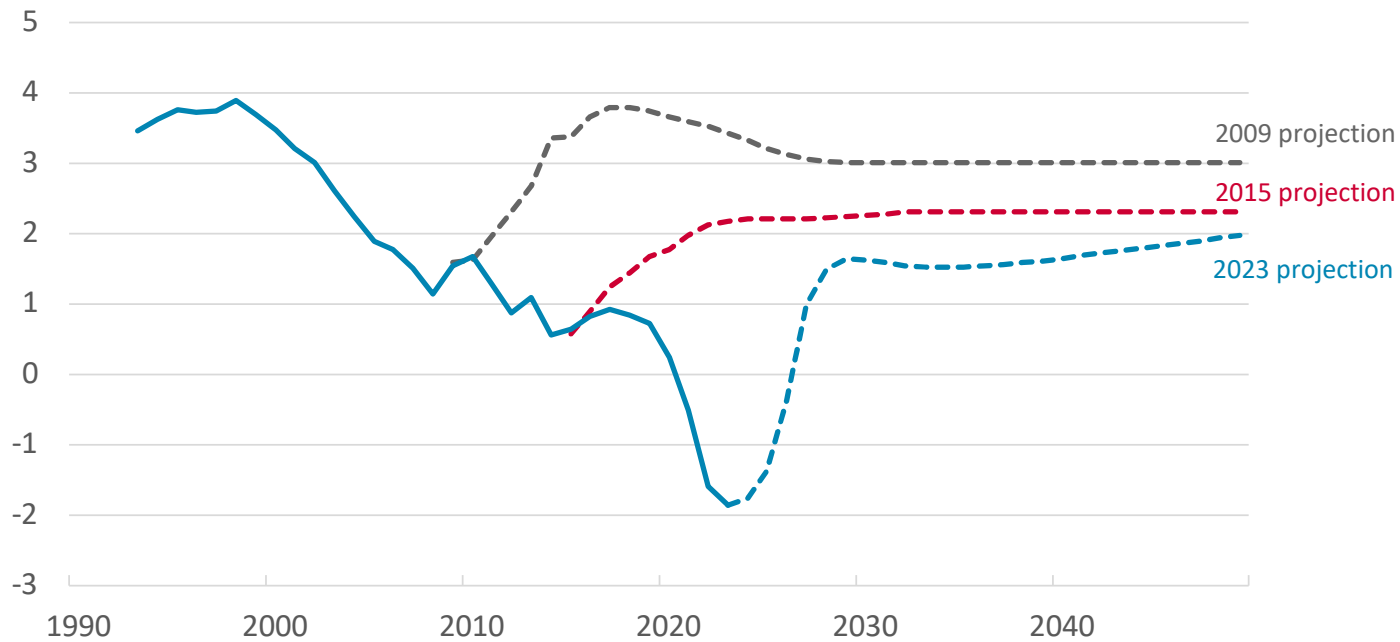


Source: CBO Long-Term Budget Outlook (2023 and earlier versions).

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Real Interest Rate on 10-Year Treasury Note

Percent (5-year lagged moving average)



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The unsustainability of US fiscal policy is a significant problem but not an urgent one

Lower interest rates reduce the pace at which debt builds up, for any given noninterest deficits, which makes reducing deficits less urgent

In addition, lower interest rates probably show that the cost to the economy of government borrowing is lower too, which makes reducing deficits less important

Intuition: Low interest rates are a sign that investable funds are available in large quantities relative to businesses' and households' needs, so the "crowding out" of household and business borrowing is less costly than otherwise

More research is needed on this issue

The unsustainability of US fiscal policy is a significant problem but not an urgent one

Even though delaying action is probably less damaging than we previously believed, there are still good reasons to put fiscal policy on a sustainable path:

- More debt leads to less private investment, which probably lowers future output and income
- More debt increases the risk of a fiscal and financial crisis
- More debt increases the vulnerability of the government budget to potential increases in interest rates
- More debt reduces “fiscal space” for responding to emerging public needs
- Enacting significant changes in fiscal policy in advance gives families and businesses time to plan ahead

Putting US fiscal policy on a sustainable path would require significant changes in policy

To keep to the projections I showed earlier, policymakers need to:

- Let the 2017 tax cuts expire as scheduled after 2025
- Allow real bracket creep to increase revenue/GDP in an atypical way
- Keep spending apart from Social Security and major health care programs trending down relative to GDP in an atypical way

To stabilize debt/GDP near its current level for the next 30 years, policymakers need to do all those things AND:

- (Based on last year's projections) Reduce spending, increase revenue, or some combination by roughly 2.8% of GDP beginning in 2027: That's roughly \$800 billion in 2027, which is about \$2400 per person (340,000 Yen)

There is no near-term prospect of significant changes in US budget policy

All the potential changes have significant substantive disadvantages

Neither the Republican Party nor the Democratic Party is focused on this issue now:

- The debt-ceiling dispute was resolved with tweaks to budget policies
- Republicans have learned from Democrats to say they'll protect Social Security and Medicare, and they're more focused on cultural issues
- Democrats have learned from Republicans to say they won't raise taxes on anyone except the very wealthy, and the progressive wing of the party is strongly against cutting social spending

Thank you!



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