



Reducing the Budget Deficit: Policy Issues

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Summary

The budget deficit (the difference between outlays and revenues) each year from 2009 to 2011 has been the highest ever in dollar terms and significantly higher as a share of gross domestic product (GDP) than in any other year since World War II. The budget is not projected to be on a sustainable path under current policy, in the sense that it would cause the federal debt to continuously grow more quickly than GDP. While there has been no difficulty financing the deficit to date, at some point, investors could refuse to continue to finance deficits that they believed were unsustainable.

As one example of the policy changes that would return the budget to a sustainable path, CRS estimates that to stabilize debt as a share of GDP at its 2011 level would require budget deficits averaging no more than 2.5% to 3% of GDP over the next 10 years. In dollar terms, this would amount to a deficit of about \$400 billion in 2012, rising to about \$550 billion in 2015. Under a current policy baseline, the deficit would decline from more than 9% of GDP in 2011 to 5% of GDP in 2014, and rise to 6% of GDP by 2019. To reduce the deficit to sustainable levels would require some combination of spending cuts and tax increases equivalent to roughly \$700 billion in 2012 and \$400 billion in 2015 compared to a projection of current policy.

The recent growth in deficits is the result of spending reaching its highest level as a share of GDP since 1945 and revenues reaching their lowest level as a share of GDP since 1950. Revenues are projected to be higher than their historical average from 2013 on if the “alternative minimum tax (AMT) patch” and “Bush tax cuts” expire as scheduled. Those tax provisions were extended through 2011 and 2012, respectively, by P.L. 111-312, which CBO projects increased the deficit by \$374 billion in 2011 (\$204 billion of which is attributable to expiring tax provisions). If these tax cuts are extended again, revenues are estimated to be reduced by about 2% of GDP each year from 2014 on, and will remain around their historical average from 2014 on.

Assigning the relative contribution of past policy decisions to the current deficit depends on one’s starting reference point. Compared to CBO’s 2001 baseline projection, legislative changes in 2009 and 2010 increased the 2010 deficit by \$570 billion, while legislative changes from 2001 to 2008 increased the 2010 deficit by \$947 billion. Changes to the economic projection increased the 2010 deficit by \$135 billion.

Spending cuts in FY2011 are equivalent to less than 1% of the 2011 budget deficit. Under current projections, even if total discretionary spending (defense and non-defense combined) were reduced to zero in 2011, there would still be a budget deficit. Freezing total discretionary spending at 2011 levels (which would reduce spending in inflation-adjusted terms) would reduce the deficit by about 0.1% of GDP in 2012, gradually rising to a 1% of GDP reduction by 2018. If defense is not included in the freeze, the reduction in the deficit is less than half as large. Defense, Social Security, and Medicare account for more than half of total spending. Outside of those three programs and net interest, all other spending is about the same size as the budget deficit in 2011.

Growth in entitlement spending on the elderly drives long-term projections of large budget deficits—by mid-century, outlays on Social Security and health programs would exceed total revenues. Most proposals to reform entitlement programs for the elderly would generate significant budgetary savings in the long run, but little budgetary savings in the short run, partly because most proposals exempt current retirees from reform and partly because the savings from these changes would compound over time.

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The federal budget has been in deficit (spending has exceeded revenues) since 2002, but became significantly larger in 2009. That year, the deficit topped \$1 trillion for the first time ever, and it is projected to remain above \$1 trillion in 2011.¹ Relative to the overall size of the economy, budget deficits from 2009 to 2011 have been significantly larger than in any other year since World War II. From 1946 to 2008, budget deficits averaged 1.7% of gross domestic product (GDP) and exceeded 5% of GDP only three times (equaling 7.2% in 1946, 6.0% in 1983, and 5.1% of GDP in 1985). From 2009 to 2011, budget deficits are projected to average 9.4% of GDP.² Current deficits are larger as a share of GDP than any recorded historically except for those recorded during the Civil War, World War I, and World War II. Under current policy, deficits are projected to cause the federal debt to continuously grow faster than national income, which is unsustainable. The federal debt held by the public has grown from 40% of GDP in 2008 to a projected 69% of GDP in 2011.

Congress has expressed interest in examining policy options to reduce the deficit. In the 112th Congress, the Department of Defense and Full Year Continuing Appropriations Act of 2011 (H.R. 1473), signed into law as P.L. 112-10 on April 15, 2011, reduces discretionary 2011 outlays by \$10 billion relative to the Congressional Budget Office's (CBO's) January baseline.³ But other policy goals, such as stimulating the economy, have led to recent policy changes that, on balance, have made the deficit larger. For example, CBO estimates that, in the 111th Congress, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) increased the deficit by \$374 billion in 2011, \$204 billion of which is attributable to the extension of expiring tax provisions.

CRS does not take a position on the best way to reduce the deficit. This report organizes and presents information to help policymakers frame the debate. This report first discusses the size of projected budget deficits, then discusses how much the deficit would need to be reduced to return to long-term sustainability, then analyzes the best time frame for reducing the deficit, then discusses broad policy choices for reducing the deficit, and finally presents information on how deficits reached their current levels.

¹ All budget data presented in this report are from Congressional Budget Office, *Preliminary Analysis of the President's Budget for FY2012*, March 2011 and Congressional Budget Office, Budget and Economic Outlook, Jan. 2011 (hereafter referred to as "CBO baseline"), or Office of Management and Budget, *FY2012 Budget of the U.S. Government*, Feb. 2011 (hereafter referred to as "President's Budget"). The budget deficit is the excess of outlays over revenues in a given year, broadly similar to the amount borrowed from the public that year. The publicly held debt is the accumulation of all past borrowing from the public. The gross debt is the publicly held debt and the intragovernmental debt (the debt that one part of the federal government borrows from another part, mainly government trust funds). For background information on the debt and deficit, see CRS Report WKS0001_Overview, *Federal Debt and Deficit*, by Justin Murray.

² Expressing budget data as a percentage of GDP is most appropriate for making comparisons over extended periods of time because it allows the relative size of those amounts to be consistently compared. Dollar figures are not appropriate because of inflation, which means that a dollar has a smaller amount of purchasing power over time, and because as the economy has become larger, there are more resources available to finance spending through borrowing or taxes.

³ H.R. 1473 would reduce FY2011 budget authority by \$47 billion relative to the January baseline. Over 10 years, CBO estimates that H.R. 1473 would reduce outlays by \$20 to \$25 billion relative to 2010 levels. See: http://www.cbo.gov/ftpdocs/121xx/doc12143/additional_info_hr1473.pdf.

How Large Are Projected Deficits Under Current Policy?

Absent policy changes, budget deficits would change over time because spending and revenue automatically change over time. Baseline budget projections are used to provide a benchmark against which budgetary decisions can be made and policy proposals can be compared over the budget window. The projected magnitude and path of budget deficits depends greatly on what baseline assumptions are made. The Congressional Budget Office (CBO) estimates a 10-year *current law* baseline, which assumes that certain provisions of law will expire as scheduled, even though many of these provisions have routinely been extended in the past. Examples of such provisions include the 2001 and 2003 tax cuts (popularly known as the “Bush tax cuts”⁴), which were extended until the end of 2012, when they were first scheduled to expire, by P.L. 111-312, and the “alternative minimum tax (AMT) patch,” which has been repeatedly extended, most recently until the end of 2011.⁵ Another example is the Medicare cuts required in law by the sustainable growth physician payment formula; Congress has enacted legislative overrides to prevent those cuts (popularly known as the “doc fix”) each year since 2003.⁶ A *current policy* baseline, which assumes that provisions in place now would remain in place, yields much larger budget deficits, because the policy changes raise outlays or lower revenues and because the larger budget deficits increase the interest that must be paid on the national debt.

Table 1 illustrates the changes to deficit projections when baseline assumptions are altered. Under the CBO “current law” baseline, the deficit would decline to about 3% of GDP by 2014, mostly due to the baseline assumptions that the Bush tax cuts and AMT patch will be allowed to expire as scheduled. If actual policy followed CBO assumptions, very limited policy changes would be required to place the budget on a sustainable path (as defined in the next section). For illustrative purposes, if the baseline is adjusted to match current policy, and these expiring provisions and the “doc fix” are extended,⁷ the deficit would more than double by the end of the 10-year window, and much larger policy changes would be needed to place the deficit on a sustainable path. Under a “current policy” baseline, deficits would bottom out at 5.2% of GDP in 2014. It would then begin to rise again, and reach 6.4% of GDP by the end of the projection window.

⁴ The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA; P.L. 108-27) are popularly referred to as the “Bush tax cuts.”

⁵ See CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Steven Maguire.

⁶ For more information, see CRS Report R40907, *Medicare Physician Payment Updates and the Sustainable Growth Rate (SGR) System*, by Jim Hahn.

⁷ In addition to the “Bush tax cuts” and “AMT patch,” there are about 80 smaller tax provisions that are scheduled to expire in the future under current law. These other provisions are not included in Table 1; if they were all extended, it would increase the deficit by \$950 billion over 10 years. Some of these provisions have been routinely extended in the past.

Table 1. Deficit Projections Under Alternative Assumptions

	Fiscal Year										
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	billions of dollars										
CBO Baseline Deficit (as of March 2011)	\$1,399	\$1,081	\$692	\$513	\$538	\$635	\$590	\$585	\$665	\$710	\$729
+ “Doc Fix”	\$0	\$12	\$20	\$20	\$23	\$28	\$30	\$35	\$40	\$45	\$49
+ Extend “Bush Tax Cuts” and “AMT Patch”	\$0	\$12	\$228	\$359	\$418	\$463	\$513	\$566	\$622	\$683	\$749
= “Current Policy” Baseline Deficit	\$1,399	\$1,105	\$940	\$892	\$979	\$1,126	\$1,133	\$1,186	\$1,327	\$1,438	\$1,527
	% of GDP										
CBO Baseline Deficit	9.3%	6.9%	4.2%	3.0%	3.0%	3.3%	2.9%	2.8%	3.0%	3.1%	3.1%
“Current Policy” Deficit	9.3%	7.0%	5.7%	5.2%	5.4%	5.9%	5.7%	5.7%	6.1%	6.3%	6.4%
“Current Policy” Deficit if Discretionary Spending is Constant Share of GDP	9.3	7.2%	6.0%	5.7%	6.1%	6.8%	6.8%	7.0%	7.6%	8.0%	8.3%

Source: CRS calculations based on CBO data.

Notes: Cost of alternative policy assumptions includes additional debt service generated by those assumptions.

Under either the CBO “current law” baseline or the alternative “current policy” baseline in **Table 1**, the budget balance as a share of GDP is projected to improve compared to 2009-2011 levels. It improves because

- CBO assumes that budget authority will return to the levels prevailing before the enactment of the American Reinvestment and Recovery Act (ARRA, P.L. 111-5, popularly known as the 2009 “Economic Stimulus Act”). ARRA was intended to be only a temporary boost to spending to stimulate the economy, and Congress has allowed budget authority to return to close to pre-ARRA levels to date.⁸
- CBO projects that revenues automatically rise and certain mandatory spending automatically falls as the economy eventually returns to full employment. Economists refer to these changes as “automatic stabilizers.” Assuming the tax cuts and AMT patch are extended, revenues are projected to rise from about 15% of GDP in 2011 to about 18.5% of GDP in 2021.⁹ By 2016, unemployment compensation is projected to fall to one-third of its 2011 level in nominal dollars, although this is partly due to the expected expiration of the temporary extension of benefits.

⁸ In 2008, non-defense discretionary budget authority was \$494 billion. In 2009, it was \$803 billion. In 2010, it was \$549 billion. After adjusting for inflation, the annual increase between 2008 and 2010 was about 4%.

⁹ Revenues also rise relative to GDP automatically over time because of “real bracket creep,” meaning that the same tax system yields more revenue as national income rises.

- Most financial stabilization outlays in the federal budget occurred within the Troubled Asset Relief Program (TARP)¹⁰ or on transfers to the government sponsored enterprises (GSEs). CBO projects that there will be only minimal outlays on financial stabilization programs going forward, due to improvements in financial markets and the expiration of Treasury authority with regards to TARP and the GSEs in 2010. In 2009, outlays of \$243 billion were recorded for TARP and the GSEs. In 2010, transfers to the GSEs declined and, due to budgetary conventions, TARP reduced the deficit.¹¹

Discretionary spending poses problems for baseline projections. Baseline projections are attempting to extrapolate current policy, not predict the most likely outcome. Because it is determined on an annual basis, there is more than one reasonable assumption of what could be considered an extension of “current policy” into the future. In its baseline projection, CBO assumes that discretionary spending will grow at the rate of inflation, but discretionary spending has grown faster than the rate of inflation in every year since 1997.¹² Another reasonable baseline assumption would be to hold discretionary spending constant as a share of GDP in the future. Under this assumption, deficits would be nearly 2 percentage points of GDP larger by the end of the 10-year budget window.

A baseline is not meant to be the best guess of future outcomes or the most desirable outcome, but a reasonable starting point for comparing policy options. From the perspective of crafting a deficit reduction proposal, if one believes that a policy included in the baseline is unrealistic, such as a reduction in military spending in Iraq and Afghanistan or the omission of future spending in response to an unforeseen emergency in the next 10 years, it can be included in a budget proposal rather than altering the baseline.¹³

Budget projections are subject to a high degree of uncertainty—based on history, actual outcomes are likely to be much better or worse than projections. OMB estimates that the absolute average errors for its budget deficit projections are 1.5% of GDP for the next budget year and 3.5% of GDP for five years in the future.¹⁴ This implies that maintaining the status quo (under the “current policy” baseline) could lead to a successful return to sustainability in five years, or to sustainability problems that are more serious than current projections would suggest.

Long-term projections indicate that budget deficits would increase rapidly relative to GDP outside the projection window under current policy if revenues remain similar to their historical

¹⁰ TARP was created by the Emergency Economic Stabilization Act (P.L. 110-343).

¹¹ Reductions in TARP’s projected lifetime cost led to a negative outlay in 2010 to compensate for what proved in hindsight to be too large an estimate of its cost in 2009.

¹² Since full year appropriations had still not been enacted at the time of the baseline, CBO extrapolates the levels used in the March 2 continuing resolution (P.L. 112-4) in future years.

¹³ Spending on emergencies and overseas military operations are extrapolated in the baseline at currently authorized levels, and can be sensitive to the timing of appropriations acts. The adjusted baseline in the President’s budget includes a placeholder for future emergencies equal to \$92 billion over 10 years.

¹⁴ Office of Management and Budget, *FY2012 Budget of the U.S. Government, Analytical Perspectives*, Feb. 2011, p. 471.

share of GDP. Under a long-term projection of current policy, CBO projects deficits would exceed 10% of GDP by 2026 and 20% of GDP by 2042.¹⁵

How Much Deficit Reduction is Necessary?

The targeted amount of deficit reduction depends on the policy goal. A balanced budget could be pursued so that the government would have a neutral effect on the national saving rate (by accounting identity, budget deficits reduce the national saving rate¹⁶). Since the United States has a low national saving rate relative to other countries and relative to domestic investment needs, a case could be made that the government should at least not continue to reduce the national saving rate by running budget deficits in the future. If the policy goal were for the government to increase the national saving rate, then the government could target a budget surplus. Some economists call for a balanced structural budget, which would allow for modest deficits in downturns and budget surpluses in boom times. For 2010, a structurally balanced budget would have allowed for an actual deficit of about 2½% of GDP.¹⁷

A less ambitious policy goal would be to return fiscal policy to a sustainable path. History demonstrates that budget deficits can be sustained indefinitely as long as they are small enough that government debt does not continuously grow more quickly than GDP. The budget is not projected to be on a sustainable path under a “current policy” baseline because the federal debt would continuously grow more quickly than GDP, implying that an ever-growing portion of national income would be needed to meet interest payments. As long as investors remain willing to finance large deficits, there is no barrier to the debt continuing to grow relative to GDP, and there has been no difficulty in financing it to date. At some point, however, it follows that investors would refuse to continue to finance such deficits, since the proportion of national income devoted to interest payments cannot rise indefinitely.¹⁸

The size of the deficit compatible with sustainability depends on the size of the debt at the time it is stabilized, projected GDP growth rates, and projected interest rates. For illustrative purposes, CRS estimates that to stabilize debt as a share of GDP at its projected 2011 level (69% of GDP) would require annual budget deficits no larger than 2½% to 3% of GDP over the next 10 years, based on CBO’s projections of GDP growth and interest rates. In dollar terms, this would amount to a deficit of about \$400 billion in 2012, rising to about \$575 billion in 2015. Compared to the current policy baseline in **Table 1**, this would require some combination of spending cuts and tax increases equivalent to roughly \$700 billion in 2012, falling to \$400 billion in 2015, and rising each year thereafter.

¹⁵ Long-term budget data can be found in Congressional Budget Office, *The Long-Term Budget Outlook*, June 2010. The figures cited here are under CBO’s “alternative fiscal scenario.” For more information, see CRS Report RL32747, *The Economic Implications of the Long-Term Federal Budget Outlook*, by Marc Labonte.

¹⁶ In simple terms, saving is measured by the excess of income over spending. When the government’s outlays exceed its revenues, it must borrow to finance the difference, and it has a negative saving rate.

¹⁷ Congressional Budget Office, *The Budget and Economic Outlook*, Table E-11.

¹⁸ Economic effects of an unsustainable budget deficit are discussed in CRS Report R40770, *Economic Effects of a Budget Deficit Exceeding \$1 Trillion*, by Marc Labonte.

Were GDP to grow more slowly or interest rates to be higher than projected, the deficit would have to be smaller to be sustainable, and vice versa. By historical standards, CBO's projections of economic growth over the next 10 years are relatively modest, but this is mostly because CBO projects that the labor supply will grow much more slowly than it has historically due to the aging of the population. Projections assume that interest rates will remain at relatively low levels over the next 10 years. CBO estimates that if interest rates rose to their average level from 1991 to 2000, the budget deficit would be an average of \$100 billion higher per year over the next 10 years. If interest rates rose to their average level from 1981 to 1990, the budget deficit would be an average of \$500 billion higher per year over the next 10 years.¹⁹

Since deficits are projected to continue to grow in the long run, growing cuts in spending or increases in taxes would be required over time to maintain sustainability. Larger cuts in spending or increases in taxes would be required today to spread those changes evenly over time. For example, CBO projects that spending would need to be cut or revenues increased by 8.7% of GDP immediately to stabilize the debt-to-GDP ratio over the next 75 years, which would result in a budget surplus in 2012.²⁰

The U.S. fiscal outlook is not a purely long-term issue, however—deficits are already at unsustainable levels today, and while projected deficits are larger than today's deficits outside the 10-year budget window, they are also more uncertain. The deficit is a long-term issue in that economic consequences from running large deficits have been minor to date, but there is the risk that that the deficit's effect on the economy could become negative, possibly acutely so, at any time. Deficits are also a long-term issue in the sense that most observers believe fundamental reforms to outlays and revenues would be necessary to put the budget on a sustainable path; however, any delay to implementing those changes increases the eventual budgetary cost of returning to a sustainable fiscal path, all else equal.

How Quickly Should the Deficit Be Reduced?

The state of the economy is an important factor to consider in determining the desired timing of deficit reduction. All else equal, mainstream economic theory predicts that reducing the deficit would have a contractionary effect on the economy in the short run, whether it be through tax increases or spending reductions. During a period of robust economic growth, that contractionary effect would be more easily absorbed by other sectors of the economy, and the expansion would likely be sustained. During a period of high unemployment, such as the present, reducing the budget deficit would be expected to make unemployment higher (or fall more slowly) than would otherwise be the case, all else equal. On these grounds, an argument could be made for postponing deficit reduction until the economy improves. Given that the effect on the economy is proportional to the size of the deficit reduction, avoiding unwanted contractionary effects also argues for a gradual approach to deficit reduction.

¹⁹ Congressional Budget Office, *Letter to the Honorable Paul Ryan*, Feb 24, 2011, Table 2.

²⁰ Congressional Budget Office, *The Long-Term Budget Outlook*, June 2010, p. 15. Economists call this concept the "fiscal gap."

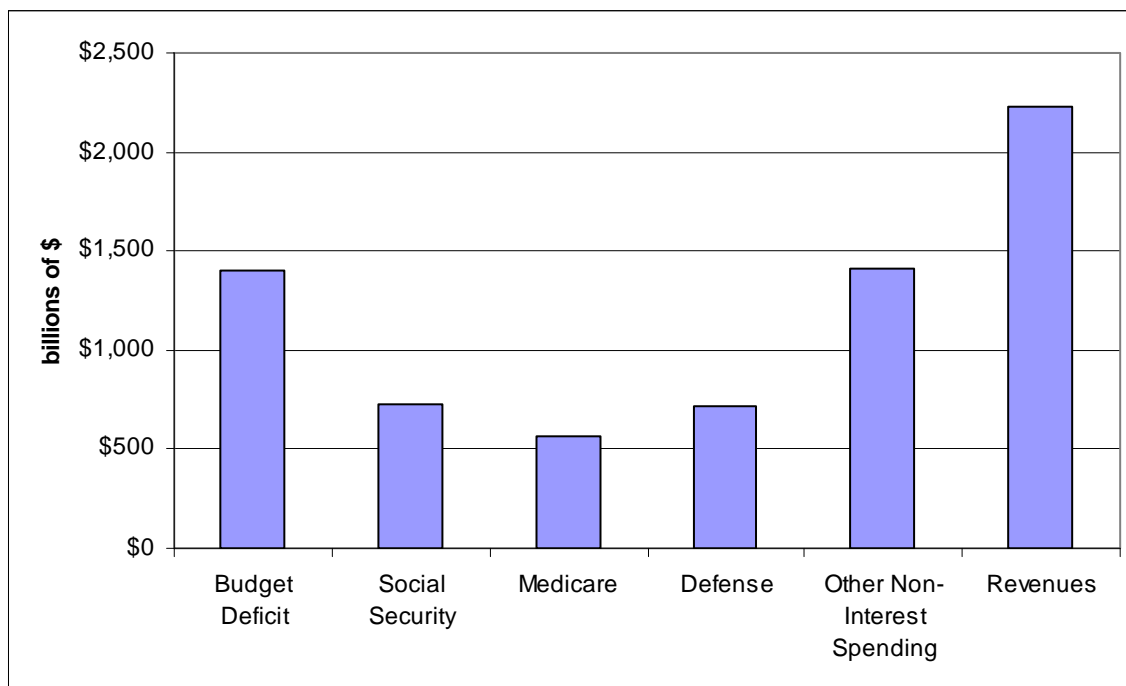
On the other hand, the risk of a fiscal crisis as long as the deficit is at an unsustainable level would argue for moving to sustainability as quickly as possible to eliminate that risk. Low interest rates indicate that markets believe there is little risk of a crisis currently, but market sentiment can change quickly, as has occurred in countries such as Greece and Ireland. In these countries, GDP has contracted deeply and unemployment has risen sharply.

CBO projects that unemployment will remain above 9% through 2011 and 7% through 2014. These economic projections are based on the CBO “current law” baseline deficit, which is reduced rapidly between 2012 and 2013, primarily due to the expiration of tax cuts and the AMT patch. A slower pace of deficit reduction might lead to a somewhat faster decline in the unemployment rate, but CBO projects that significant deficit reduction under the current law baseline would not prevent the eventual return to full employment by 2016.

Policy Options for Deficit Reduction

Budget deficits can be reduced through cuts in spending, higher taxes, or a combination of both. **Figure 1** compares the deficit to overall spending and revenues in FY2011. It shows that the deficit is about the same size as all non-interest spending outside of Social Security, Medicare, and defense discretionary. It is also larger than total discretionary spending (defense and non-defense combined). It is about two-thirds the size of total revenues.

Figure 1. Selected Data from FY2011 Federal Budget
Billions of dollars

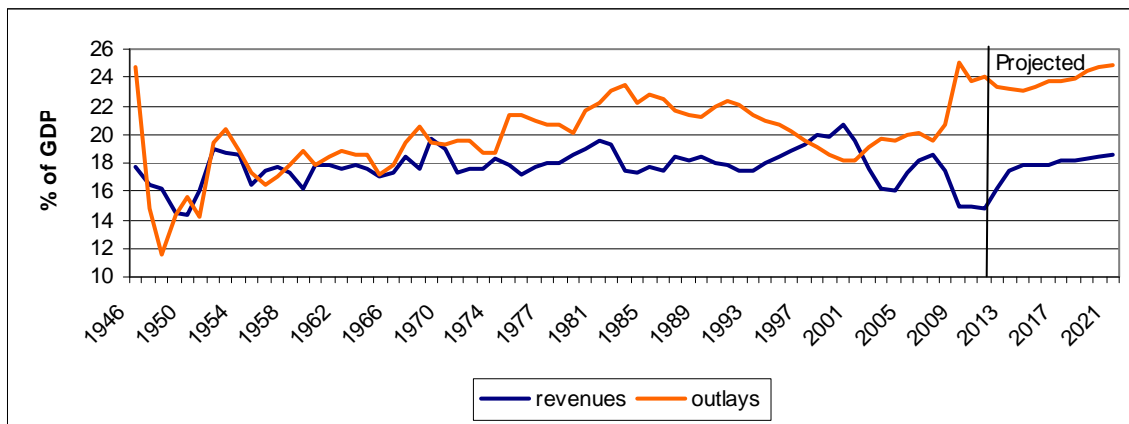


Source: CRS calculations based on CBO data

Note: Spending and revenues for 2011 are projected based on the March CBO baseline.

Budget deficits are the result of the shortfall between spending and revenue. As seen in **Figure 2**, spending in 2009 reached its highest level as a share of GDP since 1945 and revenues have reached their lowest level as a share of GDP since 1950. From 1946 to 2008, outlays averaged 19.6% of GDP, and were generally below 20% of GDP until 1975, above 20% of GDP from 1975 to 1996, and below 20% of GDP from 1997 to 2005. From 2009 to 2011, outlays averaged an estimated 24.3% of GDP. From 1946 to 2008, revenues averaged 17.8% of GDP, showing no long-term upward or downward trend from 1952 to 2007. Revenues were at least 17% of GDP in each year during that period except for 1955, 1959, 2003, and 2004, when they were between 16% and 17%. Since 2009, revenues have been below 15%.

Figure 2. Federal Revenues and Outlays, Historical and Projected Under a Current Policy Baseline
1946-2021



Source: OMB and CRS calculations based on CBO data

Notes: See **Table I** for details on the current policy baseline.

Just as recent deficits are the combination of all past outlay and revenue decisions, returning the budget to balance would be difficult without a combination of outlay and revenue changes. For instance, to return the budget to balance while maintaining 2011 revenue levels would require that outlays decline to a share of GDP last seen in the early 1950s. Likewise, to balance the budget while maintaining 2011 outlay levels would require revenues to rise to their highest share of GDP ever.

Total Spending

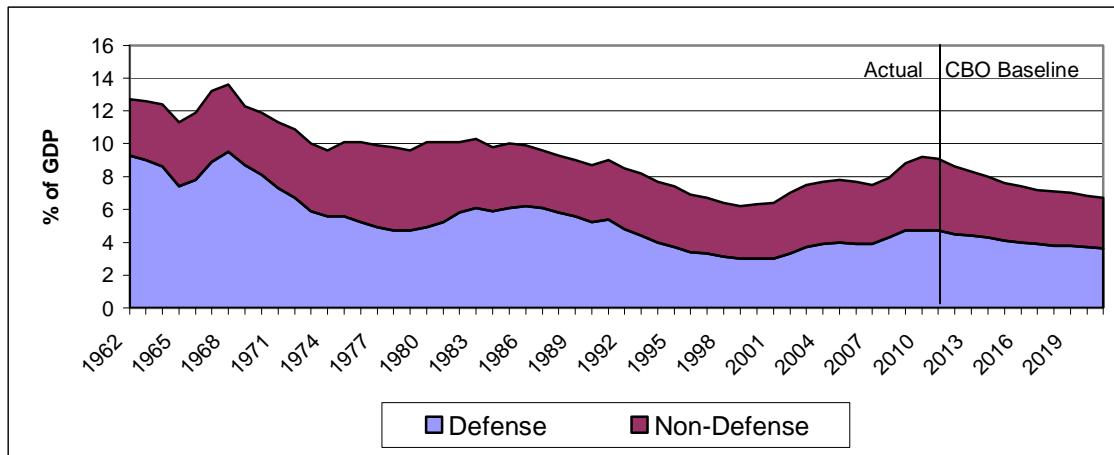
Total spending under the current policy baseline would fall by about one percentage point of GDP from 2011 to 2012, but is not projected to fall below 23% of GDP in the 10-year budget window. (Total spending under the CBO current law baseline never falls below 22.9% of GDP.) From 1946 to 2008, there were only three years when outlays were above 23% of GDP. By 2019, total spending is projected to exceed its 2011 share of GDP under the current policy baseline because mandatory spending grows relative to GDP and net interest on the federal debt nearly doubles as a share of GDP from current levels. The projected increase in net interest is due to the growth in the federal debt and the return to more normal interest rates from the below-average rates currently prevailing.

At over \$1 trillion per year from 2009 to 2011, the budget deficit is an order of magnitude larger than types of spending cited by some as wasteful. For example, budget authority for total earmarks disclosed by Congress in FY2010 equaled \$32 billion.²¹ Budget authority for all terminations, reductions, and savings proposed by the Administration in the FY2012 budget totaled \$147 billion.²²

Discretionary Spending

Large budget deficits relative to GDP since 2009 have corresponded with higher levels of discretionary spending relative to GDP, but not historically high levels since data was first available in 1962, as seen in **Figure 3**. Defense discretionary spending was higher from 1962 to 1992 as a share of GDP than it was in 2010. From 1963 to 2001, defense discretionary spending generally fell relative to GDP—but not in terms of nominal dollars. It then began to grow, when overseas military operations expanded. It currently remains well below the share of GDP that prevailed before the 1990s. Non-defense discretionary spending has shown no long-term upward or downward trend relative to GDP—except for an elevated period from 1975 to 1981, it has always stayed within 3.5% to 4.0% of GDP. Over the late 1990s, it fell to its lowest level of GDP since data has been collected, and then rose from that low base in the 2000s. It has been above its long-term average since 2009, but below the levels prevalent from 1975 to 1981. Since 2009, much of the growth in non-defense discretionary spending was a result of the 2009 Economic Stimulus Act. Most discretionary spending under this act will be completed by 2011.

Figure 3. Discretionary Spending, Historical and Projected in the Baseline
1962-2021



Source: OMB and CBO

In contrast to the growth in mandatory spending and net interest, discretionary spending declines significantly relative to GDP over the 10 years in the baseline. (The CBO “current law”

²¹ CRS Report R40976, *Earmarks Disclosed by Congress: FY2008-FY2010 Regular Appropriations Bills*, by Carol Hardy Vincent and Jim Monke, Table 3.

²² Office of Management and Budget, *Terminations, Reductions, and Savings*, Feb. 2011.

baseline and the “current policy” baseline in **Table 1** make the same assumptions about discretionary spending.) This occurs not because of explicit policies already in place, but because of the nature of discretionary spending. Since discretionary spending is determined annually, these baselines make the simple assumption that current policy is equivalent to maintaining a constant real (inflation-adjusted) level of discretionary spending. If this occurred, it would mark a significant break from past policy, as shown in **Table 2**. In that sense, the baselines underestimate the magnitude of policy changes needed to put the budget back on a sustainable path.

Table 2. Average Annual Real Growth Rates of Discretionary Spending Outlays

Actual and CBO Baseline, Adjusted for Inflation

	Defense	Non-Defense
2000-2008 (Actual)	5.1%	3.0%
2009-2010 (Actual)	5.7%	11.4%
2011-2021 (CBO Baseline)	0.5%	-0.7%

Source: CRS calculations based on OMB and CBO data.

Notes: The CBO baseline assumes that future discretionary budgetary authority (rather than outlays) will grow at the rate of inflation (with small exceptions) as measured by the GDP deflator and government salaries will grow at the rate of the change in the employment cost index. This means that the growth of discretionary outlays will be slightly larger or smaller than the inflation rate.

By 2021, defense discretionary spending under the baseline would decline to its lowest share of GDP since 2002, before there were significant overseas operations, and non-defense discretionary spending would decline to its lowest share of GDP ever since the data series begins in 1962, as shown in **Figure 3**. Reducing the deficit through discretionary spending cuts would require reducing spending to even lower shares of GDP.

One deficit-reduction proposal is to freeze discretionary spending in nominal terms.²³ This proposal would not result in rapid deficit reduction. Relative to the baseline, this proposal would reduce the deficit by less than one-tenth of 1% in 2012, gradually rising to 1% of GDP by 2018. If defense is not included in the freeze, the reduction in the deficit is less than half that size. Significant reductions in the deficit through discretionary spending would require discretionary spending to fall in nominal terms (i.e., not adjusted for inflation), which has occurred rarely historically. Since 1963, discretionary spending has fallen in nominal terms in only four years, most recently in 1996. H.R. 1, as passed by the House on February 19, 2011, would reduce discretionary spending by \$19 billion relative to the January CBO baseline, which is equivalent to less than 2% of the projected 2011 deficit. H.R. 1473, signed into law as P.L. 112-10 on April 15, 2011, reduces 2011 discretionary outlays by \$10 billion relative to the January baseline.

Due to the timing of defense funding authorizations relative to the CBO baseline, the most recent baseline includes the continuation of spending on overseas military operations at current levels (about \$170 billion a year in 2011 dollars) throughout the 10-year budget window. For defense, the timing and magnitude of any potential drawdown in overseas military operations could cause

²³ For more information, see CRS Report R41174, *Impact on the Federal Budget of Freezing Non-Security Discretionary Spending*, by Mindy R. Levit.

military spending to decline relative to the baseline, but traditionally such changes have not been motivated by deficit reduction. Even if current operations are reduced, future geopolitical events could require military personnel to be deployed elsewhere in the next 10 years, so the baseline does not necessarily overestimate future defense spending.

In long-term projections, CBO holds discretionary spending constant as a share of GDP since it is determined annually. (Using the baseline assumption that discretionary spending is constant in inflation-adjusted terms would lead to unrealistically small levels of future spending if extrapolated for 75 years.) Since discretionary spending is constant, it is not responsible for the growth of the budget deficit in long-term projections.

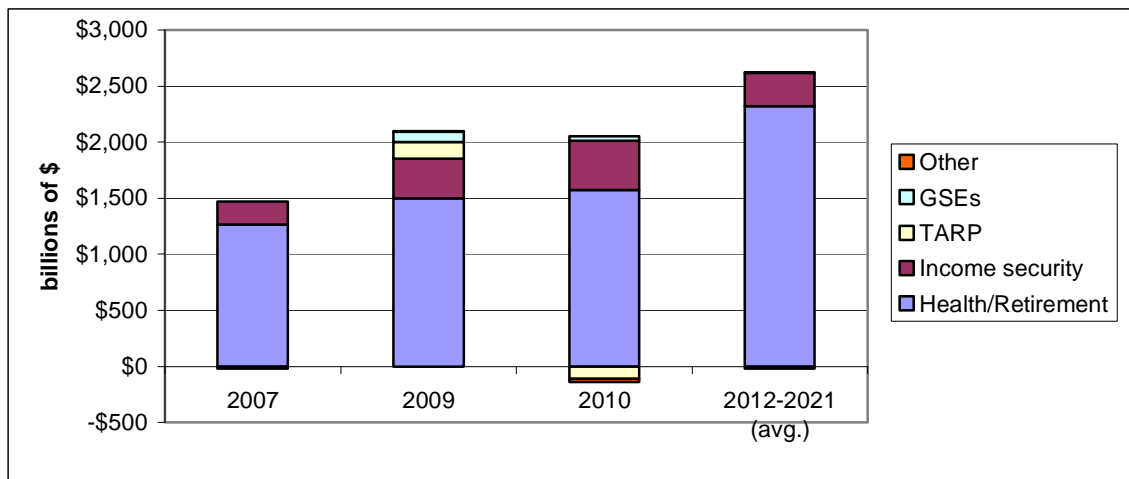
Mandatory Spending

Unlike discretionary spending, mandatory spending grew rapidly from 5% of GDP in 1962 to a range of 9% to 10.5% of GDP from 1975 to 2007, peaking in recession years because of automatic stabilizers. It averaged over 13% of GDP from 2009 to 2011, marking its highest share of GDP since data were first compiled in 1962. Since 1962, mandatory spending fell in nominal terms in only one year, 2010; if TARP and deposit insurance, which recorded negative outlays that year, are removed, all other mandatory spending grew in 2010.

Over the long term, the upward trend in mandatory spending in the past and future is dominated by Social Security, Medicare, and Medicaid, which accounted for about three-quarters of total mandatory spending in 2010. Between 2007 and the 2009 to 2011 period, the growth in mandatory spending was dominated by financial crisis programs, 2009 Economic Stimulus Act spending, and automatic stabilizers (primarily located in the Income Security category). From 2007 to 2009, mandatory health and retirement programs (including Social Security, Medicare, and Medicaid) increased by \$234 billion or 19%, as shown in **Figure 4**. Over the same period, income security outlays increased by \$146 billion or 73%. In 2009, TARP was created and the GSEs began to receive financial assistance, adding \$152 billion and \$91 billion to mandatory spending, respectively.

Figure 4. Mandatory Spending in Selected Years

Billions of nominal dollars



Source: CRS calculations based on CBO data.

Notes: Health/Retirement = Social Security, Medicare, Medicaid, Civil Service and Military Retirement, Veterans, and other health programs (net of offsetting receipts); GSEs = Government Sponsored Enterprises; TARP = Troubled Asset Relief Program; Income Security = unemployment benefits, means-tested transfer programs to households, refundable tax credits; Other = remaining programs net of offsetting receipts. Outlays can be negative for a category because offsetting receipts exceed spending or because of subsidy reestimates for credit programs. Totals for joint state-federal programs include only the federal share.

Outside of health and retirement programs, other mandatory programs are projected to decline significantly in nominal terms over the next 10 years. TARP registered a negative outlay of \$110 billion in 2010, representing a downward revision of the estimated cost of the program, and is projected to spend an average of \$1 billion per year over the next 10 years. Transfers to the GSEs declined to \$41 billion in 2010, and are projected to average \$5 billion per year over the next 10 years. As the economy improves, “automatic stabilizer” spending is also projected to decline: spending on income security programs more than doubled in nominal terms between 2007 and 2010, but is projected to decline from \$438 billion in 2010 to an annual average of \$296 billion over the next 10 years.

In long-term budget projections, rising budget deficits are driven primarily by the growth in entitlement programs for the elderly, particularly health spending. Social Security outlays are projected to rise from 4.8% of GDP today to 6.2% of GDP in 2035, and federal health outlays (mainly on Medicare and Medicaid) are projected to rise from 5.5% today to as much as 10.9% of GDP in 2035. By 2050, outlays on Social Security and health programs would exceed total revenues. In part, this is driven by the assumptions that go into these projections—revenues and discretionary spending are assumed to stay constant relative to GDP in the long run, while health spending per capita is projected to continue to grow faster than GDP per capita because it has historically grown much more quickly. If health spending per capita grew at the same rate as GDP per capita (technically, this is referred to as an excess cost growth rate of zero), much of the increase in federal spending would be avoided, although spending would still grow somewhat because of demographic changes, namely the retirement of the baby boomers, that increased the number of recipients.²⁴

The growth in elderly entitlement spending keeps deficits unsustainably large in the long run. Restraining the future growth rate of this spending would keep the deficit from growing, but it alone would not reduce the budget deficit in the short run. In effect, since the debt is already growing faster than GDP today, restraining elderly entitlement growth would keep the debt to GDP ratio on its current upward—and therefore, unsustainable—trajectory.²⁵ Most proposals to reform elderly entitlement programs would generate significant budgetary savings in the long run, but little budgetary savings in the short run, partly because most proposals exempt current retirees from reform and partly because the savings from these changes would compound over time. For example, immediately reducing excess cost growth for federal health spending to zero would reduce federal spending by 2% of GDP after 15 years, but by 0.6% of GDP after 5 years.²⁶

²⁴ For more information, see CRS Report RL32747, *The Economic Implications of the Long-Term Federal Budget Outlook*, by Marc Labonte.

²⁵ This would be the case under the assumptions that discretionary spending and revenues stay around the historical average, as opposed to revenues being determined by current law.

²⁶ Congressional Budget Office, *Long-Term Budget Outlook*, June 2010, Figure 2-5.

Revenues

Since 2009, revenues have been at historically low shares of GDP across all major categories—individual income taxes are at their lowest share of GDP since 1950, corporate income taxes are at their lowest share of GDP since the 1930s, social insurance receipts are at their lowest share of GDP since the 1970s, and excise taxes are at their lowest share of GDP since 1934, the first year for which data are available. In recent years, most revenues have come from the individual and social insurance categories.

Revenues in the CBO “current law” baseline are projected to exceed 20% of GDP from 2015 on, which is higher than the historical average. This increase occurs primarily because CBO assumes that the “Bush tax cuts” and “AMT patch” expire as scheduled in current law. If the tax cuts and AMT patch continue to be extended, revenues would be about 2% of GDP lower from 2014 on. In this scenario, they would gradually increase over the next 10 years due to the improvement in the economy (initially) and “real bracket creep,” returning to their historical average around 2014. Real bracket creep refers to the fact that the same tax structure generates more revenue relative to GDP when incomes rise.

If policymakers decided to increase revenue to reduce the deficit, five broad choices are often discussed²⁷:

- redesigning the structure of the tax system;
- adding new revenue sources, such as a carbon tax or a value added tax (VAT);
- increasing existing taxes;
- “broadening the tax base” by eliminating tax expenditures (deductions, exemptions, and credits); or
- allowing tax cuts to expire as scheduled.

Redesigning the tax system or adding new revenue sources could theoretically improve economic efficiency and might be more appealing to some than increasing existing taxes, but in practice, pressure to compensate those made worse off from these changes may result in those policies raising little additional revenue. Generally, economists favor eliminating tax expenditures over raising marginal tax rates on efficiency grounds, although some specific expenditures may promote economic efficiency. Tax expenditures have also been criticized on the grounds of equity and complexity.²⁸

For long-term projections, defining revenues under current policy is problematic. Under current law, revenues are projected to gradually rise relative to GDP over the next 75 years because some parts of the tax system, notably the AMT, are not indexed for inflation and other parts of the system would experience “real bracket creep.”²⁹ If current policy was instead considered to be

²⁷ For a further analysis, see CRS Report R41641, *Tax Policy Options for Deficit Reduction*, by Molly F. Sherlock.

²⁸ For more information, see CRS Report RL33641, *Tax Expenditures: Trends and Critiques*, by Thomas L. Hungerford.

²⁹ The reason regular AMT “patches” have been enacted in recent years is to prevent an increase in taxpayers subject to (continued...)

defined as setting revenues at current levels or returned to historical levels, revenues would be insufficient to match the long-term growth in spending under current policy, and progressively larger budget deficits would result.

What Caused the Budget Deficit?

After recording a FY2000 federal budget surplus of \$236 billion, in January 2001 CBO projected growing surpluses throughout the decade, with a \$796 billion surplus expected for FY2010.³⁰ However, enactment of major legislation during the past decade, in combination with changing economic conditions, altered the long-term federal budget outlook dramatically. In FY2002, the budget recorded a deficit for the first time since 1997, and the federal government has run a deficit in each subsequent year. Most recently, the FY2010 deficit was \$1.3 trillion, a \$2.1 trillion deterioration in budget balance from the 2010 surplus of \$796 billion projected by CBO in 2001.³¹

The broad reason the budget moved from surplus to deficit is because Congress chose an overall level of spending that exceeded chosen revenue levels. However, the budget is the sum of its parts, so no single spending or tax decision can be taken in isolation and be said to have “caused” the deficit in an absolute sense. Furthermore, some determinants of spending and revenues are not directly controlled by Congress. When economic conditions change, spending and revenues automatically change without any change in law.

For a detailed examination of why the budget moved from surplus to deficit, it is necessary to have a benchmark against which the actual deficit can be compared. One benchmark would be to compare the 2010 deficit to the 2001 surplus, but this approach would be fraught with several difficulties. For one thing, spending and revenues are expected to increase over time because of inflation and economic growth, among other factors, so that \$1 spent in 2010 is not equivalent to \$1 spent in 2001. In addition, the economy in 2010 is not at the same level of production or in the same position in the business cycle as the economy in 2001, so the economy’s effect on the budget is not the same either. Finally, the same law yields different levels of spending or revenue over time. For example, entitlement spending can increase automatically if the number of beneficiaries increases. Therefore, comparing spending or revenue levels from one year to the next could give the false impression that policy had changed when it had not.

This report uses a different benchmark: it compares the actual budget balance since 2001 to CBO’s January 2001 baseline projection of the surplus for each of those years. Any year could have been chosen as the benchmark; this report uses CBO’s 2001 baseline as the benchmark because estimated 10-year surpluses peaked in this projection. In subsequent reports, the surplus projections would become deficits and be continually adjusted downward, as CBO became

(...continued)

the AMT due to inflation.

³⁰ Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2002-2011*, Table 1-2, January 2001, available at <http://www.cbo.gov/ftpdocs/27xx/doc2727/entire-report.pdf>.

³¹ Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, Table 1-3, January 2010, available at <http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf>.

progressively more pessimistic about the future path of deficits. Thus, the results that follow are partly a function of the benchmark chosen.

Table 3 shows the differences between CBO's January 2001 baseline projections and the actual budget balance for FY2001 to FY2010, attributing deficit increases to the legislative, economic, and technical categories.

Table 3. Differences Between 2001 Projected Baseline and Actual Budget Balance, FY2001-2010

billions of dollars

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Cumulative Total: 2001-2010
Baseline Surplus Projection in Jan. 2001	281	313	359	397	433	505	573	635	710	796	5,002
Legislative Changes	-81	-150	-363	-519	-543	-632	-721	-1,005	-1,412	-1,517	-6,943
Revenue	-74	-81	-186	-272	-218	-199	-233	-381	-370	-424	-2,438
Nondefense Discretionary Spending	0	-12	-35	-49	-65	-93	-83	-89	-135	-241	-802
Defense Spending	0	-38	-84	-122	-155	-177	-205	-245	-283	-302	-1,611
Mandatory Spending	-7	-14	-43	-41	-41	-72	-72	-118	-396	-256	-1,060
Debt Service	0	-5	-15	-37	-60	-93	-131	-175	-227	-286	-1,029
Economic Changes	-37	-121	-114	-59	2	15	21	-1	-143	-135	-572
Technical Changes	-35	-201	-259	-231	-206	-137	-33	-88	-566	-434	-2,189
GSEs	0	0	0	0	0	0	0	0	-96	-40	-136
Other Technical Changes	-35	-201	-259	-231	-206	-137	-33	-86	-470	-394	-2,053
Total Changes	-153	-471	-737	-810	-751	-753	-734	-1,094	-2,123	-2,090	-9,716
Actual Budget Surplus (+) / Deficit (-)	128	-158	-378	-413	-318	-248	-161	-459	-1,413	-1,294	-4,714

Source: Congressional Research Service. Data compiled from Congressional Budget Office, *The Budget and Economic Outlook* (January 2001 to January 2011); and Congressional Budget Office, *An Analysis of the President's Budgetary Proposals* (May 2001 to March 2010).

Notes: Negative numbers indicate an increase in the deficit. Columns may not be additive due to rounding. In the January baseline, CBO does not report changes to the previous year deficit that occurred since the August baseline. Therefore, any changes between the actual deficit and the baseline deficit projected in August have been apportioned evenly between economic and technical changes. Amounts for the GSEs (Fannie Mae and Freddie Mac) are actual, ex-post totals, not the original projections for those programs. CBO classified its decision to place Fannie Mae and Freddie Mac on budget once those institutions began receiving funds from Treasury as a technical change to the baseline. The amounts recorded for Fannie Mae and Freddie Mac reflect the cash transfers from Treasury, and not the subsidy estimate.

Legislative changes refer to enacted laws affecting revenue, mandatory spending, or discretionary spending. Besides the direct effect of these changes on the deficit, they have also increased the national debt and the cost of debt servicing. The combined change in debt servicing attributed to the enactment of all new legislation is reported separately in **Table 3**. Over the past 10 years, legislative changes have increased federal budget deficits by approximately \$6.9 trillion. Each year since 2003, legislative changes alone would have caused a deficit based on the CBO projections from January 2001.³²

At the same time, independent of the effects of any new legislation enacted by Congress, economic variables such as inflation, the unemployment rate, and interest rates have turned out to be different over the last decade compared to the projection from 2001, affecting both outlays and federal receipts. CBO classifies these effects as *economic changes*. In addition, differences between budget projections and the actual annual deficit or surplus were also caused by actual outcomes being different from the technical assumptions underlying CBO's projection from 2001. For example, if more beneficiaries took up an entitlement benefit than projected, or if fewer taxpayers claimed a tax credit than projected, there would be a technical change to CBO's projections. *Technical changes* exceeded \$2 trillion from 2001 to 2010, highlighting the uncertainty inherent in budget projections. Legislative changes are based on the official score of a spending or revenue change at the time of enactment; if those amounts turn out after the fact to be different than the score, it is counted as a technical change. Economic changes to the projection were smaller than legislative or technical changes from 2002 on. Economic changes exceeded \$100 billion in 2002, 2003, 2009, and 2010.

For 2010, legislative changes accounted for about \$1.5 trillion or three-quarters of the shift from surplus to deficit that has occurred since the 2001 projection. Of these changes, the largest are the "Bush tax cuts" and various extensions of its provisions (\$213 billion), the 2009 Economic Stimulus Act (\$220 billion in spending and \$180 billion in tax cuts), and discretionary spending in excess of the rate of inflation since 2001 (\$300 billion for defense and \$132 billion for non-defense not attributable to the stimulus act).³³ For defense discretionary spending, this increase was largely attributable to overseas operations. Due to budgeting conventions, TARP reduced the budget deficit in 2010. Economic changes played a small role in the shift to deficit—although there was a severe recession not anticipated in the 2001 projection, the actual level of GDP in 2010 was still fairly close to what CBO had projected in 2001. Technical changes made up an estimated \$434 billion of the shift to deficit in 2010, of which \$40 billion was funds transferred to Fannie Mae and Freddie Mac, which CBO moved on to the federal budget after the Treasury took them into conservatorship in 2008. Although CBO did not consider this to be a legislative change, conservatorship can be thought of as a policy change because it resulted in these entities receiving large-scale direct federal support.

While **Table 3** demonstrates that legislative changes increased the deficit by a growing dollar amount each year since 2001, legislation enacted in that year was not necessarily the source of the deficit in any given year, since most legislation affects the deficit for several years into the future.

³² For detailed information on the major legislative changes from 2001 to 2009, see CRS Report R41134, *The Impact of Major Legislation on Budget Deficits: 2001 to 2009*, by Marc Labonte.

³³ For consistency, these costs are the original estimates of the legislation. Some legislation has been reestimated since, but others have not. These totals do not include the accompanying increase in debt service.

Table 4 illustrates that legislation enacted in 2009 had the single largest effect on the 2009 and 2010 budget balances, but most of the legislative changes adding to the deficit those years occurred as a result of legislation enacted in earlier years. Legislation enacted in FY2009, notably the Emergency Economic Stabilization Act and the 2009 Economic Stimulus Act, caused the 2009 deficit to increase by \$509 billion, while legislative changes from 2001 to 2008 caused the 2009 deficit to increase by an additional \$903 billion. Stated differently, if no legislation had been enacted after 2008, there would still have been a deficit of about \$900 billion in 2009 and \$725 billion in 2010. For the decade as a whole, it can be estimated that legislative changes have increased deficits, relative to the 2001 baseline projections, by \$6.9 trillion. Laws enacted in 2001 and 2003, notably the “Bush tax cuts,” generated the largest 10-year increases in budget deficits.

Table 4. Budgetary Effects of Legislative Changes by Year of Enactment, FY2001-FY2010
billions of dollars

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Cumulative Total: 2001-2010
2001 Legislation	-81	-52	-107	-131	-138	-174	-201	-221	-241	-274	-1,620
2002 Legislation	0	-98	-131	-127	-113	-99	-103	-112	-121	-134	-1,037
2003 Legislation	0	0	-125	-259	-212	-159	-164	-182	-189	-196	-1,486
2004 Legislation	0	0	0	-2	-40	-82	-105	-116	-128	-140	-613
2005 Legislation	0	0	0	0	-40	-52	-15	-3	3	5	-102
2006 Legislation	0	0	0	0	0	-66	-106	-85	-92	-102	-451
2007 Legislation	0	0	0	0	0	0	-27	-36	-32	-37	-132
2008 Legislation	0	0	0	0	0	0	0	-250	-103	-69	-422
2009 Legislation	0	0	0	0	0	0	0	0	-509	-457	-966
2010 Legislation	0	0	0	0	0	0	0	0	0	-113	-113
Total 2001-2010 Legislative Changes	-81	-150	-363	-519	-543	-632	-721	-1,005	-1,412	-1,517	-6,943

Source: Congressional Research Service. Data compiled from Congressional Budget Office, *The Budget and Economic Outlook* (January 2001 to January 2011); and *An Analysis of the President’s Budgetary Proposals* (May 2001 to March 2011).

Notes: Negative numbers indicate an increase in the deficit. Columns may not be additive due to rounding. On a cash flow basis, conservatorship of Fannie Mae and Freddie Mac added \$96 billion to the deficit in 2009 and \$40 billion in 2010. These amounts are not included in the Table because CBO classifies them as a technical, as opposed to legislative, changes.

Mandatory spending in existing programs (i.e., outside of TARP, the GSEs, the prescription drug benefit enacted in 2003 (P.L. 108-173), and the 2009 Economic Stimulus Act) grew significantly in the last decade, but was not responsible for the budget deficit under the method used in this

section. That is because the growth in mandatory spending that occurred was not due to legislative changes—it was due to the automatic growth of entitlement benefits under existing law in 2001—and was largely already built into the 2001 CBO projections that yielded large budget surpluses. In fact, each year until 2009, actual mandatory spending was less than CBO’s projection of mandatory spending in 2001.³⁴ In other words, the budget would have been in surplus over the last decade despite the growth in existing mandatory spending programs, were it not for the legislative changes that took place since 2001.

Reversing these policy changes is one possible path that could put the budget back on a sustainable path or even back into balance. Because these policy changes are recent does not mean, however, that reversing them is necessarily the most desirable option on economic, policy, or other grounds.

Conclusion

Budget deficits have reached historically high and unsustainable levels since 2009 because spending has been at its highest level since 1945 and revenues have reached their lowest level as a share of GDP since 1950. By 2014, deficits decline to about 3% of GDP—a nearly sustainable level—under the official CBO “current law” baseline. This baseline makes several assumptions that would mark a significant change from current policy—that the Bush tax cuts and AMT patch would be allowed to expire as scheduled although they have already been extended at least once, that cuts to physician payments would be allowed although Congress has routinely prevented those cuts, and that discretionary spending will grow much more slowly than it has in the past. Even if discretionary spending is held constant in inflation-adjusted terms, budget deficits under current policy (as opposed to current law) would remain above 5% of GDP and would continually rise as a share of GDP after 2014 over the next 10 years.

One policy goal is to place the deficit on a sustainable path so that the federal debt stabilizes as a share of GDP. For illustrative purposes, CRS estimates that to stabilize debt as a share of GDP at its projected 2011 level (69% of GDP) would require annual budget deficits no larger than 2½% to 3% of GDP over the next 10 years, based on CBO’s projections of GDP growth and interest rates. In dollar terms, this would amount to a deficit of about \$400 billion in 2012, rising to about \$550 billion in 2015. Compared to the “current policy” baseline, this would require some combination of spending cuts and tax increases equivalent to more than \$700 billion in 2012 and \$400 billion in 2015.

Balancing the budget through changes to one subsection of the budget at 2011 levels is not mathematically possible. For example, total spending outside of Social Security, Medicare, defense, and net interest is projected to be roughly the same size as the budget deficit in 2011. To date, legislation to reduce the budget deficit has focused on reducing discretionary spending, but total discretionary spending (defense and non-defense combined) is projected to be smaller than the budget deficit in 2011. Relative to the baseline, freezing discretionary spending in nominal terms would reduce the deficit by less than one-tenth of 1% in 2012, gradually rising to 1% of

³⁴ CRS Report R41134, *The Impact of Major Legislation on Budget Deficits: 2001 to 2009*, by Marc Labonte, Table 2.

GDP by 2018. If defense is not included in the freeze, the reduction in the deficit is less than half as large.

In long-term projections of current policy, unsustainable budget deficits are largely driven by the growth in elderly entitlement spending. By 2050, outlays on Social Security and health programs are projected to exceed total revenues. But since deficits are already at unsustainable levels today, restraining the future growth rate of elderly entitlement spending alone would still leave an unsustainably large budget deficit—in effect, it would simply keep the deficit from getting larger. Most proposals to curb the future growth of these programs call for gradual changes that exempt those who are now elderly or near-elderly. These types of proposals typically result in modest deficit reduction in the short term.

Assigning the relative contribution of past policy decisions to the current deficit depends on one's starting reference point. Although some of the increase in the deficit is attributable to economic and technical changes to CBO's projections, legislative changes alone would have resulted in a deficit since 2003. Compared to CBO's 2001 baseline projection, legislative changes from 2009 and 2010 increased the 2010 deficit by \$570 billion, while legislative changes from 2001 to 2008 increased the 2010 deficit by \$947 billion.

To date, legislation to reduce the deficit has been more than offset by legislation (motivated by other policy goals, such as stimulating the economy) that increases the deficit. In the 112th Congress, the Department of Defense and Full Year Continuing Appropriations Act of 2011 (H.R. 1473), signed into law as P.L. 112-10 on April 15, 2011, reduces 2011 discretionary outlays by \$10 billion relative to CBO's January baseline. But in the 111th Congress, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) increased the deficit by an estimated \$374 billion in 2011, \$204 billion of which is attributable to the extension of expiring tax provisions.

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