Congressional Budget Office

Testimony

Statement of
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The Budget and Economic Outlook: Fiscal Years 2011 to 2021

before the
Committee on the Budget
U.S. House of Representatives

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Chairman Ryan, Congressman Van Hollen, and Members of the Committee, thank you for inviting me to testify on the Congressional Budget Office's (CBO's) most recent analysis of the outlook for the budget and the economy. My statement summarizes CBO's new economic forecast and baseline budget projections, which cover fiscal years 2011 through 2021. Those estimates were released a few weeks ago in the report titled *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*.

The United States faces daunting economic and budgetary challenges. The economy has struggled to recover from the recent recession, which was triggered by a large decline in house prices and a financial crisis—events unlike anything this country has seen since the Great Depression. During the recovery, the pace of growth in the nation's output has been anemic compared with that during most other recoveries since World War II, and the unemployment rate has remained quite high.

For the federal government, the sharply lower revenues and elevated spending deriving from the financial turmoil and severe drop in economic activity—combined with the costs of various policies implemented in response to those conditions and an imbalance between revenues and spending that predated the recession—have caused budget deficits to surge in the past two years. The deficits of $1.4 trillion in 2009 and $1.3 trillion in 2010 are, when measured as a share of gross domestic product (GDP), the largest since 1945—representing 10.0 percent and 8.9 percent of the nation's output, respectively.

For 2011, the Congressional Budget Office projects that if current laws remain unchanged, the federal budget will show a deficit of close to $1.5 trillion, or 9.8 percent of GDP (see Table 1). The deficits in CBO's baseline projections drop markedly over the next few years as a share of output and average 3.1 percent of GDP from 2014 to 2021. Those projections, however, are based on the assumption that tax and spending policies unfold as specified in current law. Consequently, they understate the budget deficits that would occur if many policies currently in place were continued, rather than allowed to expire as scheduled under current law.

The Economic Outlook

Although recent actions by U.S. policymakers should help support further gains in real (inflation-adjusted) GDP in 2011, production and employment are likely to stay well below the economy's potential for a number of years. CBO expects that economic growth will remain moderate this year and next. As measured by the change from the fourth quarter of the previous year, real GDP is projected to increase by 3.1 percent this year and by 2.8 percent next year (see Table 2). That forecast reflects CBO's expectation of continued strong growth in business investment, improvements in both residential investment and net exports, and modest increases in consumer spending. It also includes the impact of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (referred to in this report as the 2010 tax act), enacted in December, which provides a short-term boost to the economy by reducing some taxes, extending unemployment benefits, and delaying an increase in taxes that would otherwise have occurred in 2011. CBO projects that inflation will remain very low in 2011 and 2012, reflecting the large amount of unused resources in the economy, and will average no more than 2.0 percent a year between 2013 and 2016.

The recovery in employment has been slowed not only by the moderate growth in output in the past year and a half but also by structural changes in the labor market, such as a mismatch between the requirements of available jobs and the skills of job seekers, that have hindered the reemployment of workers who have lost their job. Payroll employment, which declined by 7.3 million during the recent recession, gained a mere 70,000 jobs (or 0.06 percent), on net, between June 2009 and December 2010. (By contrast, in the first 18 months of past recoveries, employment rose by an average of 4.4 percent.) Consequently, the rate of unemployment has fallen by only a small amount: After climbing to 10.1 percent of the labor force during 2009, the unemployment rate declined only to 9.4 percent by December 2010. Other measures of labor market conditions suggest even more slack than does the unemployment rate. For example, almost 9 million workers who have wanted full-time work in the past two years have been employed only part time.

As the recovery continues, the economy will add roughly 2.5 million jobs per year over the 2011–2016 period,

Table 1.

CBO's Baseline Budget Outlook

	Actual, 2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total 2012-2016	Total 2012-2021
								In Billions of Dollars						
Total Revenues	2,162	2,228	2,555	3,090	3,442	3,651	3,832	4,075	4,275	4,489	4,712	4,963	16,570	39,084
Total Outlays	3,456	3,708	3,655	3,794	3,975	4,202	4,491	4,691	4,885	5,185	5,451	5,726	20,117	46,055
Total Deficit (-) or Surplus	**-1,294**	**-1,480**	**-1,100**	**-704**	**-533**	**-551**	**-659**	**-617**	**-610**	**-696**	**-739**	**-763**	**-3,547**	**-6,971**
On-Budget	-1,371	-1,548	-1,186	-792	-621	-641	-752	-706	-693	-768	-798	-808	-3,992	-7,765
Off-Budget[a]	77	68	86	88	87	90	94	90	82	73	59	45	445	794
Debt Held by the Public at the End of the Year	9,018	10,430	11,598	12,386	12,996	13,625	14,358	15,064	15,767	16,557	17,392	18,253	n.a.	n.a.
								As a Percentage of GDP						
Total Revenues	14.9	14.8	16.3	18.8	19.9	20.1	20.0	20.3	20.4	20.5	20.7	20.8	19.1	19.9
Total Outlays	23.8	24.7	23.3	23.1	23.0	23.1	23.5	23.4	23.3	23.7	23.9	24.0	23.2	23.5
Total Deficit	**-8.9**	**-9.8**	**-7.0**	**-4.3**	**-3.1**	**-3.0**	**-3.4**	**-3.1**	**-2.9**	**-3.2**	**-3.2**	**-3.2**	**-4.1**	**-3.6**
Debt Held by the Public at the End of the Year	62.1	69.4	73.9	75.5	75.3	74.9	75.0	75.2	75.3	75.8	76.2	76.7	n.a.	n.a.

Source: Congressional Budget Office.

Note: n.a. = not applicable.

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

CBO estimates. However, even with significant increases in the number of jobs, a substantial reduction in the unemployment rate will take some time. CBO projects that the unemployment rate will gradually fall in the near term, to 9.2 percent in the fourth quarter of 2011, 8.2 percent in the fourth quarter of 2012, and 7.4 percent at the end of 2013. Only by 2016, in CBO's forecast, does it reach 5.3 percent, close to the agency's estimate of the natural rate of unemployment (the rate of unemployment arising from all sources except fluctuations in aggregate demand, which CBO now estimates to be 5.2 percent).

For the period beyond 2016, CBO's economic projections are based on trends in the factors that underlie potential output, including the labor force, capital accumulation, and productivity. The projections therefore do not explicitly incorporate fluctuations resulting from the business cycle. In CBO's projections, growth of real GDP averages 2.4 percent annually from 2017 to 2021, a pace that matches the growth of potential GDP over those years. The unemployment rate averages 5.2 percent in that same period.

The Budget Outlook

The recovery now under way might be expected to lessen the budget imbalance in 2011 by increasing tax revenues and decreasing spending for certain income-support programs, such as unemployment compensation. However, revenue growth will be restrained by the slow and tentative pace of the recovery and by the 2010 tax act.

Moreover, outlays for many programs are projected to continue to grow and more than offset the decreases in spending (for unemployment compensation, for example) yielded by improving economic conditions.

The resulting federal budget deficit of nearly $1.5 trillion projected for this year will equal 9.8 percent of GDP, a share that is nearly 1 percentage point higher than the shortfall recorded last year and almost equal to the deficit posted in 2009, which at 10.0 percent of GDP was the highest in nearly 65 years.

By CBO's estimates, federal revenues in 2011 will be $123 billion (or 6 percent) more than the total revenues recorded two years ago, in 2009. The continued slow

Table 2.

CBO's Economic Projections for Calendar Years 2010 to 2021

	Estimated, 2010	Forecast 2011	Forecast 2012	Projected Annual Average 2013–2016	Projected Annual Average 2017–2021
	Fourth Quarter to Fourth Quarter (Percentage change)				
Real GDP	2.5	3.1	2.8	3.4	2.4
PCE Price Index	1.4	1.2	1.3	1.7	2.0
Core PCE Price Index[a]	1.0	1.0	1.2	1.6	2.0
Consumer Price Index[b]	1.2 [c]	1.3	1.3	2.0	2.3
Core Consumer Price Index[a]	0.6 [c]	0.9	1.2	1.9	2.2
	Fourth Quarter Level (Percent)				
Unemployment Rate	9.6 [c]	9.2	8.2	5.3 [d]	5.2 [e]
	Calendar Year Average				
Interest Rates (Percent)					
Three-month Treasury bill rate	0.1 [c]	0.3	1.1	3.6	4.4
Ten-year Treasury note rate	3.2 [c]	3.4	3.8	4.7	5.4
Unemployment Rate (Percent)	9.6 [c]	9.4	8.4	6.4	5.2
Nominal GDP (Percentage change)	3.8	3.7	4.4	5.1	4.4

Sources: Congressional Budget Office (CBO); Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve.

Notes: Data for the fourth quarter of 2010 were not available when CBO's forecast was completed in early December. Numbers for gross domestic product (GDP) in the table for 2010 are therefore based on CBO's estimates made in early December. More recent estimates from other forecasters, based on additional data, suggest that growth of nominal and real (inflation-adjusted) GDP in the fourth quarter was higher than CBO estimated.

PCE = personal consumption expenditures.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Actual value for 2010.

d. Value for 2016.

e. Value for 2021.

improvement in economic conditions is anticipated to boost revenues from individual income taxes, corporate taxes, and other sources by nearly $200 billion between those two years; however, revenues from social insurance taxes are projected to decline by more than $70 billion relative to their level two years ago, mostly as a result of a one-year reduction in payroll taxes included in the 2010 tax act.

Spending, for the most part, has been growing faster than revenues. Programs related to the federal government's response to the problems in the housing and financial markets are an exception; outlays recorded for the Troubled Asset Relief Program (TARP), for example, will decrease by $176 billion from 2009 to 2011, CBO projects.[1] But if current laws remain unchanged, federal outlays other than those for the TARP are projected to be $366 billion (or 11 percent) higher in 2011 than they were in 2009.

1. The Administration recorded outlays of $151 billion for the TARP in 2009, which reflected its estimate of the cost of the actions that had been undertaken by the Treasury. Because the financial system stabilized and many institutions repaid the assistance provided by the TARP earlier than expected, the Administration—following the standard procedures for federal credit programs—reduced the previously recorded cost by posting a large *negative* outlay (that is, a reduction in spending) in 2010. The program will again reduce the deficit in 2011, CBO estimates—showing negative outlays of $25 billion, mostly reflecting a further adjustment to the estimated cost recorded in 2009.

According to CBO's projections, mandatory spending excluding outlays for the TARP will increase by $191 billion (or 10 percent) between 2009 and 2011.[2] Significant growth in many areas—in particular, for Social Security, Medicare, and Medicaid—is expected to be offset only partially by reductions in outlays for other programs, primarily for Fannie Mae, Freddie Mac, and deposit insurance. Discretionary spending will increase by an estimated $137 billion over the two-year period; about one-third of that increase stems from funding provided by the American Recovery and Reinvestment Act of 2009 (ARRA). In addition, outlays for net interest will rise by an estimated $38 billion from 2009 to 2011, mostly because of substantial increases in borrowing.

Under current law, CBO projects, budget deficits will drop markedly over the next few years—to $1.1 trillion in 2012, $704 billion in 2013, and $533 billion in 2014. Relative to the size of the economy, those deficits represent 7.0 percent of GDP in 2012, 4.3 percent in 2013, and 3.1 percent in 2014. From 2015 through 2021, the deficits in the baseline projections range from 2.9 percent to 3.4 percent of GDP.

The deficits that will accumulate under current law will push federal debt held by the public to significantly higher levels. Just two years ago, debt held by the public was less than $6 trillion, or about 40 percent of GDP; at the end of fiscal year 2010, such debt was roughly $9 trillion, or 62 percent of GDP, and by the end of 2021, it is projected to climb to $18 trillion, or 77 percent of GDP. With such a large increase in debt, plus an expected increase in interest rates as the economic recovery strengthens, interest payments on the debt are poised to skyrocket over the next decade. CBO projects that the government's annual spending on net interest will more than double between 2011 and 2021 as a share of GDP, increasing from 1.5 percent to 3.3 percent.

CBO's baseline projections are not intended to be a forecast of future budgetary outcomes; rather, they serve as a neutral benchmark that legislators and others can use to assess the potential effects of policy decisions. Consequently, they incorporate the assumption that current laws governing taxes and spending will remain unchanged. In particular, the baseline projections in this report are based on the following assumptions:

- Sharp reductions in Medicare's payment rates for physicians' services take effect as scheduled at the end of 2011;
- Extensions of unemployment compensation, the one-year reduction in the payroll tax, and the two-year extension of provisions designed to limit the reach of the alternative minimum tax all expire as scheduled at the end of 2011;
- Other provisions of the 2010 tax act, including extensions of lower tax rates and expanded credits and deductions 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, expire as scheduled at the end of 2012; and
- Funding for discretionary spending increases with inflation rather than at the considerably faster pace seen over the dozen years leading up to the recent recession.

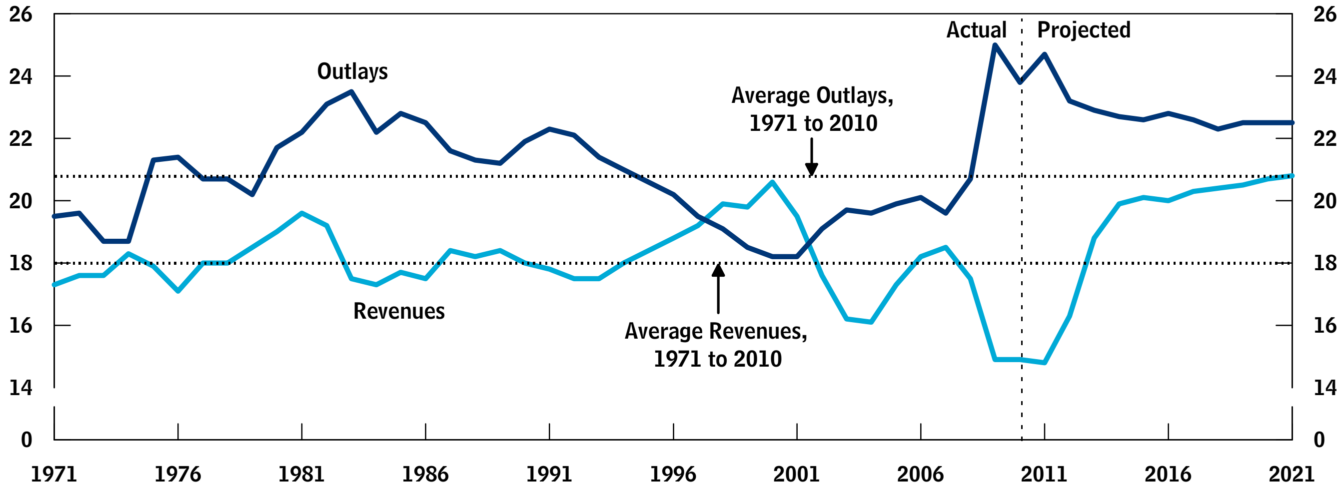
The projected deficits over the latter part of the coming decade are much smaller relative to GDP than is the current deficit, mostly because, under those assumptions and with a continuing economic expansion, revenues as a share of GDP are projected to rise steadily—from about 15 percent of GDP in 2011 to 21 percent by 2021 (see Figure 1).

As a result, the baseline projections understate the budget deficits that would arise if many policies currently in place were extended, rather than allowed to expire as scheduled under current law. For example, if most of the provisions in the 2010 tax act that were originally enacted in 2001, 2003, and 2009 or that modified estate and gift taxation were extended (rather than allowed to expire on December 31, 2012), and the alternative minimum tax was indexed for inflation, annual revenues would average about 18 percent of GDP through 2021 (which is equal to their 40-year average), rather than the 19.9 percent shown in CBO's baseline projections. If Medicare's payment rates for physicians' services were held constant as well, then deficits from 2012 through 2021 would average about 6 percent of GDP, compared with 3.6 percent in the baseline. By 2021, the budget deficit would be about double the baseline projection, and with cumulative deficits totaling nearly $12 trillion over the

2. Mandatory spending is governed by permanent law; in contrast, discretionary spending is controlled by annual appropriation acts.

Figure 1.
Total Revenues and Outlays

(Percentage of gross domestic product)



Source: Congressional Budget Office.

2012–2021 period, debt held by the public would reach 97 percent of GDP, the highest level since 1946.

Beyond the 10-year projection period, further increases in federal debt relative to the nation's output almost certainly lie ahead if current policies remain in place. The aging of the population and rising costs for health care will push federal spending as a percentage of GDP well above that in recent decades. Specifically, spending on the government's major mandatory health care programs—Medicare, Medicaid, the Children's Health Insurance Program, and health insurance subsidies to be provided through insurance exchanges—along with Social Security will increase from roughly 10 percent of GDP in 2011 to about 16 percent over the next 25 years.[3] If revenues stay close to their average share of GDP for the past 40 years, that rise in spending will lead to rapidly growing budget deficits and surging federal debt. To prevent debt from becoming unsupportable, policymakers will have to substantially restrain the growth of spending, raise revenues significantly above their historical share of GDP, or pursue some combination of those two approaches.

3. See Congressional Budget Office, *The Long-Term Budget Outlook* (June 2010, revised August 2010).