



# The Federal Budget: Issues for FY2011, FY2012, and Beyond

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## Summary

The federal budget is central to Congress's ability to exercise its "power of the purse." Over the last several fiscal years the imbalance between spending and revenues has grown as a result of the economic downturn and policies enacted in response to financial turmoil. In FY2010, the last completed fiscal year, the U.S. government spent \$3,456 billion (23.8% of GDP) and collected \$2,162 billion in revenue (14.9% of GDP), resulting in a budget deficit of \$1,294 billion (8.9% of GDP).

The Congressional Budget Office (CBO) baseline estimates the FY2011 budget deficit at \$1,480 billion or 9.8% of GDP and deficits throughout the 10-year budget window. The deficit is projected to be higher than that of FY2010 due to increases in mandatory spending and restrained growth in revenues as a result of the temporary payroll tax reduction. Under the President's Budget, deficit estimates for FY2011 amount to \$1,645 billion or 10.9% of GDP. This is larger than CBO's baseline deficit estimate, primarily due to differences in assumptions used relating to funding levels for the remainder of the fiscal year.

Congress and the President have yet to complete action on any of the 12 FY2011 regular appropriations acts. As a result, the federal government has been operating on a series of seven continuing resolutions since the beginning of the fiscal year. If further budget authority is not provided either through another continuing resolution or regular appropriations acts, a funding gap will occur for those projects and activities that are funded through annual appropriations acts.

The Obama Administration released its FY2012 budget on February 14, 2011. In FY2012, the President's Budget projects that the deficit will reach \$1,101 billion. Budget deficits are projected throughout the 10-year budget window. On the spending side, the FY2012 budget largely focused on a proposal to freeze non-security discretionary spending through FY2015 and increasing investments in various sectors. The budget proposal also included various tax proposals including the permanent extension of the 2001/2003/2010 tax cuts for families making less than \$250,000, changes in the estate tax parameters, a three-year proposal to pay for the indexation of the AMT "patch" for inflation, and some details on corporate tax reforms. The President also proposes a fee on the financial services industry over at least the next 10 years to recoup the cost of TARP.

Separately, on April 6, 2011, the House Budget Committee reported its budget resolution (H.Con.Res. 34, 112<sup>th</sup> Congress) by a vote of 22-16. The resolution provided for revenue levels of \$2,533 billion and outlays of \$3,529 billion in FY2012 for a deficit of \$995 billion, or approximately 6.3% of GDP. By FY2021, the deficit is projected to fall to \$385 billion or 1.6% of GDP.

Along with Congress, CBO, GAO, and the Administration agree that the current mix of federal fiscal policies is unsustainable in the long-term. The nation's aging population, combined with rising health care costs per beneficiary, seems likely to keep federal health costs rising faster than per capita GDP. Keeping future federal outlays at 20% of GDP, or approximately at its historical average, and leaving fiscal policies unchanged, according to CBO projections, would require drastic reductions in all spending other than that for Medicare, Social Security, and Medicaid, or reigning in the costs of these programs. As the economic recovery continues, Congress may focus more effort on balancing the budget and reining in the debt. This would require less spending, increases in revenue collections, faster-than-average economic growth, or a combination of these things. This report will be updated as events warrant.

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The federal budget is central to Congress's ability to exercise its "power of the purse." Federal budget decisions express Congress's priorities and reinforce Congress's influence on federal policies. Making budgetary decisions for the federal government is a complex process and requires balancing competing goals.<sup>1</sup> Recent economic turmoil has strained the federal budget as a result of declining revenues and increasing spending levels. As the economic recovery continues, the budget process will allow the President and Congress to negotiate priorities and refine spending plans.

The federal government faces very large budget deficits, rising costs of entitlement programs, significant spending on overseas military operations, and low revenue levels. The enactment of financial intervention and fiscal stimulus legislation in FY2008 and FY2009 may have helped to bolster the economy, though it increased the budget deficit. While GDP growth has returned in recent quarters,<sup>2</sup> unemployment remains elevated and government spending on "automatic stabilizer" programs, such as unemployment insurance and income support, remains higher than historical averages.<sup>3</sup> This suggests that the recession's effects on the budget will likely linger for several more fiscal years.

In addition to the current challenges, concerns remain about the federal government's long-term fiscal situation. The rising costs of federal health care programs and the effects of the baby boom generation's retirement present serious challenges to future fiscal stability. Operating these programs in their current form may pass on substantial economic burdens to future generations. To avoid this would require significant government action and public sacrifice at levels greater than those needed to counteract the recent economic downturn.

## Overview

### Budget Cycle

A single year's budget cycle takes roughly three calendar years from initial formation by the Office of Management and Budget (OMB) until final audit.<sup>4</sup> The executive agencies begin the budget process by compiling detailed budget requests in the calendar year before the President's budget submission. Many agencies start working on their budgets during the spring and summer—about a year and a half before the fiscal year begins. OMB oversees the development of these agency requests. The President is required to submit a budget to Congress, which is based on OMB's work, by the first Monday in February.<sup>5</sup>

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<sup>1</sup> For more information, see CRS Report 98-721, *Introduction to the Federal Budget Process*, coordinated by Bill Heniff Jr.

<sup>2</sup> U.S. Department of Commerce, Bureau of Economic Analysis, "Economy Picks Up in Fourth Quarter – Second Estimate of GDP," press release BEA 11-07, February 25, 2011, available at <http://www.bea.gov/newsreleases/national/gdp/gdphighlights.pdf>.

<sup>3</sup> Unless stated otherwise, data used in this report are from U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, January 2011, available at <http://www.cbo.gov/doc.cfm?index=12039>.

<sup>4</sup> CRS Report 98-325, *The Federal Fiscal Year*, by Bill Heniff Jr.

<sup>5</sup> The contents of the Presidential budget submission are governed by 31 U.S.C. §1105. For reasons why the budget may be delayed, see CRS Report RS20179, *The Role of the President in Budget Development*, by Bill Heniff Jr.

Congress typically begins formal consideration of the budget resolution once the President submits his budget request. The budget resolution sets out a plan, agreed to by the House and Senate, that establishes the framework for subsequent budget legislation. Because the budget resolution is a concurrent resolution, it is not sent to the President for approval.<sup>6</sup>

House and Senate Appropriations Committees and their subcommittees typically begin reporting discretionary spending bills after the budget resolution is agreed upon. Appropriations Committees review agency funding requests and propose levels of budget authority (BA). Appropriations acts passed by Congress set the amount of BA available for specific programs and activities. Authorizing committees, which control mandatory spending, and committees with jurisdiction over revenues also play important roles in budget decision making.

During the fiscal year, which begins on October 1, Congress and OMB oversee the execution of the budget. Once the fiscal year ends on the following September 30, the Treasury Department and the Government Accountability Office (GAO) begin year-end audits.

## **Budget Baseline Projections**

Budget baseline projections are used to measure what impact future legislation would have on the budget picture. They are not meant to be predictions of the future budget outlook. These future projections of budget deficit levels are garnering even greater attention due to the increasing calls for attention on the country's fiscal health. Due to the nature of projections, slight changes in assumptions can lead to large effects in outyear totals. Therefore, it is important to understand what projections include and the assumptions on which they are based.

The Congressional Budget Office (CBO) computes current law baseline projections using assumptions set out in budget enforcement legislation.<sup>7</sup> Forecasts based on these assumptions typically yield higher revenue estimates and slower growth of discretionary spending relative to scenarios independent forecasters consider likely. More specifically, CBO baseline projections incorporate certain assumptions: that discretionary spending remains constant in inflation-adjusted terms, that the 2001/2003/2010 tax cuts fully expire after 2012 (as current law specifies), that one-year "patches" to the alternative minimum tax (AMT) will lapse even though past Congresses have extended AMT patches year after year, that sharp reductions in Medicare's payment rates for physicians' services will take effect at the end of 2011 as scheduled, and that extensions of unemployment compensation will expire as scheduled on December 31, 2011.<sup>8</sup> However, CBO does provide projections of these costs separately from its baseline. In addition to these legislative assumptions, macroeconomic assumptions, namely the point at which CBO expects the recession to end and the speed of the recovery, will also affect the baseline estimates and projections, especially given the current economic climate.

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<sup>6</sup> Congress does not always complete action on a budget resolution. In years when Congress is late in adopting, or does not adopt, a budget resolution, the House and Senate independently may adopt "deeming resolution" provisions for the purpose of enforcing certain budget levels. For more information, see CRS Report RL30297, *Congressional Budget Resolutions: Historical Information*, by Bill Heniff Jr. and Justin Murray and CRS Report RL31443, *The "Deeming Resolution": A Budget Enforcement Tool*, by Megan Suzanne Lynch.

<sup>7</sup> While some budget enforcement legislation constraining the computation of CBO baseline estimates has expired, CBO has continued to follow those legislative guidelines.

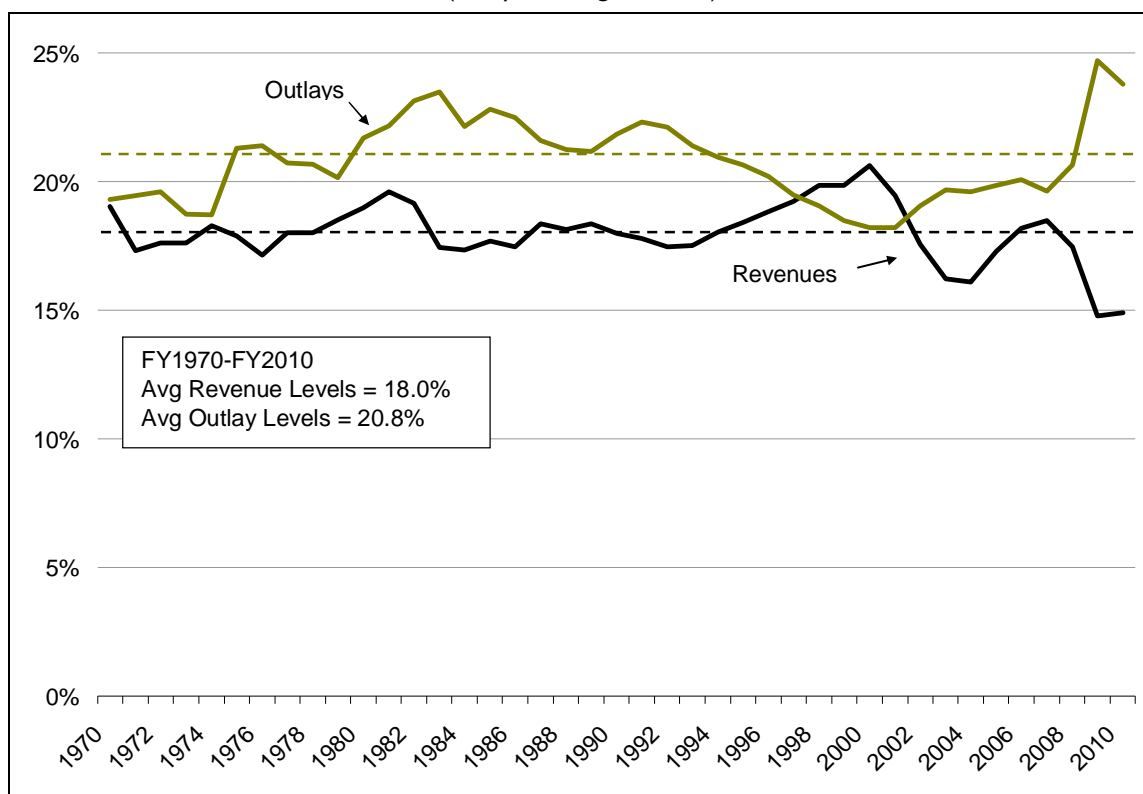
<sup>8</sup> U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, January 2011, p. 1.

Baseline projections showed substantial growth in receipts after 2012, when most of the tax cuts from 2001/2003/2010 expire. However, federal deficits are expected to grow rapidly beyond the 10-year forecast window unless major policy changes are made, largely because of increased outlays due to rapidly growing health care costs and baby boomer retirements.

## Spending and Revenue Trends

Over the last four decades, on average, federal spending accounted for approximately 21% of the economy (as measured by gross domestic product—GDP), while federal revenues averaged roughly 18% of GDP. Since FY2001, spending has exceeded revenues, resulting in budget deficits. Over the last several fiscal years the imbalance between spending and revenues has grown as a result of the economic downturn and policies enacted in response to financial turmoil. In FY2010, the last completed fiscal year, the U.S. government spent almost \$3.5 trillion and collected \$2.2 trillion in revenue.<sup>9</sup> Between FY2008 and FY2010, outlays increased by \$473 billion while revenues decreased by \$362 billion (in nominal terms). The trends in revenues and outlays between FY1970 and FY2011 are shown in **Figure 1**.

**Figure 1. Total Outlays and Revenues, FY1970-FY2010**  
(as a percentage of GDP)



**Source:** CRS figure using data from CBO, *Historical Tables*, available at <http://www.cbo.gov/ftpdocs/120xx/doc12039/HistoricalTables%5B1%5D.pdf>.

<sup>9</sup> U.S. Congressional Budget Office, *Historical Tables*, available at <http://www.cbo.gov/ftpdocs/120xx/doc12039/HistoricalTables%5B1%5D.pdf>.

## Federal Spending

Federal outlays are often divided into the broad categories of discretionary and mandatory spending, and net interest. Discretionary spending is controlled by annual congressional appropriations acts. Mandatory spending encompasses spending on entitlement programs and spending controlled by laws other than annual appropriation acts.<sup>10</sup> Entitlement programs such as Social Security, Medicare, and Medicaid make up the bulk of mandatory spending. Congress sets eligibility requirements and benefits for entitlement programs, rather than appropriating a fixed sum each year. Therefore, if the eligibility requirements are met for a specific mandatory program, outlays are made automatically. Net interest comprises the government's interest payments on the debt held by the public, offset by small amounts of interest income the government receives from certain loans and investments.<sup>11</sup>

In FY2000, total outlays equaled 18.2% of GDP. By FY2010, total outlays reached 23.8% of GDP. Under the CBO baseline, total outlays are projected to be 24.0% of GDP in FY2021.

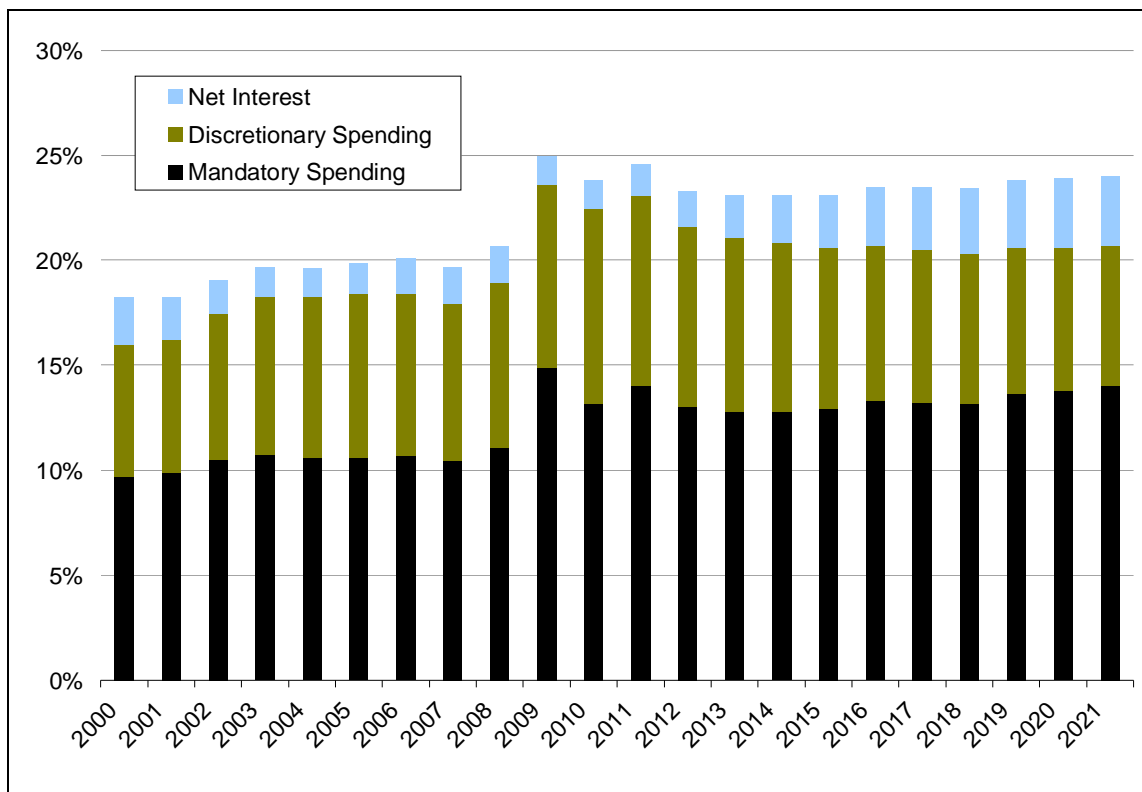
**Figure 2** shows the level of federal spending as a percentage of GDP, broken into the discretionary, mandatory, and net interest categories, from FY2000-FY2021.

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<sup>10</sup> For more information on trends in discretionary and mandatory spending, see CRS Report RL34424, *Trends in Discretionary Spending*, by D. Andrew Austin and Mindy R. Levit and CRS Report RL33074, *Mandatory Spending Since 1962*, by D. Andrew Austin and Mindy R. Levit.

<sup>11</sup> Net interest is discussed in further detail below in the section "Deficits, Debt, and Interest."

**Figure 2. Outlays by Type, FY2000-FY2021**  
(as a percentage of GDP)



**Source:** CRS figure using data from CBO, *Historical Tables and Budget Projections*, January 2011, available at <http://www.cbo.gov/ftpdocs/120xx/doc12039/BudgetTables%5B1%5D.pdf>. Data for FY2011 are estimates and data for FY2012-FY2021 are projections.

In FY2010, discretionary spending totaled 9.3% of GDP. Since FY2000, discretionary spending as a share of GDP has increased 8.2% a year, on average, in nominal terms. Increases in discretionary spending over this period have largely been a result of military operations in Iraq and Afghanistan and, most recently, the funding provided in the American Recovery and Reinvestment Act (ARRA; P.L. 111-5). On average, from FY2000 to FY2010, defense discretionary outlays grew 8.9% per year in nominal terms, while non-defense discretionary outlays grew 7.5% per year in nominal terms. By FY2021, according to CBO’s baseline projections (which assume that discretionary spending remains constant in real terms), discretionary spending will fall to 6.7% of GDP, close to its levels in the late 1990s. Non-defense discretionary spending, under the baseline, is projected to fall to its lowest level since before FY1962. The assumption that discretionary spending will remain constant in real terms is at odds with the historical growth rate of discretionary spending, leading to projections which often understate discretionary spending levels.

Mandatory spending totaled 13.2% of GDP in FY2010, up from 9.7% of GDP in FY2000, as shown in **Figure 2**. Mandatory spending levels have been elevated since FY2009 as a result of increases in outlays in income security programs and costs linked to the Troubled Asset Relief Program (TARP) and federal conservatorship of Fannie Mae and Freddie Mac. Though the economic recovery is expected to lower mandatory spending on certain programs over the next few fiscal years, the growth in mandatory spending due to increases in certain entitlement



programs will begin by the end of the decade. As a result, under current law, CBO projects that FY2021 mandatory spending will total 14.0% of GDP, higher than the FY2010 level.

In FY2010, mandatory spending totaled 55.3% of total outlays, discretionary spending totaled 39.0% of total outlays, and net interest comprised 5.7% of total outlays. Social Security, Medicare, and the federal share of Medicaid alone constitute 43% of all federal spending. Because discretionary spending represents slightly more than one-third of total federal outlays, some budget experts contend that any significant reductions in federal spending must include mandatory spending cuts. Other budget and social policy experts contend that cuts in mandatory spending would cause substantial disruption to many households, because mandatory spending funds important parts of the social safety net. Nevertheless, there is widespread agreement that action is needed to bring down anticipated high debt and deficit levels to restore long-term fiscal health.<sup>12</sup>

## Federal Revenue

In FY2000, revenues equaled 20.6% of GDP. In FY2010, federal revenue collection totaled 14.9% of GDP or its lowest level since FY1950. Revenue collection has remained depressed over the last few fiscal years as the result of the economic downturn and the tax relief provision in ARRA. Revenues are expected to remain depressed in FY2011. The longer term revenue outlook depends on the speed of economic recovery and the legislative actions of Congress on certain expiring tax provisions and potential tax reform. Under the CBO baseline, revenues are projected to total 20.8% of GDP in FY2021. The increase in revenue levels in the baseline is largely due to the assumptions that certain tax provisions expire as scheduled under current law, resulting in increases in tax rates and higher revenue collection.<sup>13</sup>

Individual income taxes have long been the largest source of federal revenues, followed by social insurance (payroll) and corporate income taxes.<sup>14</sup> In FY2010, individual income tax revenues totaled 6.2% of GDP. Payroll tax revenue accounted for 6.0% of GDP and corporate income tax revenues equaled 1.3% of GDP in FY2010. Overall, federal revenues increased very slightly relative to their FY2009 levels. **Figure 3** shows revenue collections between FY2000 and FY2021.

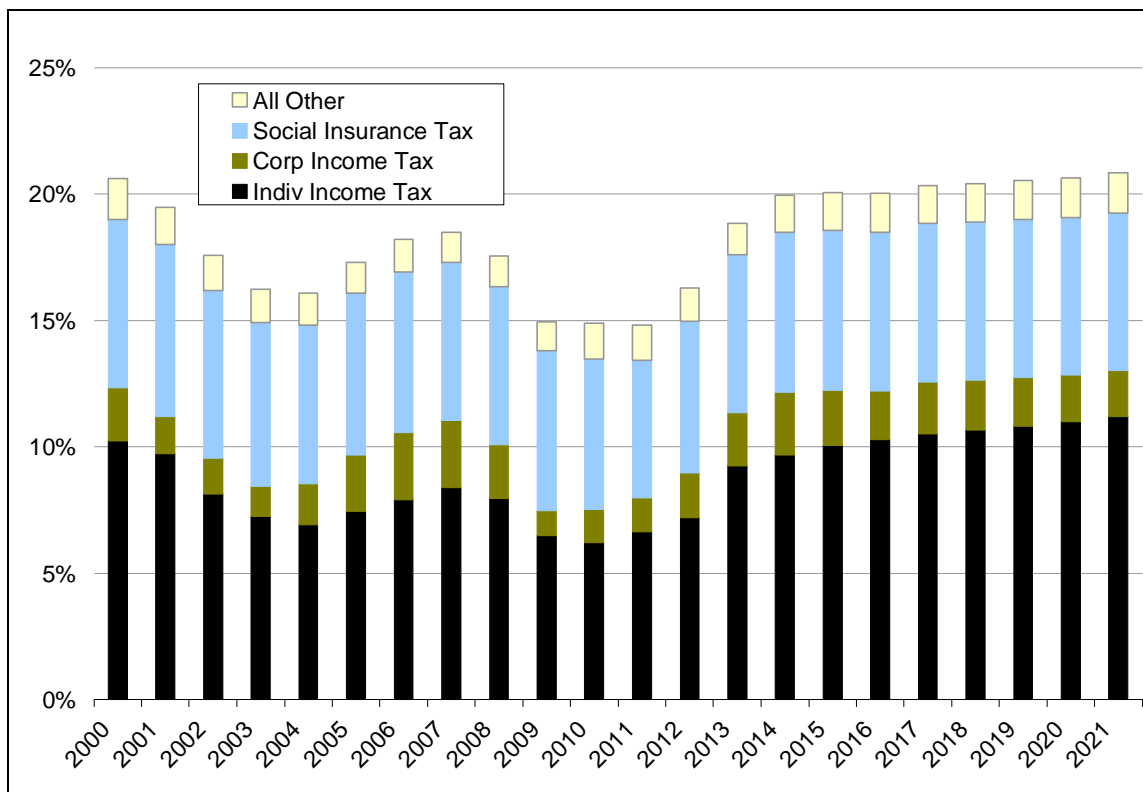
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<sup>12</sup> In various reports, the Congressional Budget Office, the Government Accountability Office, and the Administration agree that the federal government's budget is on an unsustainable path. For more information, see the section of this report titled, "Long-Term Considerations."

<sup>13</sup> For more information, see CRS Report R41591, *Tax Reform: An Overview of Proposals in the 112<sup>th</sup> Congress*, by James M. Bickley.

<sup>14</sup> For more information, see CRS Report RL32808, *Overview of the Federal Tax System*, by Molly F. Sherlock and Donald J. Marples.

**Figure 3. Revenue by Type, FY2000-FY2021**  
(percentage of GDP)



**Source:** CRS figure using data from CBO, *Historical Tables and Budget Projections*, January 2011. Data for FY2011 are estimates and data for FY2012-FY2021 are projections under CBO baseline assumptions.

## Deficits, Debt, and Interest

The annual differences between revenue (i.e., taxes and fees) that the government collects and outlays (i.e., spending) result in the budget deficit (or surplus).<sup>15</sup> Annual budget deficits or surpluses determine, over time, the level of federal debt and affect the growth of interest payments to finance the debt.

Beginning with FY2009, annual budget deficits as a percentage of GDP have been sharply higher than deficits in any period since FY1945. The total deficit in FY2010 was \$1,294 billion, or 8.9% of gross domestic product (GDP). The total deficit, according to some budget experts, gives an incomplete view of the government’s fiscal condition because it includes Social Security surpluses (which are held in Treasury trust funds until used to pay future benefits).<sup>16</sup> Excluding off-budget items (Social Security benefits paid net of Social Security payroll taxes collected and the U.S. Postal Service’s net balance) the on-budget FY2010 federal deficit was \$1,530 billion.

<sup>15</sup> Most economists use data on federal outlays to track larger budget trends, while most program analysts use budget authority to track changes in specific program areas.

<sup>16</sup> From an overall budget perspective, these surpluses are used to offset other federal spending, thereby decreasing the current budget deficit while increasing the amount of Treasury securities held in the Trust Fund.

## Federal Deficits

Deficit projections for the next several fiscal years are high relative to historic standards. The deficit reached its peak in FY1943 at 30.3% of GDP. The FY2010 total deficit was \$1,294 billion (8.9% of GDP), slightly lower than the FY2009 deficit of 10.0% of GDP. Recent budget deficits have been the largest in proportion to GDP since FY1945.<sup>17</sup> Estimates for FY2011 show deficits increasing relative to FY2010 levels, before falling towards the middle of the decade.

Occasional deficits, in and of themselves, are not necessarily problematic. Deficit spending can allow governments to smooth outlays and taxes to shield taxpayers and program beneficiaries from abrupt economic shocks in the short-term. Persistent deficits, however, lead to growing levels of federal debt that may lead to higher interest payments and may also have adverse macroeconomic consequences in the long-term, including slowing investment and lowering economic growth.<sup>18</sup> Since the debt cannot grow faster than GDP forever, large deficits will eventually need to be reduced through increases in taxes, reductions in spending, or both.

## Federal Debt and Debt Limit

Gross federal debt is composed of debt held by the public and intragovernmental debt.<sup>19</sup> Intragovernmental debt is the amount owed by the federal government to other federal agencies, to be paid by the Department of the Treasury. This amount largely consists of money contained in trust funds, such as Social Security, that has been invested in federal securities as required by law.<sup>20</sup> Debt held by the public is the total amount the federal government has borrowed from the public and remains outstanding. This measure is generally considered to be the most relevant in macroeconomic terms because it is the debt sold in credit markets.

Changes in debt held by the public generally track the movements of the annual on-budget deficits and surpluses. Whether or not the movements of gross federal debt will follow those of debt held by the public depends on how intragovernmental debt changes.<sup>21</sup>

Congress sets a ceiling on federal debt through a legislatively established limit that helps Congress assert its constitutional prerogative to control spending. The debt limit also imposes a form of fiscal accountability that compels Congress, in the form of a vote authorizing a debt limit increase, and the President, by signing the legislation, to take visible action to allow further federal borrowing when nearing the statutory limit. The debt limit, however, can hinder the Treasury's ability to manage the federal government's finances when the amount of federal debt approaches this ceiling. In those instances, the Treasury has had to take unusual and extraordinary

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<sup>17</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2012, Historical Tables*, Table 1-3, available at <http://www.whitehouse.gov/omb/budget/Historicals/>.

<sup>18</sup> Committee for a Responsible Federal Budget, *Good Deficit / Bad Deficit*, April 2009.

<sup>19</sup> Gross federal debt is also referred to as total debt or total public debt outstanding. Intragovernmental debt is also referred to as intragovernmental holdings or debt held by federal government accounts.

<sup>20</sup> U.S. Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2009, Analytical Perspectives*, Feb. 2008, p. 408.

<sup>21</sup> In FY2009 and FY2010, the increase in the deficit was larger than that of debt held by the public due to the nature of the obligations incurred as a result of the government conservatorship of Fannie Mae and Freddie Mac and the TARP program.

measures to meet federal obligations, leading to inconvenience and uncertainty in Treasury operations at times.<sup>22</sup>

At the end of FY2010, federal debt subject to limit was approximately \$13,511 billion, of which \$9,019 billion was held by the public.<sup>23</sup> The debt limit was most recently raised on February 12, 2010 (P.L. 111-139), and currently stands at \$14,294 billion.<sup>24</sup> The Department of the Treasury currently estimates that the debt will reach the limit sometime in spring 2011.<sup>25</sup>

## **Net Interest**

In FY2010, the United States spent \$197 billion or 1.4% of GDP on net interest payments on the debt. What the government pays in interest depends on market interest rates as well as on the size and composition of the federal debt. Currently, low interest rates have held net interest payments as a percentage of GDP below the historical average despite increases in borrowing to finance the deficit.<sup>26</sup> Some economists, however, have expressed concern that federal interest costs could rise sharply once the economy recovers, resulting in future strain on the budget.<sup>27</sup> Net interest payments, under the CBO baseline, are projected to rise to \$792 billion or 3.3% of GDP in FY2021, greater than the amount projected to be spent on non-defense discretionary spending in that year.

## **Budgeting in Tough Economic Times**

The current economic climate poses a major challenge to policymakers shaping the federal budget. The economic downturn increased the deficit as a result of elevated levels of spending related to “automatic stabilizer” programs, like Unemployment Compensation and the Supplemental Nutrition Assistance Program (SNAP), and subsequent policy actions taken by the federal government to address the recession. Federal spending tied to means-tested social programs has also been increasing due to rising unemployment, while federal revenues have fallen as individuals’ incomes and corporate profits dropped. The pace of the economic recovery could continue to affect deficit levels.

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<sup>22</sup> General Accountability Office, *Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203, February 2011.

<sup>23</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2012, Historical Tables*, Tables 7-1 and 7-2.

<sup>24</sup> For further details, see CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin and Mindy R. Levit.

<sup>25</sup> For more information, see CRS Report R41633, *Reaching the Debt Limit: Background and Potential Effects on Government Operations*, coordinated by Mindy R. Levit.

<sup>26</sup> Since FY1970, the U.S. spent an average of 2.2% of GDP on interest payments.

<sup>27</sup> Carmen M. Reinhart and Kenneth S. Rogoff, “The Aftermath of Financial Crises,” *American Economic Review*, vol. 99 (2009), no. 2; Alan Auerbach and William Gale, “The Economic Crisis and the Fiscal Crisis: 2009 and Beyond An Update,” Tax Policy Center, September 2009, available at [http://www.taxpolicycenter.org/UploadedPDF/1001284\\_economic\\_crisis.pdf](http://www.taxpolicycenter.org/UploadedPDF/1001284_economic_crisis.pdf).

## **Federal Response to Economic and Financial Market Turmoil**

The federal government responded to financial turmoil with an extraordinary set of measures in 2008 and 2009, including two major economic stimulus measures and a variety of programs within the Federal Reserve, Treasury, and Federal Deposit Insurance Corporation (FDIC). In February 2008, Congress enacted a \$152 billion package (P.L. 110-185, Economic Stimulus Act of 2008) to stimulate consumption by sending refunds to taxpayers and letting firms depreciate capital investments more quickly.

Another effort to jump-start economic growth came in the form of a second stimulus package signed into law by President Obama on February 17, 2009. The American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5) included provisions that are now estimated to total \$821 billion in increased discretionary and mandatory spending and reduced tax revenue over the FY2009-FY2019 period. CBO estimates that over 88% of ARRA's direct impact on the deficit will have occurred by the end of FY2011.<sup>28</sup> ARRA contains support for state and local governments in the form of increased transportation project, Medicaid, and school funding; funding for health care information technology; extended unemployment benefits; as well as tax cuts and rebates among other provisions.<sup>29</sup>

In addition to these stimulus efforts, various governmental bodies, through legislative and existing authority, engaged in numerous financial stability programs. The federal government placed government-sponsored enterprises Fannie Mae and Freddie Mac into conservatorship in September 2008, thereby gaining temporary authority to provide unlimited funds if necessary to help them remain solvent. In October 2008, Congress passed the Emergency Economic Stabilization Act of 2008 (EESA; P.L. 110-343), which authorized the Treasury Secretary to use \$700 billion (subject to certain congressional restrictions and notifications) to purchase troubled assets through the Troubled Assets Relief Program (TARP). As part of this program, Treasury purchased preferred shares from banks, assisted AIG and the domestic automakers, and provided other assistance to financial institutions. The Federal Reserve created a panoply of lending facilities, to provide financial institutions with loans in exchange for various types of collateral. The FDIC has used its standing authority to resolve failed banks and administer the federal guarantees on individual deposits, in addition to carrying out a broad guarantee program on debt issued by banks and supporting joint interventions in large banks.<sup>30</sup>

The size, variety, and complexity of federal responses to financial and economic turmoil present many challenges to budget analysis. The ultimate costs of these responses will depend on how the economy performs, how well firms with federal credit guarantees weather future financial shocks, and whether government funds are ultimately repaid. Estimating how much these responses will cost the federal government is difficult, for both conceptual and operational reasons. As a result, estimates of the costs of some of these programs have already changed significantly.

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<sup>28</sup> The cost estimate for ARRA has changed since it was originally projected due to revised economic and technical assumptions and certain legislative changes. See source for additional notes. U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, January 2011, Box 1-2.

<sup>29</sup> For more information on the provisions of ARRA, see CRS Report R40537, *American Recovery and Reinvestment Act of 2009 (P.L. 111-5): Summary and Legislative History*, by Clinton T. Brass et al.

<sup>30</sup> For further details on these actions, see CRS Report R41073, *Government Interventions in Response to Financial Turmoil*, by Baird Webel and Marc Labonte.

Estimating the precise budgetary impact of programs like TARP and the government's conservatorship of Fannie Mae and Freddie Mac (also known as government sponsored enterprises or GSEs) is difficult. Improved market conditions have lowered the estimates of the amount of TARP authority needed, and bank repurchases of stock sold to the government have decreased the impact of the program on the budget deficit. Assumptions about default rates and market borrowing rates have also become much more favorable. As a result, the expected cost of TARP has fallen considerably from initial estimates. For example, CBO has reduced its estimate for the lifetime cost of TARP from \$356 billion to \$25 billion.<sup>31</sup> Because of budgetary conventions, TARP increased the deficit significantly in FY2009, but reduced the deficit in FY2011 and FY2012.

Estimating the cost of the aid given to the GSEs, in budgetary terms, is also complex. Unlike TARP, no legislation stipulated the precise methodology with which to use when accounting for the budgetary impact of these interventions. Because of this, OMB and CBO have used different accounting methodologies to calculate the budgetary impact of GSE assistance, leading to divergent effects on the budget. CBO recorded a subsidy cost of \$291 billion in FY2009 and \$25 billion in FY2010. OMB placed the budgetary cost for the GSE intervention in FY2009 at \$96 billion and in FY2010 of \$40 billion in cash outlays.<sup>32</sup> OMB has faced criticism for its methodology, as some argue that they do not account for the full budgetary cost of the program.<sup>33</sup> Once the fiscal year ends, CBO uses the figures recorded by OMB.

## **Budget Deficit Estimates for FY2011**

The CBO baseline estimates the FY2011 budget deficit at \$1,480 billion or 9.8% of GDP, higher than the FY2010 (8.9% of GDP) deficit and nearly equal to the FY2009 deficit (10.0% of GDP). The deficit is projected to be higher than that of FY2010, due to increases in mandatory spending and restrained growth in revenues as a result of the temporary payroll tax reduction. Spending remains several percentage points above the historical average, while receipts remain well below their historical average (see **Figure 1**).

Under the President's Budget, deficit estimates for FY2011 amount to \$1,645 billion or 10.9% of GDP. This is larger than CBO's baseline deficit estimate primarily due to differences in economic assumptions used. In addition, the Obama Administration assumes a level of discretionary spending in FY2011 that is higher than the level that CBO estimated.<sup>34</sup>

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<sup>31</sup> For specifics on these figures and the source documentation, see *ibid*, Table 2.

<sup>32</sup> For more information on these accounting methodologies, see U.S. Congressional Budget Office, *CBO's Budgetary Treatment of Fannie Mae and Freddie Mac*, January 2010, available at <http://www.cbo.gov/ftpdocs/108xx/doc10878/01-13-FannieFreddie.pdf> and *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, January 2011, Table 3-3; U.S. Office of Management and Budget, *The Budget for Fiscal Year 2011, Analytical Perspectives*, pp. 346-358, available at <http://www.whitehouse.gov/omb/budget/fy2011/assets/topics.pdf>.

<sup>33</sup> U.S. Congressional Budget Office, Director's Blog, *The Budgetary Impact of Fannie Mae and Freddie Mac*, September 16, 2010, available at <http://cboblog.cbo.gov/?p=1422>.

<sup>34</sup> Because full-year appropriations have yet to be enacted, CBO assumed full-year funding for FY2011 based on amounts provided under the continuing resolution due to the rules that govern the baseline. U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, January 2011, p. 11; U.S. Office of Management and Budget, *Budget for Fiscal Year 2012, The Budget*, Tables S-2 and S-7 and *Budget for Fiscal Year 2012, Analytical Perspectives*, Table 2-2.

## Appropriations in FY2011

Congress and the President have yet to complete action on any of the 12 FY2011 regular appropriations acts. As a result, the federal government has been operating on a series of seven continuing resolutions (CRs) since the beginning of the fiscal year (P.L. 111-242; P.L. 111-290; P.L. 111-317; P.L. 111-322; P.L. 112-4; P.L. 112-6; P.L. 112-8). Thus far, funding for FY2011 has generally been provided for at FY2010 levels, with some exceptions in certain programs. Funding changes have resulted in an overall reduction in discretionary budget authority of \$13 billion relative to FY2010 levels.<sup>35</sup> The current CR expires April 15, 2011, and is estimated by CBO to provide an annualized discretionary outlay level of \$1,358 billion.<sup>36</sup> The House passed H.R. 1, 112<sup>th</sup> Congress, on February 19, 2011, which would fund the government for the rest of the fiscal year at an annualized discretionary outlay level of \$1,356 billion.<sup>37</sup> To date, the Senate has yet to pass a measure which would provide funding for the rest of the fiscal year.

If further budget authority is not provided either through another continuing resolution or regular appropriations acts, a funding gap will occur for those projects and activities that are funded on an annual basis through appropriations acts. If this occurs, the federal government begins a shutdown of the affected agencies, entailing the prompt furlough of non-expected personnel and curtailment of agency activities. Projects and activities that are funded on a multi-year basis or by laws other than annual appropriations acts—for example, some entitlement programs—may, or may not, be affected by a funding gap.<sup>38</sup>

## Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) was signed into law. This legislation had numerous provisions, including the extension of the 2001 and 2003 (“Bush”) tax cuts until the end of 2012, reinstating the estate tax until the end of 2012, and “patching” the alternative minimum tax until the end of 2011. Under the law, emergency unemployment benefits were also extended and the employee portion of the payroll tax was cut by two percentage points until the end of 2011. Relative to current law, CBO estimated that the spending and revenue measures in the bill would increase the deficit by \$390 billion in FY2011 and by \$468 billion over the FY2012-FY2020 period, with nearly all the impact on the deficit occurring between FY2011 and FY2013.<sup>39</sup>

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<sup>35</sup> For more information, see CRS Report RL30343, *Continuing Resolutions: Latest Action and Brief Overview of Recent Practices*, by Sandy Streeter.

<sup>36</sup> Appropriations acts provide budget authority; the outlays for a fiscal year result from the budget authority provided in that fiscal year as well as budget authority provided in previous fiscal years. The corresponding annualized level of budget authority provided is \$1,234 billion. The total outlays indicated here include both non-emergency and contingency operations funding. U.S. Congressional Budget Office, *Continuing Resolutions for 2011 in the 112<sup>th</sup> Session*, available at <http://www.cbo.gov/ftpdocs/121xx/doc12109/ContinuingResolutions.pdf>.

<sup>37</sup> The corresponding annualized level of budget authority provided is \$1,179 billion. The total outlays indicated here include both non-emergency, emergency, and contingency operations funding. U.S. Congressional Budget Office, *CBO Estimate of H.R. 1, the Full Year Continuing Appropriations Act, 2011 as Passed by the House of Representatives on February 19, 2011*, available at <http://www.cbo.gov/ftpdocs/120xx/doc12075/hr1asPassed.pdf>.

<sup>38</sup> For more information, see CRS Report RL34680, *Shutdown of the Federal Government: Causes, Processes, and Effects*, by Clinton T. Brass and CRS Report RS20348, *Federal Funding Gaps: A Brief Overview*, by Jessica Tollestrup.

<sup>39</sup> Between FY2014 and FY2020, the legislation is estimated to reduce the deficit by \$59 billion. U.S. Congressional (continued...)

## Budget for FY2012

The Obama Administration released its FY2012 budget on February 14, 2011. Congress began its consideration of the FY2012 budget after receiving the President's budget request.

### Obama Administration FY2012 Budget

Consistent with the presentation of the FY2010 and FY2011 budgets, the Obama Administration provided three separate deficit projections.<sup>40</sup> First, OMB projected a Budget Enforcement Act (BEA) baseline, using methods that mirror those CBO uses to project its current-law baseline. The BEA baseline assumes that discretionary spending remains constant in real (i.e., inflation-adjusted) terms, the 2001/2003/2010 tax cuts expire at the end of calendar year 2012, and that the alternative minimum tax (AMT) will not be "patched."<sup>41</sup> Many budget analysts believe such projections offer an overly rosy scenario of the long-term budget picture. Under this scenario, the FY2012 deficit is projected to total \$1,036 billion.

The Obama Administration also projected an Adjusted Baseline, which in its view, provides a more transparent and realistic reflection of the federal government's current fiscal situation.<sup>42</sup> They use this methodology as a base for understanding how new policy choices affect the fiscal outlook, essentially replacing the current BEA baseline. The Administration's Adjusted Baseline assumes that the 2001/2003/2010 tax cuts will be extended for middle income taxpayers, that the alternative minimum tax (AMT) will be "patched," effectively adjusting the exemption level for inflation, and that the estate taxes will be extended at 2009 levels. This baseline also includes an incremental cost adjustment to fund the maximum Pell Grant award and a funding placeholder to reflect the costs of possible emergencies. The deficit under this scenario is projected to reach \$1,090 billion in FY2012.

The final deficit projection, the Proposed Budget, illustrates the impact on the budget outlook if all of the policies of the Obama Administration are implemented. In FY2012, the Administration projects that the deficit will reach \$1,101 billion. Both the Adjusted Baseline and the Proposed Budget project deficits throughout the 10-year budget window, with deficits peaking in FY2011. Under the Proposed Budget, the deficit would fall from 7.0% of GDP in FY2012 to 2.9% of GDP by FY2018, before rising to 3.1% of GDP in FY2021.<sup>43</sup> Generally, the deficit levels in the Proposed Budget scenario fall between the lower BEA baseline and the higher Adjusted Baseline figures. Critics argue that the President's budget makes the deficit worse in the short-term and takes credit for deficit reduction over 10 years that would happen automatically under the baseline.

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(...continued)

Budget Office, *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, January 2011, Box 1-1.

<sup>40</sup> For details of these projections, see U.S. Office of Management and Budget, *Budget for Fiscal Year 2012, The Budget*, Tables S-1 (Proposed Budget) and S-7 (BEA Baseline and Adjusted Baseline).

<sup>41</sup> The tax cuts were enacted in the Economic Growth and Taxpayer Relief Act of 2001 (EGTRRA; P.L. 107-16) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA; P.L. 108-27) and extended as part of The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). For more information on the tax proposals in the President's Budget, see CRS Report R41699, *An Overview of Major Tax Proposals in the President's FY2012 Budget*, coordinated by Mark P. Keightley.

<sup>42</sup> In prior years, this scenario had been known as the Current Policy Baseline.

<sup>43</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2012, The Budget*, Tables S-1.



### ***What Do these Baselines Reflect?***

As stated above, the Adjusted Baseline assumes that certain policies due to expire will be continued. The President's Budget views the Adjusted Baseline as the most realistic projection of the budget deficit and it is used as their benchmark to measure the impact of their budget proposals. The Proposed Budget, however, is the one that illustrates the resulting budget outlook if all of the policies proposed by the President were implemented. Whether or not a certain policy proposal increases or decreases the deficit, depends on which baseline is being used as the starting point.

There are no real limits on what assumptions can be used to construct the Adjusted Baseline as opposed to the BEA baseline whose parameters were set by legislation. The Adjusted Baseline in the FY2012 budget assumes, for example, costly increases to "patch" the AMT and continue the 2001 and 2003 tax cuts for the middle class. Because these policies serve to increase the deficit, the Administration can show decreases in the deficit by measuring its Proposed Policy against this constructed Adjusted Baseline, rather than against the BEA baseline. For example, because the Administration includes a "patch" for the AMT in its Adjusted Baseline, at a cost of \$1,550 billion between FY2012 and FY2021, their proposal included in the Proposed Policy to pay for three years of the AMT "patch" by reducing the value of certain tax expenditures, results in a "savings" of \$321 billion over the same period. However, relative to the BEA baseline, the AMT "patch" results in an increase in the deficit of \$1,229 billion.

A similar methodology can be used in understanding how the tax cuts are being accounted for in each baseline. The Adjusted Policy baseline incorporates a permanent extension to the tax cuts for middle class taxpayers, which increases the deficit by \$1,250 billion over the FY2012-FY2021 period relative to the BEA Baseline. Because this proposal is included in the Adjusted Baseline, it does not have any additional deficit impact on the Proposed Policy.

### ***Major FY2012 Budget Proposals***

In his budget for FY2012, President Obama presented his policy agenda, largely focused on cuts to the discretionary side of the federal budget and increasing investment in various sectors. The main policy initiatives he emphasized include various spending and tax proposals, as well as some broad outlines geared towards longer term deficit reduction. The budget also emphasizes continued investment in and reform of education and job training programs as well as a continued push for research and development incentives and infrastructure improvements, with the goal of continued economic growth and job creation. Overall, the proposed budget cuts the deficit in half, in dollar terms (and as a percentage of GDP) by the middle part of the decade. However, the deficit begins to rise again in the second half of the decade.

On the spending side of the budget, the President proposed to freeze non-security discretionary spending through FY2015, including a two-year freeze on federal civilian pay. Additional savings are projected on the security side of the discretionary budget by reducing the amount of spending on Overseas Contingency Operations and achieving zero real growth in the defense budget for the next five years. According to the projections in the budget, the non-security discretionary spending freeze will save \$406 billion over the next 10 years, relative to the adjusted baseline. Security savings amount to roughly \$900 billion, relative to the adjusted baseline, over the same

period.<sup>44</sup> In addition, the President has also proposed terminations and reductions in over 200 programs, which could save approximately \$30 billion in FY2012 if enacted.<sup>45</sup>

The budget proposal also included various tax proposals including the permanent extension of the 2001/2003/2010 tax cuts for families making less than \$250,000, changes in the estate tax parameters, and a three-year proposal to pay for the indexation of the AMT “patch” for inflation. Details are also provided on ways to begin reforming the corporate tax by eliminating certain tax expenditures. Like the FY2011 budget proposal, the President also proposes a fee to be imposed on the financial services industry over at least the next 10 years to recoup the cost of TARP. Under the proposal, this fee would generate \$30 billion by FY2021.

Longer term budgetary challenges remain the biggest driver of fiscal challenges. These challenges are partially addressed by a variety of budget proposals. The President’s budget proposes to address the unfunded liabilities in the unemployment insurance system and the Pension Benefit Guaranty Corporation (PBGC) by providing additional funding mechanisms. It also provides three broad options to gradually reduce the role of the federal government in providing assistance to Fannie Mae and Freddie Mac and eventually ending conservatorship of these entities and the federal role in the mortgage market. The Administration also remains committed to implementing the provisions of the Patient Protection and Affordable Care Act (PPACA; P.L. 111-148) and the Health Care and Education Reconciliation Act of 2010 (HCERA; P.L. 111-152).<sup>46</sup> The budget also includes a two-year offset to pay for the cost of fixing Medicare’s sustainable growth rate (SGR), but lacks a plan to pay for this during the remaining eight years of the budget window. If the SGR were not fixed, doctors would face large cuts in Medicare reimbursements.<sup>47</sup> Further programmatic reforms, beyond those laid out in the budget proposal, will likely be needed to fully address these long-term deficit drivers.

## **Congressional Consideration of the FY2012 Budget Resolution**

The House and Senate Budget Committees are responsible for formulating and reporting an annual budget resolution. The budget committees typically develop the budget resolution as they receive information and testimony from various sources, such as the Administration, CBO, and congressional committees with jurisdiction over spending and revenues. The timetable established in the Congressional Budget Act directs the Senate Budget Committee to report a budget resolution by April 1, and for the House and Senate to reach final agreement on a budget resolution by April 15.<sup>48</sup>

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<sup>44</sup> These savings are exclusive of the related reductions in debt service costs. U.S. Office of Management and Budget, *Budget for Fiscal Year 2012, The Budget*, Table S-2.

<sup>45</sup> Cuts in both mandatory and discretionary programs are included. Some of these cuts are included as part of the five-year non-security discretionary spending freeze. Savings are calculated relative to FY2010 levels. U.S. Office of Management and Budget, *Budget for Fiscal Year 2012, Terminations, Reductions, and Savings*, p. 1.

<sup>46</sup> PPACA and HCERA were signed into law on March 23 and March 30, 2010, respectively. Among other provisions, this legislation established a mandate for most U.S. residents to obtain health insurance, set up insurance exchanges, expanded Medicaid, and imposed various tax code changes.

<sup>47</sup> For more information, see CRS Report R40907, *Medicare Physician Payment Updates and the Sustainable Growth Rate (SGR) System*, by Jim Hahn.

<sup>48</sup> For more information on the congressional budget process, see CRS Report RS20368, *Overview of the Congressional Budget Process*, by Bill Heniff Jr.

On April 6, 2011, the House Budget Committee reported the budget resolution (H.Con.Res. 34, 112<sup>th</sup> Congress) by a vote of 22-16. The resolution provided for revenue levels of \$2,533 billion and outlays of \$3,529 billion in FY2012 for a deficit of \$995 billion, or approximately 6.3% of GDP. By FY2021, the deficit is projected to fall to \$385 billion or 1.6% of GDP. Debt held by the public is projected to rise from \$11,418 billion in FY2012 to \$16,071 billion by FY2021.<sup>49</sup>

The budget proposal contains changes to both spending and revenue. Spending would be reduced through a five-year freeze on non-security discretionary spending, restraining growth in defense spending, and the implementation of enforceable spending caps on discretionary and total spending. Other spending reductions, including changes to the Medicare and Medicaid programs via the implementation of a Medicare “premium-support” program beginning in FY2022 and a Medicaid block grant program in FY2013, are also included.<sup>50</sup> Under this proposal, overall government spending would be reduced to the historical average of roughly 20% of GDP by FY2015. On the revenue side, the budget resolution proposes a consolidation of individual income tax brackets, with the top tax rate reduced from 35% to 25%. The corporate tax rate would also be reduced from 35% to 25%. To offset the reduction in tax rates, certain tax expenditures would also be eliminated in order to broaden the base of taxable income. Revenue collection would average roughly 18% of GDP between FY2012 and FY2021 under this proposal.

Because the budget resolution does not become law, separate legislation would have to be enacted in order to make some of the policy changes that are relied upon in the proposal. The budget proposal does not contain specifics on how some of the revenue and spending proposals would be achieved and does not contain any reconciliation directives instructing committees to report such legislative changes. Therefore, if some of the policy proposals do not become law, the spending, revenue, and deficit projections could change significantly. Further affecting deficit levels are the economic assumptions used in making any budget projections. Under the House budget resolution, GDP growth is assumed at a rate of 4% to 5% each fiscal year, which is roughly the same as the CBO baseline and lower than under the President’s budget assumptions. However, if economic growth is higher or lower, the deficit levels and related components in the budget resolution would be affected.

The Senate Budget Committee has not yet considered a budget resolution for FY2012.

## Considerations for Congress

Congress faces ongoing budgetary challenges in FY2012 with both short-run and long-run budget priorities that may conflict in critical ways. In the short term, economic issues may dominate policy debates, creating pressure for higher deficit spending to stimulate the economy. In the long term, increasing federal health care costs are expected to keep mandatory spending rising.

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<sup>49</sup> U.S. House of Representatives, Committee on the Budget, *The Path to Prosperity*, Table S-1, available at <http://budget.house.gov/UploadedFiles/PathToProsperityFY2012.pdf>.

<sup>50</sup> The majority of the savings related to the Medicare programmatic changes would occur outside the 10-year budget window.

## **Short-Term Considerations**

The economy is still recovering from the most recent recession, which lasted from December 2007 to June 2009. Conditions remain weak, in part, due to budget challenges facing state and local governments, high levels of consumer debt, and continuing weakness in many real estate markets. Most economists expect unemployment rates to remain elevated for the medium term. During this period, the budget deficit grew largely as a result of government actions taken to combat the economic downturn as well as significantly lower revenue and higher spending levels directly attributable to the economic conditions.

As the economy continues to recover, revenue should increase as unemployment falls and spending should decrease due to less reliance on federal programs meant to provide assistance during economic downturns. This should lead to decreases in the budget deficit relative to current levels in the short term. Though many argue that fiscal stimulus and other actions were needed to help the economy recover, the resulting large budget deficits and high debt levels will have an effect for many years.

Many budget analysts are concerned about future levels of federal debt and acknowledge that the current spending and revenue collection cannot continue at current or projected future levels. However, making significant changes to spending or revenue policies at this time may be harmful to the ongoing economic recovery. On the other hand, the longer that the country continues without a plan to stabilize its fiscal future, the more costly reform may be. In addition, the likelihood of a severe fiscal crisis may increase, and if that occurs, reforms may be forced by events, rather than being well planned.

## **General Budget Issues**

Congress may wish to consider some general budgeting issues beyond these short-term considerations.

### **Budget Transparency**

The budget, reflecting the size and complexity of the federal government, is complicated and detailed. The budget books that OMB compiles provide an enormous amount of information, and other budget data reported by federal agencies provide even more detail on federal spending plans. The Federal Funding Accountability and Transparency Act of 2006 (P.L. 109-282) included several measures to increase the accessibility of budget information. For example, as a result of that act, OMB now runs the USAspending.gov website, which provides detailed information on federal spending. Some, however, have raised concerns about the quality of those data.<sup>51</sup> Moreover, it is not clear that those data are thoroughly coordinated with other federal budgeting data systems.

Congress and the President have undertaken additional efforts in an attempt to improve transparency in light of the large amounts of spending currently occurring as a result of economic stabilization efforts and federal financial interventions. Websites, such as Recovery.gov, were

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<sup>51</sup> For more information, see CRS Report RL34718, *The Federal Funding Accountability and Transparency Act: Implementation and Proposed Amendments*, by Garrett Hatch.

launched to track stimulus spending. The Congressional Oversight Panel was established in the Emergency Economic Stabilization Act to oversee TARP spending. Despite this, criticisms remain and requests for greater transparency continue.

In certain cases, despite the large amount of data provided by OMB and other government agencies, it can be difficult to answer relatively simple budget questions. Critics maintain that the federal government in general and OMB in particular should take steps to make data on federal spending even more transparent to taxpayers and more useful to policymakers. Even as the President's budget mentions "a new tracking tool" to provide daily updates on spending by agency, Congress may wish to consider requiring these changes to provide more organized and transparent budget data to citizens and to itself.<sup>52</sup>

## Long-Term Considerations

Annual budget deficits or surpluses are not always the best indication of long-term fiscal stability. Most economists agree that, under certain conditions, running a budget deficit may be necessary to provide economic stimulus or pull an economy out of recession. A large budget deficit in a single year, in itself, does not necessarily indicate a longer term problem. The federal government, however, does face serious long-term budget challenges. Some measures of fiscal solvency in the long term indicate that, under current policy, the U.S. may face a major future crisis, specifically as it relates to rising health care costs and the likely impact on government-financed health care spending.

CBO, GAO, and the Administration agree that the current mix of federal fiscal policies is unsustainable in the long term. The nation's aging population, combined with rising health care costs per beneficiary, seems likely to keep federal health costs rising faster than per capita GDP. CBO projected in June 2010 that under current policy, federal spending on Medicare and Medicaid would grow from 5.5% of GDP today to about 10% of GDP in 2035, and to more than 17% by 2080.<sup>53</sup> The 2010 Economic Report of the President also called the trajectory of future federal spending on Medicare and Medicaid unsustainable.<sup>54</sup> GAO's recent long-term fiscal simulations, under an alternative policy scenario, projected debt held by the public as a share of GDP to exceed the post World War II historical high in about 10 years.<sup>55</sup>

Keeping future federal outlays at 20% of GDP, or approximately at its historical average, and leaving fiscal policies unchanged, according to CBO projections, would require drastic reductions in all spending other than that for Medicare, Social Security, and Medicaid, or reining in the costs of these programs. Under the extension of current policy, CBO estimates that the nation's current fiscal gap, a present-value measure of fiscal imbalance for a given time period, would reach 0.7% of GDP over the next 75 years. This means that an immediate and permanent reduction in spending, increase in revenues, or a combination of spending cuts and revenue increases amounting to 0.7% of GDP would be needed to make the government's debt the same size (relative to the size of the economy) at the end of that period as it was at the beginning. Under an

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<sup>52</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2011, The Budget*, p. 44.

<sup>53</sup> U.S. Congressional Budget Office, *The Long-Term Budget Outlook*, June 2010, p. 7 and "Supplemental Material."

<sup>54</sup> Council of Economic Advisors, *Economic Report of the President*, February 2010, p. 140.

<sup>55</sup> Government Accountability Office, *The Federal Government's Long-Term Fiscal Outlook: Fall 2009 Update* (GAO-10-137SP), October 15, 2009, p. 1.

alternative fiscal scenario, which incorporates some policy changes that are widely expected to occur and that policymakers have regularly made in the past, the fiscal gap reaches 8.7% of GDP.<sup>56</sup> This indicates that an immediate and permanent reduction in spending, increase in revenues, or a combination of spending cuts and revenue increases amounting to 8.7% of GDP would be needed to make the government's debt the same size (relative to the size of the economy) at the end of that period as it was at the beginning.<sup>57</sup> Enacting policies to close the fiscal gap under either scenario would likely require changes in major entitlement programs as these programs are projected to be responsible for the majority of the long-term growth in federal spending.<sup>58</sup>

As the economic recovery continues, Congress may focus more effort on balancing the budget and reining in the debt. This would require less spending, increases in revenue collections, faster-than-average economic growth, or a combination of these things. Debt requires interest payments that can strain budgets if debt levels and interest rates are high. High debt levels could limit the government's flexibility in meeting its obligations or in responding to emerging needs of its citizens. Ultimately, failing to take action to reduce the projected growth in the debt potentially might lead to future insolvency or government default.<sup>59</sup>

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<sup>56</sup> The alternative fiscal scenario includes things like the extension of certain expiring tax provisions, the continued indexation of AMT to inflation, and Medicare physician payment rates growing with the Medicare economic index. For a complete description of the assumptions included in the extended baseline and alternative fiscal scenarios, see U.S. Congressional Budget Office, *The Long-Term Budget Outlook*, June 2010, Table 1-1.

<sup>57</sup> U.S. Congressional Budget Office, *The Long-Term Budget Outlook*, June 2010, Table 1-3.

<sup>58</sup> U.S. Congressional Budget Office, *The Long-Term Budget Outlook*, June 2010, p. 8.

<sup>59</sup> See Alan Auerbach and William Gale, "The Economic Crisis and the Fiscal Crisis: 2009 and Beyond: An Update," Tax Policy Center working paper, September 2009, available at [http://www.brookings.edu/~media/Files/rc/papers/2009/06\\_fiscal\\_crisis\\_gale/06\\_fiscal\\_crisis\\_gale\\_update.pdf](http://www.brookings.edu/~media/Files/rc/papers/2009/06_fiscal_crisis_gale/06_fiscal_crisis_gale_update.pdf).

## Appendix. Budget Documents

### CBO Documents

The Congressional Budget Office (CBO) provides data and analysis to Congress throughout the budget and appropriations process. Each January, CBO issues a *Budget and Economic Outlook* that contains current-law baseline estimates of outlays and revenues. In March, CBO typically issues an analysis of the President's budget submission with revised baseline estimates and projections. In late summer, CBO issues an updated *Budget and Economic Outlook* with new baseline projections.

In these documents, CBO sets a current-law baseline as a benchmark to evaluate whether legislative proposals would increase or decrease outlays and revenue collection. Baseline estimates are not intended to predict likely future outcomes, but to show what spending and revenues would be if current law remained in effect. CBO typically evaluates the budgetary consequences of legislative proposals and the Joint Committee on Taxation (JCT) evaluates the consequences of revenue proposals.

CBO also releases other periodic publications focusing on the future fiscal health of the United States. In their publication, *The Long-Term Budget Outlook*, CBO makes projections on the state of the federal budget to FY2083. They discuss spending and revenue levels and the related issues that they expect will arise under different policy assumptions. In their *Budget Options* volumes, they provide specific policy options and the impact they will have on spending and revenues over a 10-year budget window. They also provide arguments for and against enacting each policy.

### OMB Documents

The Administration's FY2012 budget contains six volumes: (1) *The Budget*; (2) *Historical Tables*; (3) *Analytical Perspectives*; (4) *Appendix*; (5) *Terminations, Reductions, and Savings*; and (6) *Supplemental Materials*.<sup>60</sup> These documents lay out the Administration's projections of the fiscal outlook for the country, along with spending levels proposed for each of the federal government's departments and programs. The *Historical Tables* volume also provides significant amounts of budget data, much of which extends back to 1962 or earlier. Along with the Administration's budget documents, the Department of the Treasury also releases the *Green Book*, which provides further detail on the revenue proposals that are contained in the budget.<sup>61</sup>

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<sup>60</sup> The President's budget proposals can be found on the OMB website at <http://www.whitehouse.gov/omb/>. The Supplemental Materials include the Federal Credit Supplement, the Object Class Analysis, the Balances of Budget Authority, and the Public Budget Database.

<sup>61</sup> The Green Book is available at <http://www.treasury.gov/resource-center/tax-policy/Pages/Greenbook.aspx>.

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