

Looking Backward and Forward at the U.S. Fiscal Trajectory

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Outline

- 1. How Has Our Fiscal Situation Changed Since the Concord Coalition Was Formed in 1992?**
- 2. How Has Our Fiscal Situation Changed Since Bowles-Simpson in 2010?**
- 3. What Are Our Fiscal Challenges Going Forward?**
- 4. What is a Feasible Path Forward on Our Fiscal Imbalances?**



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The Deficit is Smaller

Revenues, Outlays, and Deficits, 1992 and 2016 (% of GDP)

	1992	2016
Defense Discretionary	4.7	3.2
Nondefense Discretionary	3.6	3.3
Social Security	4.4	4.9
Medicare & Medicaid	2.9	5.2
Other Non-interest	2.8	3.1
Net Interest	3.1	1.3
Total Outlays	21.5	20.9
Total Revenues	17.0	17.8
Deficit	4.5	3.2

Note: Outlay components may not sum to total outlays due to rounding. Deficit may not equal the difference between revenues and outlays due to rounding.
Source: Office of Management and Budget; author's calculations.

Largely Because Defense & Net Interest Have Fallen



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While Health Spending Has Risen

Revenues, Outlays, and Deficits, 1992 and 2016 (% of GDP)

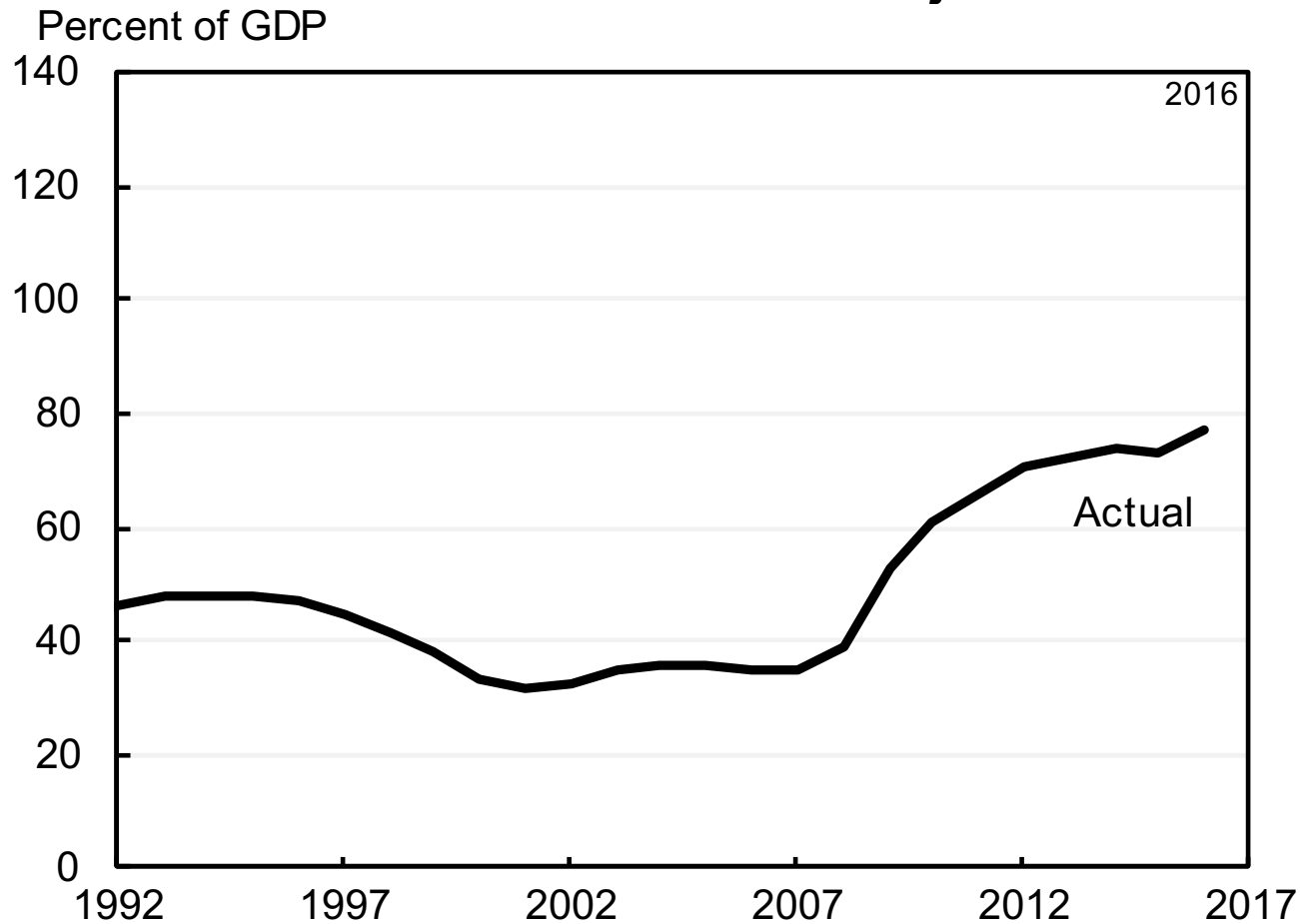
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The Debt is Substantially Larger Than It Was in 1992...



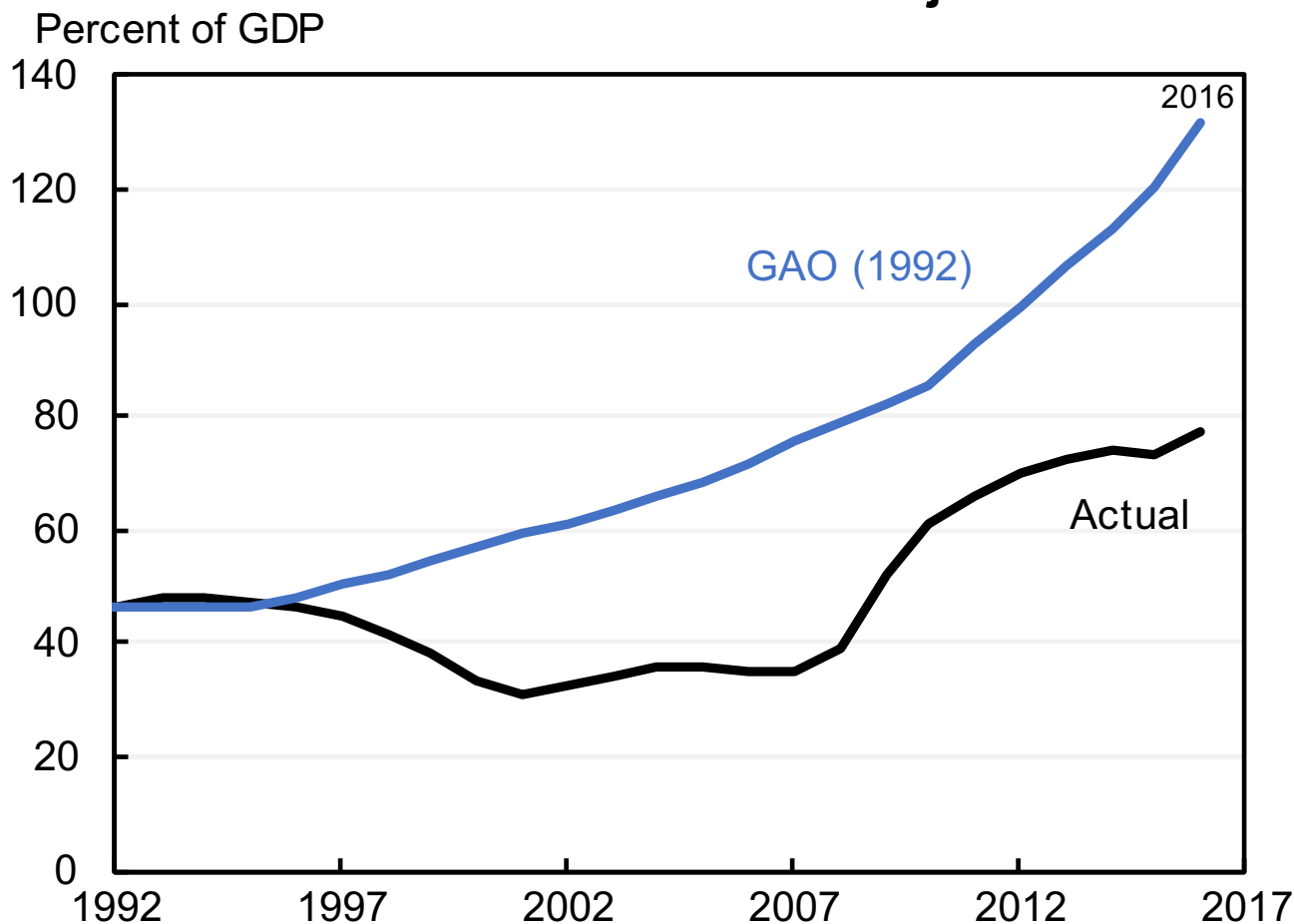
Federal Debt: Actual vs. Projected



But the Debt is Still Well Below the Forecasts Made in 1992...



Federal Debt: Actual vs. Projected

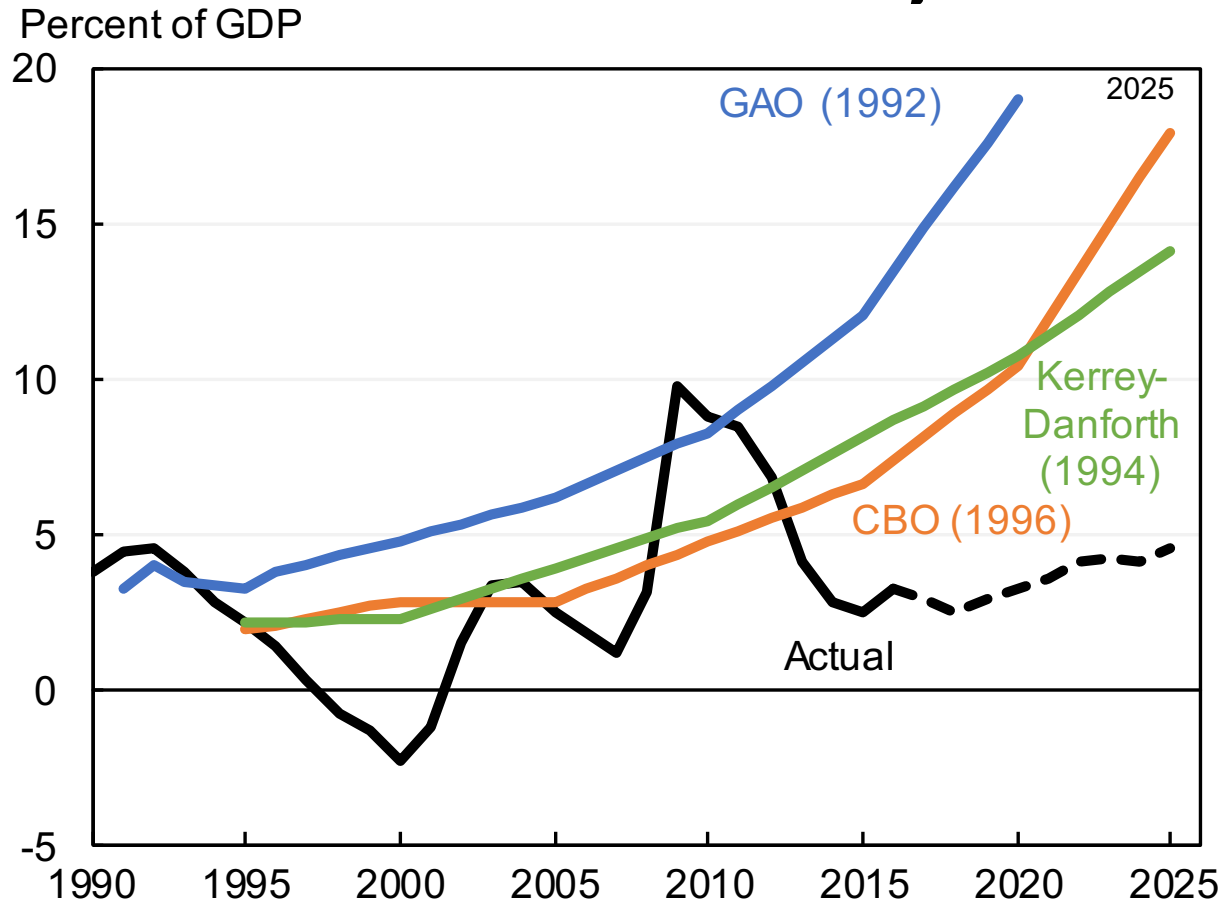


Note: Projections are adjusted to account for changes in the definition of nominal GDP since projections were released. GAO estimates were converted from percent of GNP. Source: Congressional Budget Office; Government Accountability Office; Bureau of Economic Analysis; author's calculations.



Deficits Have Generally Fallen Below Earlier Forecasts

Federal Deficit: Actual vs. Projected



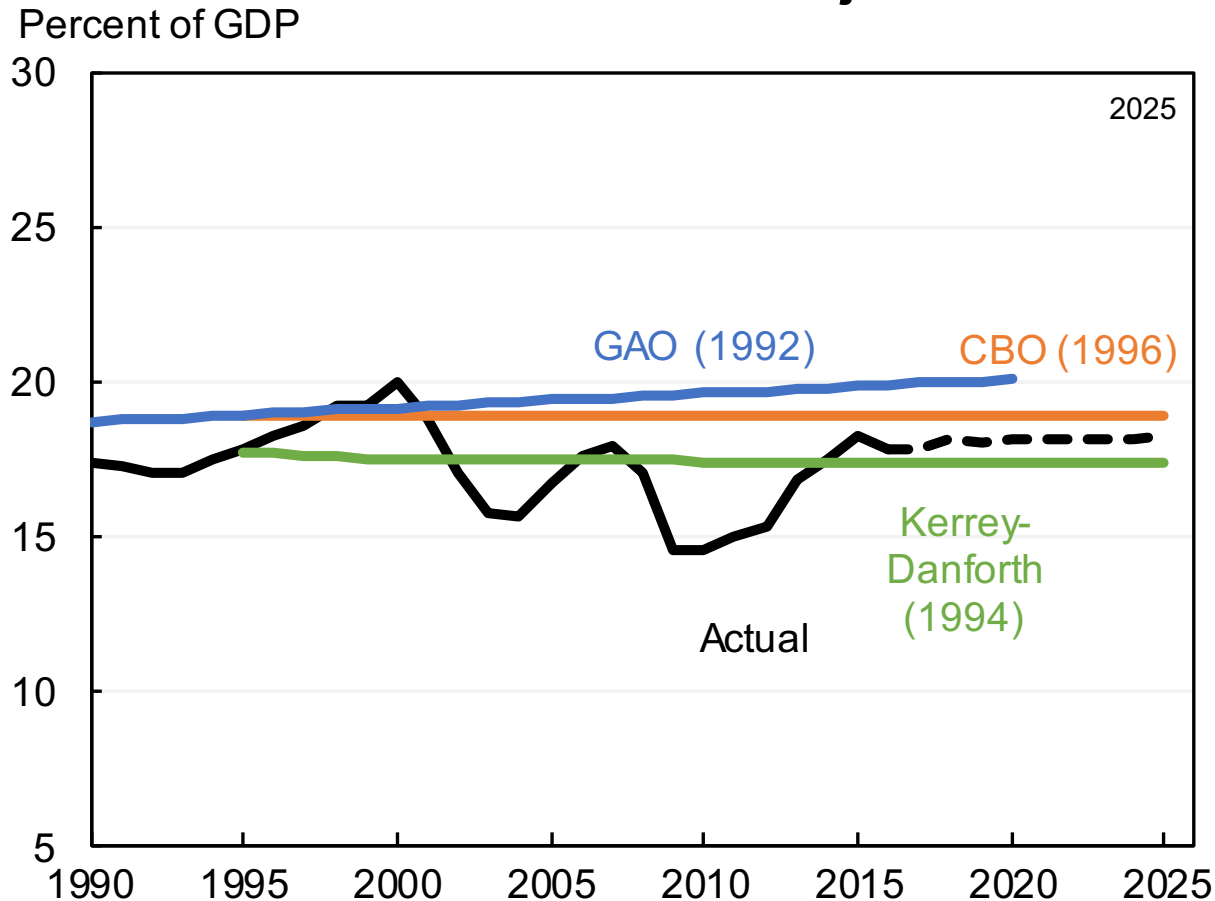
Note: Projections are adjusted to account for changes in the definition of nominal GDP since projections were released. GAO estimates were converted from percent of GNP. Dashed line indicates most recent projection.

Source: Congressional Budget Office; Bipartisan Commission on Entitlement and Tax Reform; Government Accountability Office; Bureau of Economic Analysis; Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds; author's calculations.



Revenue Has Generally Been Slightly Below What Was Expected...

Revenue: Actual vs. Projected



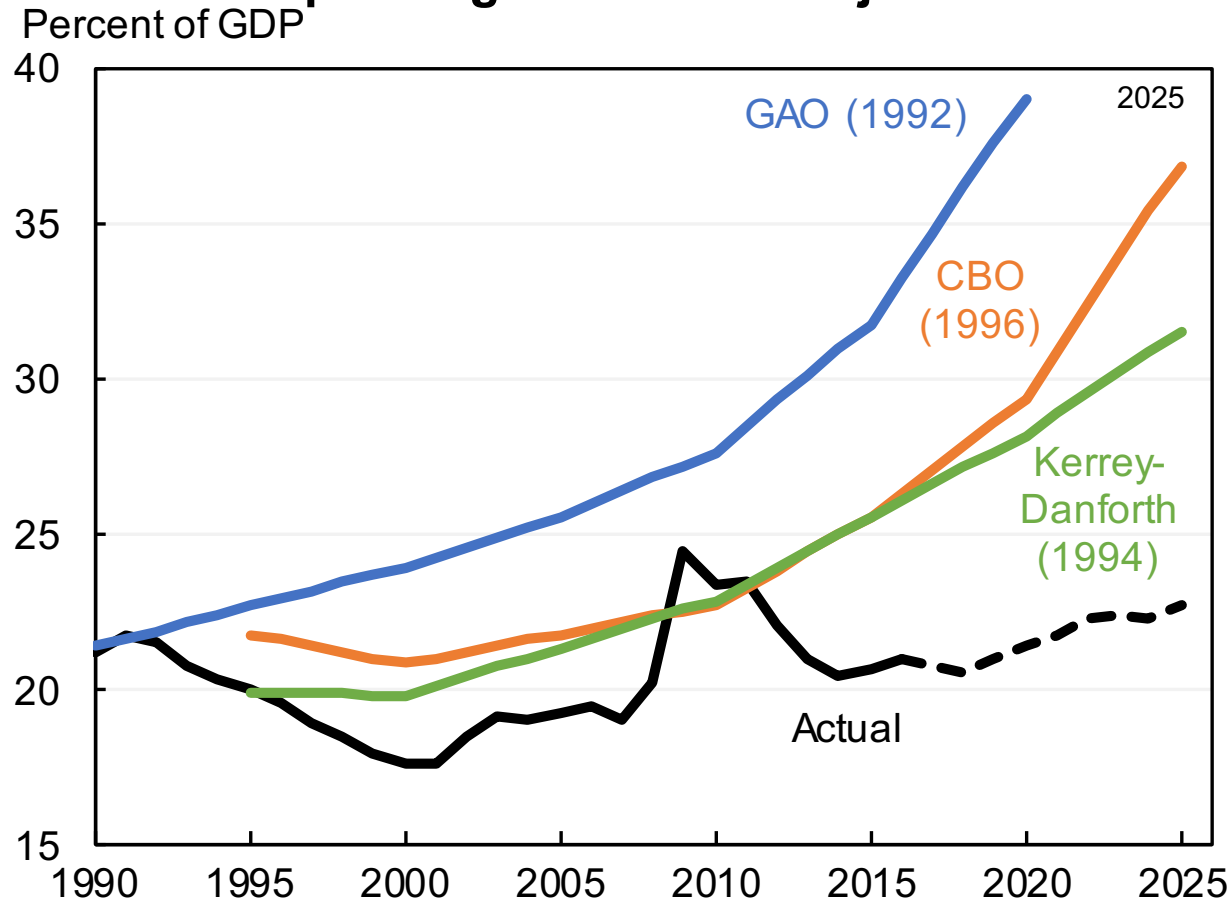
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Source: Congressional Budget Office; Bipartisan Commission on Entitlement and Tax Reform; Government Accountability Office; Bureau of Economic Analysis; Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds; author's calculations.



...But Spending Has Fallen Even Further Below Expectations

Spending: Actual vs. Projected



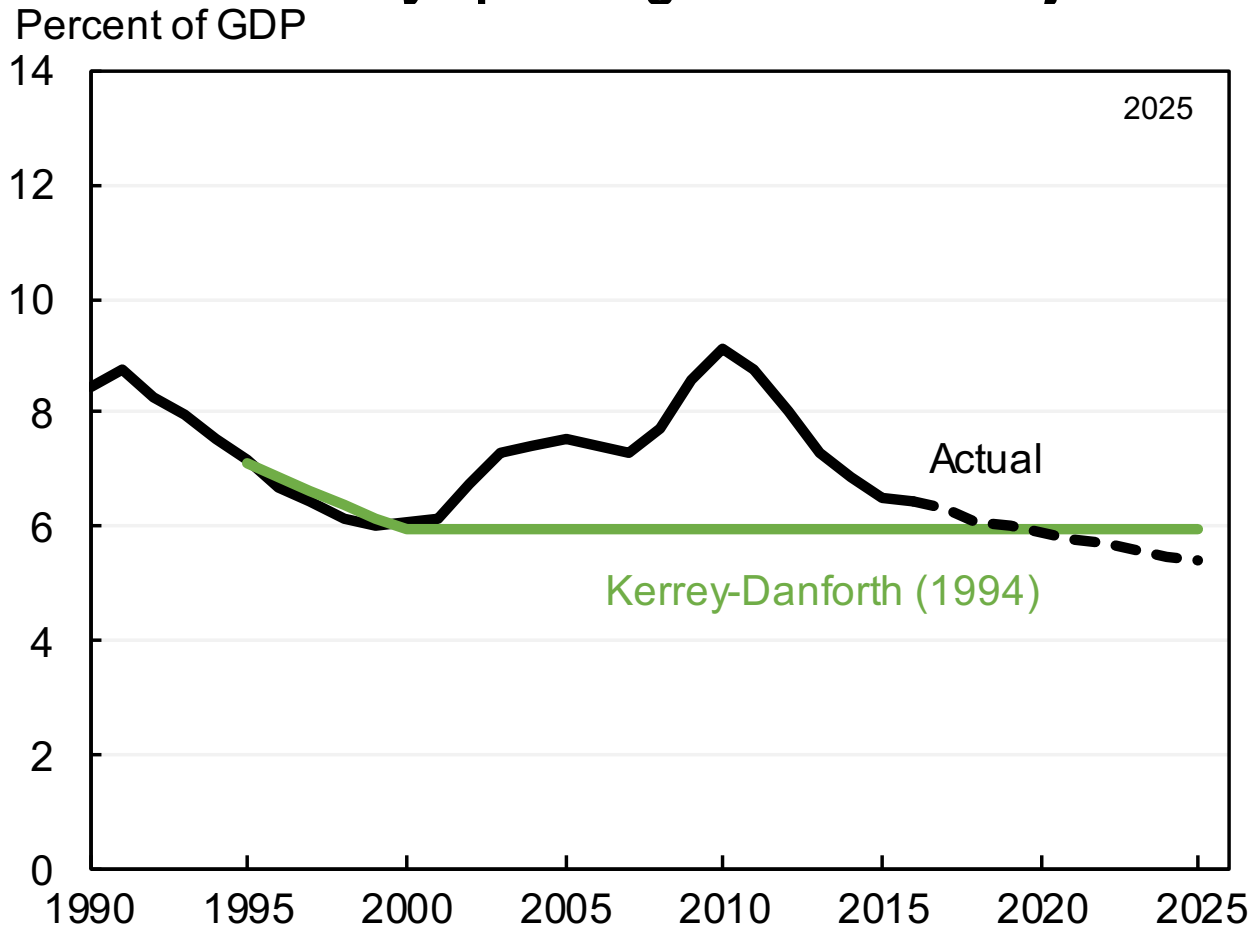
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Source: Congressional Budget Office; Bipartisan Commission on Entitlement and Tax Reform; Government Accountability Office; Bureau of Economic Analysis; Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds; author's calculations.



Discretionary Spending Has Roughly Tracked Expectations

Discretionary Spending: Actual vs. Projected



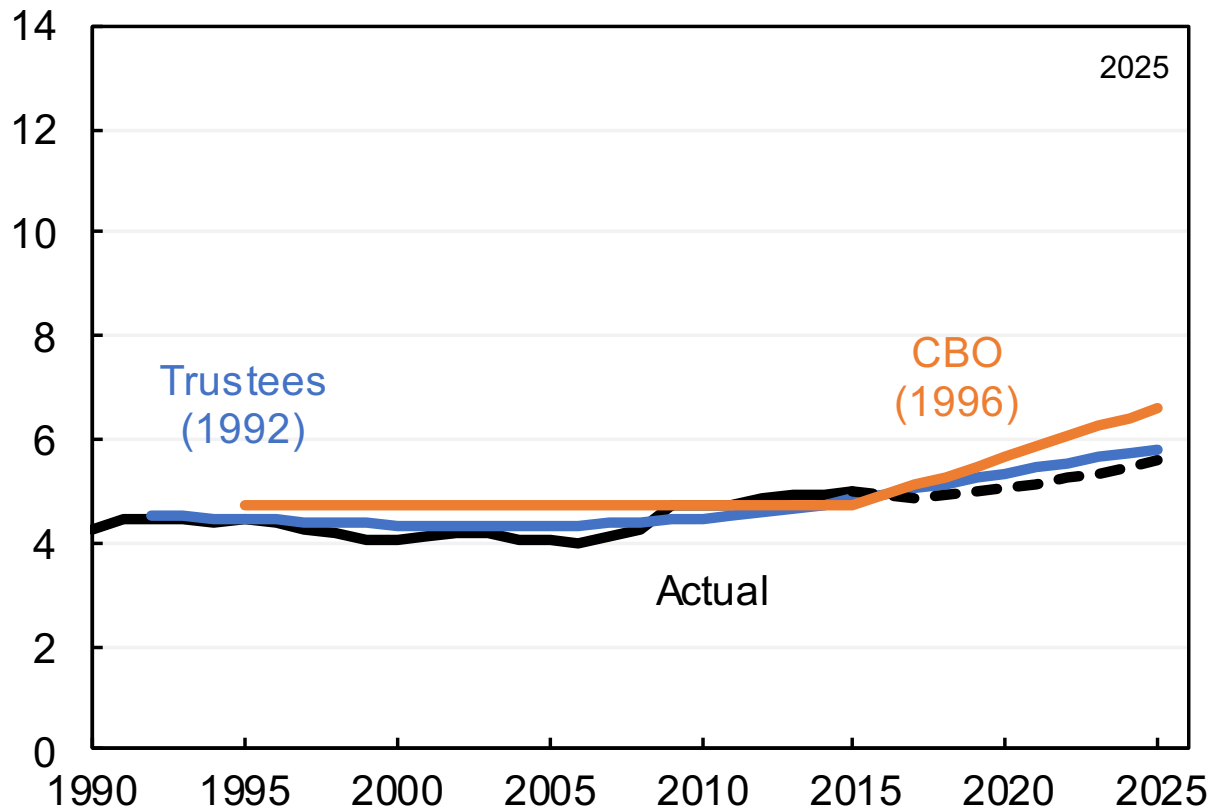
Note: Projections are adjusted to account for changes in the definition of nominal GDP since projections were released. Dashed line indicates most recent projection.
Source: Congressional Budget Office; Bipartisan Commission on Entitlement and Tax Reform; Bureau of Economic Analysis; Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds; author's calculations.



Social Security Spending Has Also Tracked Expectations

Old-Age, Survivors, and Disability Insurance Costs: Actual vs. Projected

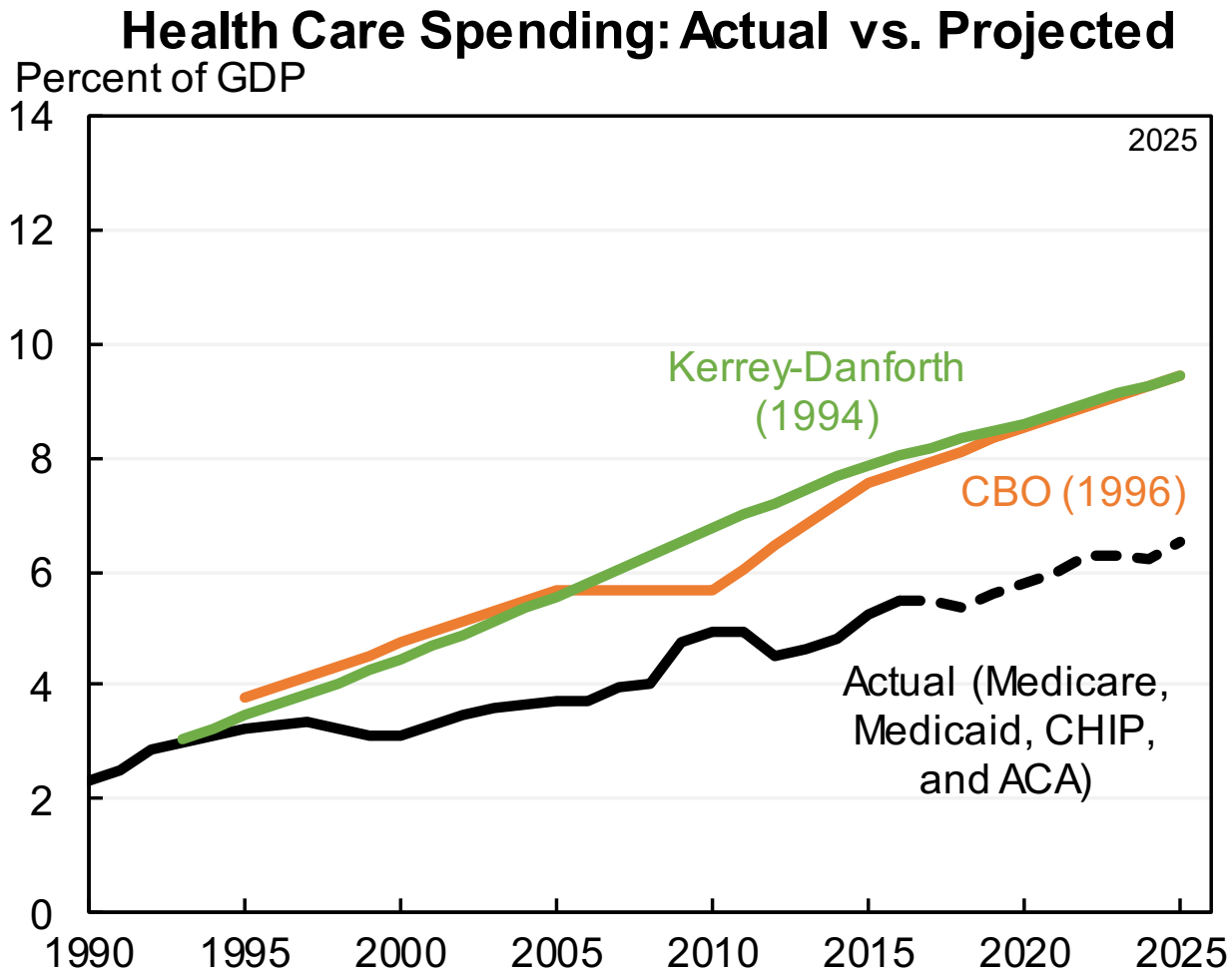
Percent of GDP



Note: Projections are adjusted to account for changes to nominal GDP since projections were released. Dashed line indicates most recent projection.

Source: Congressional Budget Office; Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds; Bureau of Economic Analysis; Council of Economic Advisers; author's calculations.

But Health Spending is Well Below Previous Forecasts



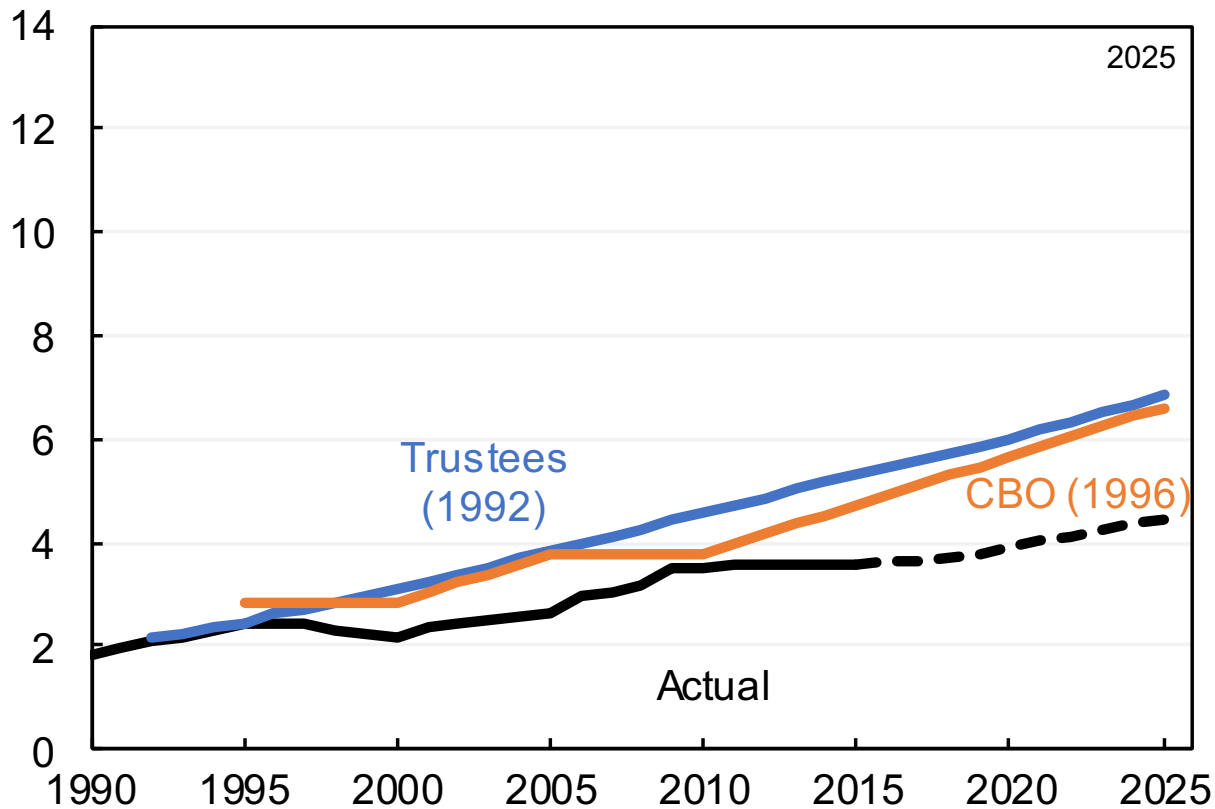
Note: Projections are adjusted to account for changes in the definition of nominal GDP since projections were released. Dashed line indicates most recent projection.
Source: Office of Management and Budget; Congressional Budget Office; Bipartisan Commission on Entitlement and Tax Reform; Bureau of Economic Analysis; Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds; author's calculations.



Including Medicare, Which Has Also Been Well Below Expectations

Hospital Insurance and Supplementary Medical Insurance Costs: Actual vs. Projected

Percent of GDP

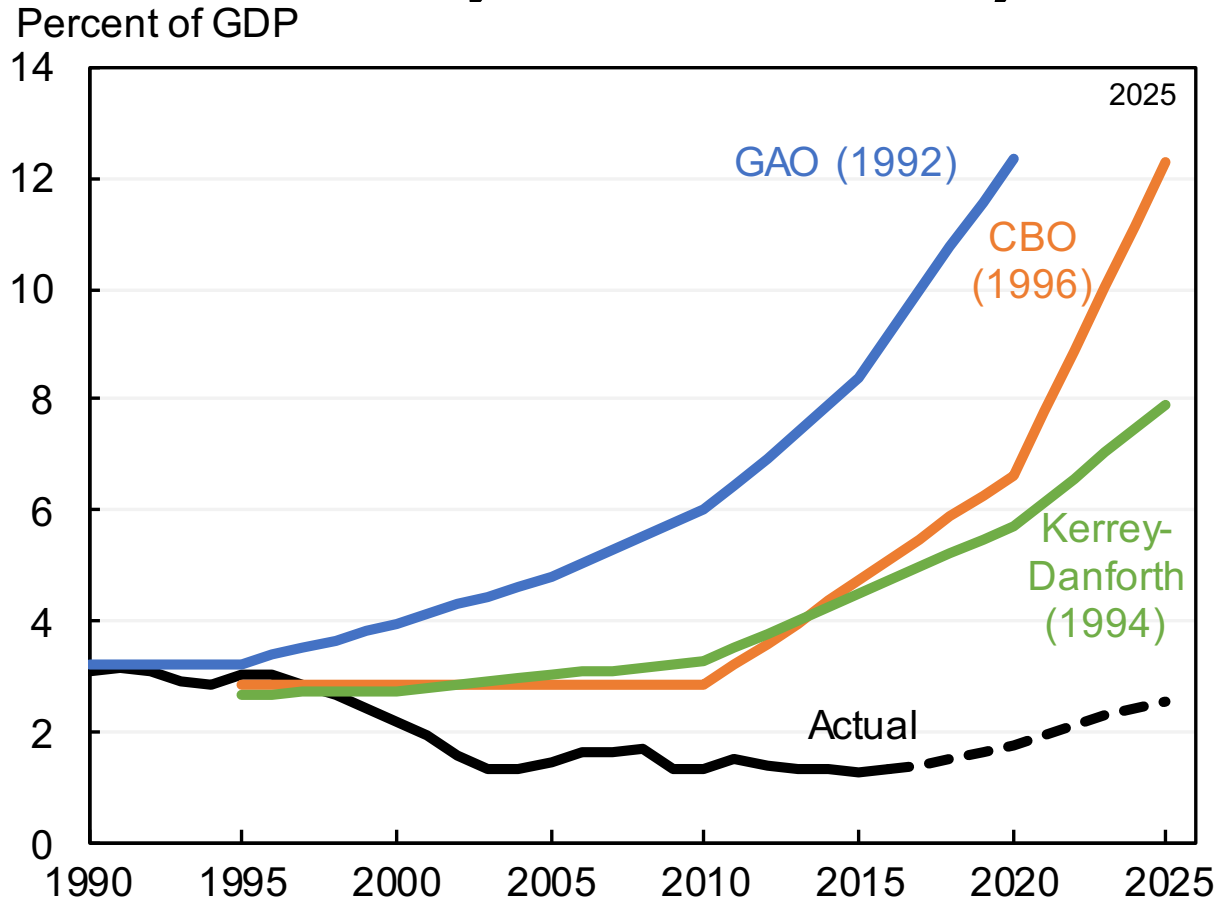


Note: Projections are adjusted to account for changes to nominal GDP since projections were released. Dashed line indicates most recent projection.
Source: Congressional Budget Office; Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds; Board of Trustees, Federal Supplementary Medical Insurance Trust Fund; Bureau of Economic Analysis; Council of Economic Advisers; author's calculations.



Net Interest Payments Have Fallen Relative to GDP—Contrary to the Projected Rise

Net Interest Payments: Actual vs. Projected



Note: Projections are adjusted to account for changes in the definition of nominal GDP since projections were released. GAO estimates were converted from percent of GNP. Dashed line indicates most recent projection.

Source: Congressional Budget Office; Bipartisan Commission on Entitlement and Tax Reform; Government Accountability Office; Bureau of Economic Analysis; Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds; author's calculations.



Growth Rates Well Above Previous Forecasts, But Interest Rates Well Below

Projected and Actual Economic Growth and Interest Rates, Calendar Year 2015 (Percent)

	Real GDP Growth	Nominal Interest Rate on Government Debt
GAO (1992)	*	7.8
Kerrey-Danforth (1994)	1.5	6.3
CBO (1996)	1.3	6.2
<i>Actual</i>	2.6	1.7

Note: *Approximately zero.



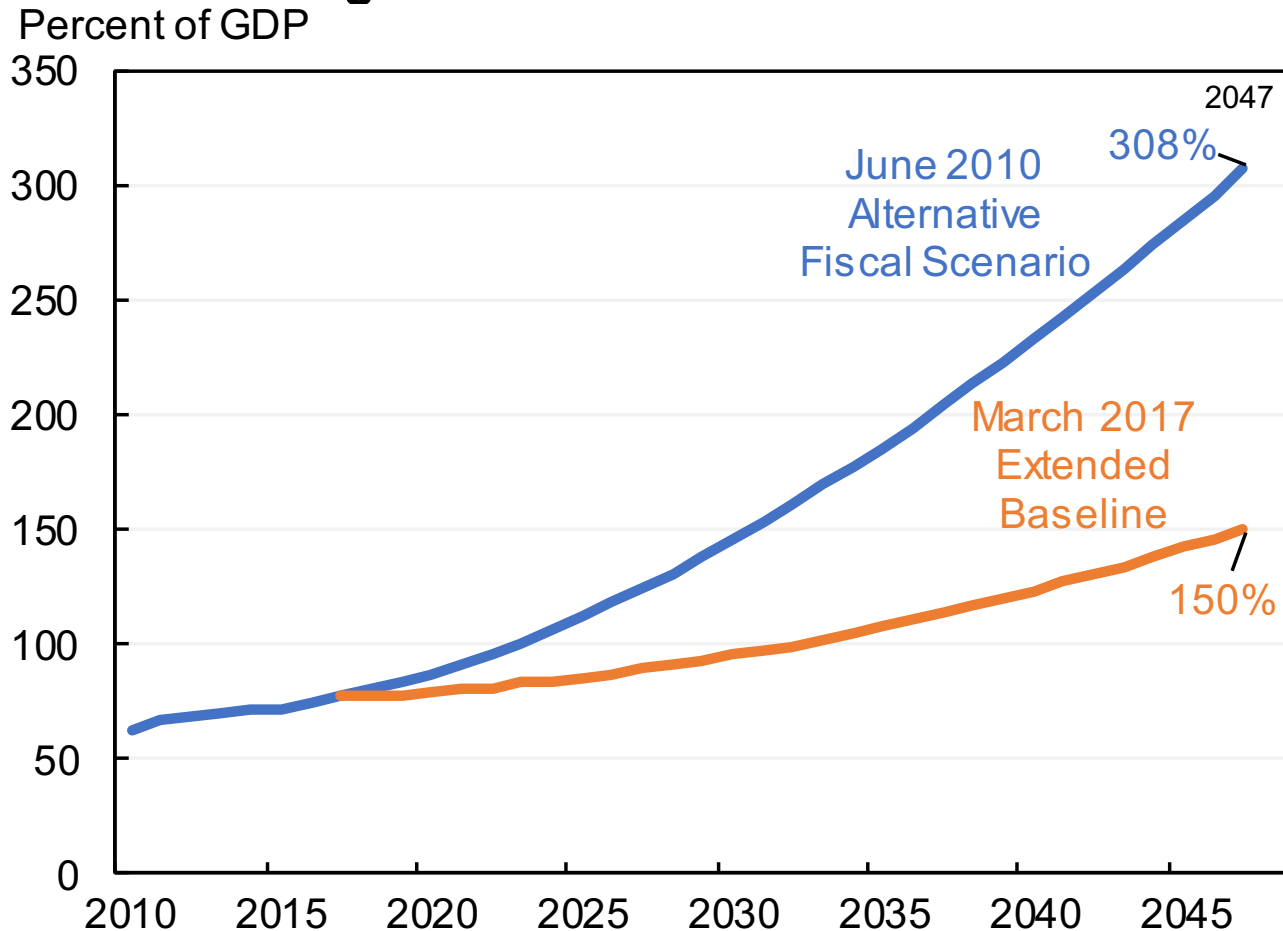
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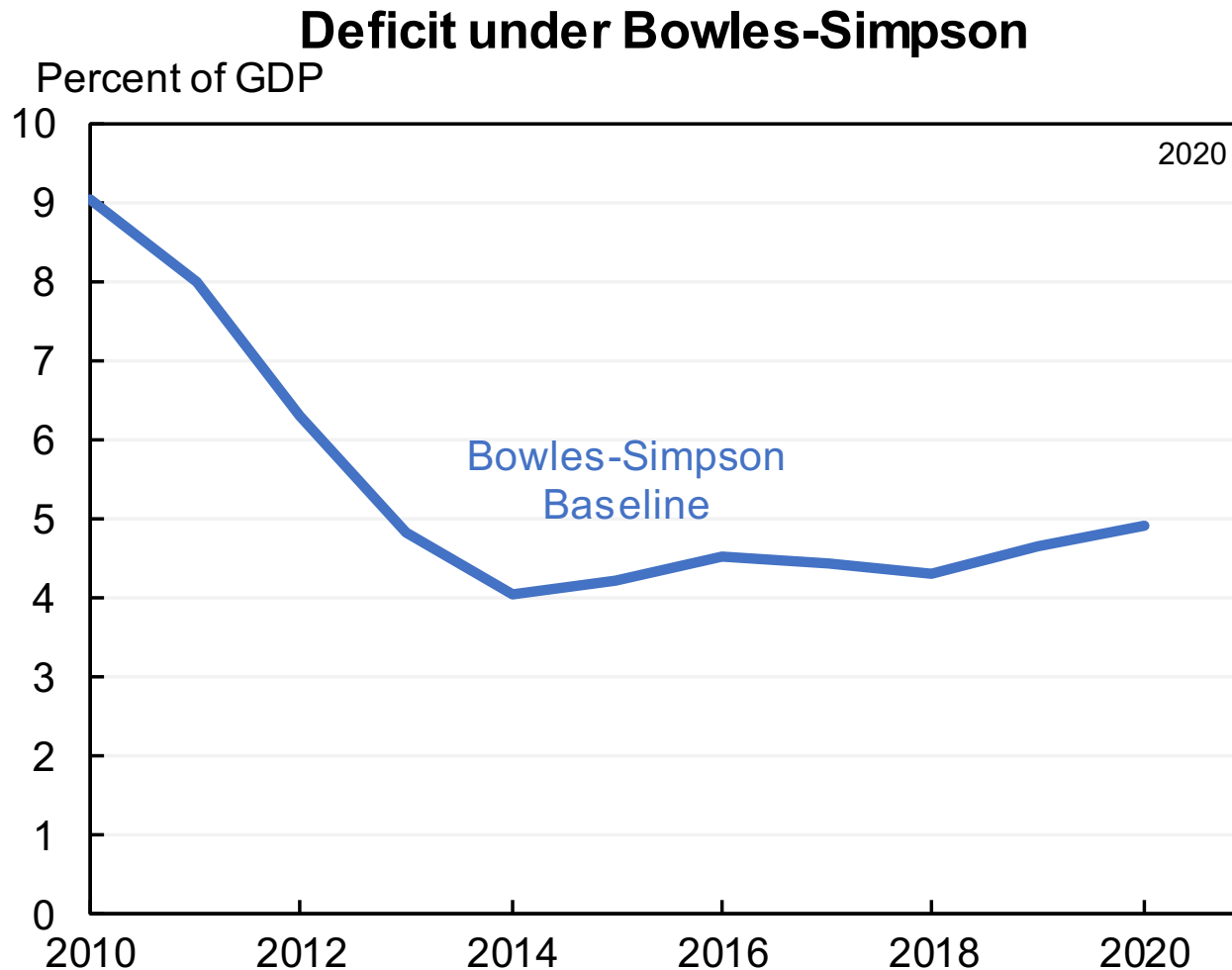
The Debt is Projected to Rise, But Some Progress Since 2010 (Caveat: Methodology Not Constant)



Long-Term Federal Debt Outlook

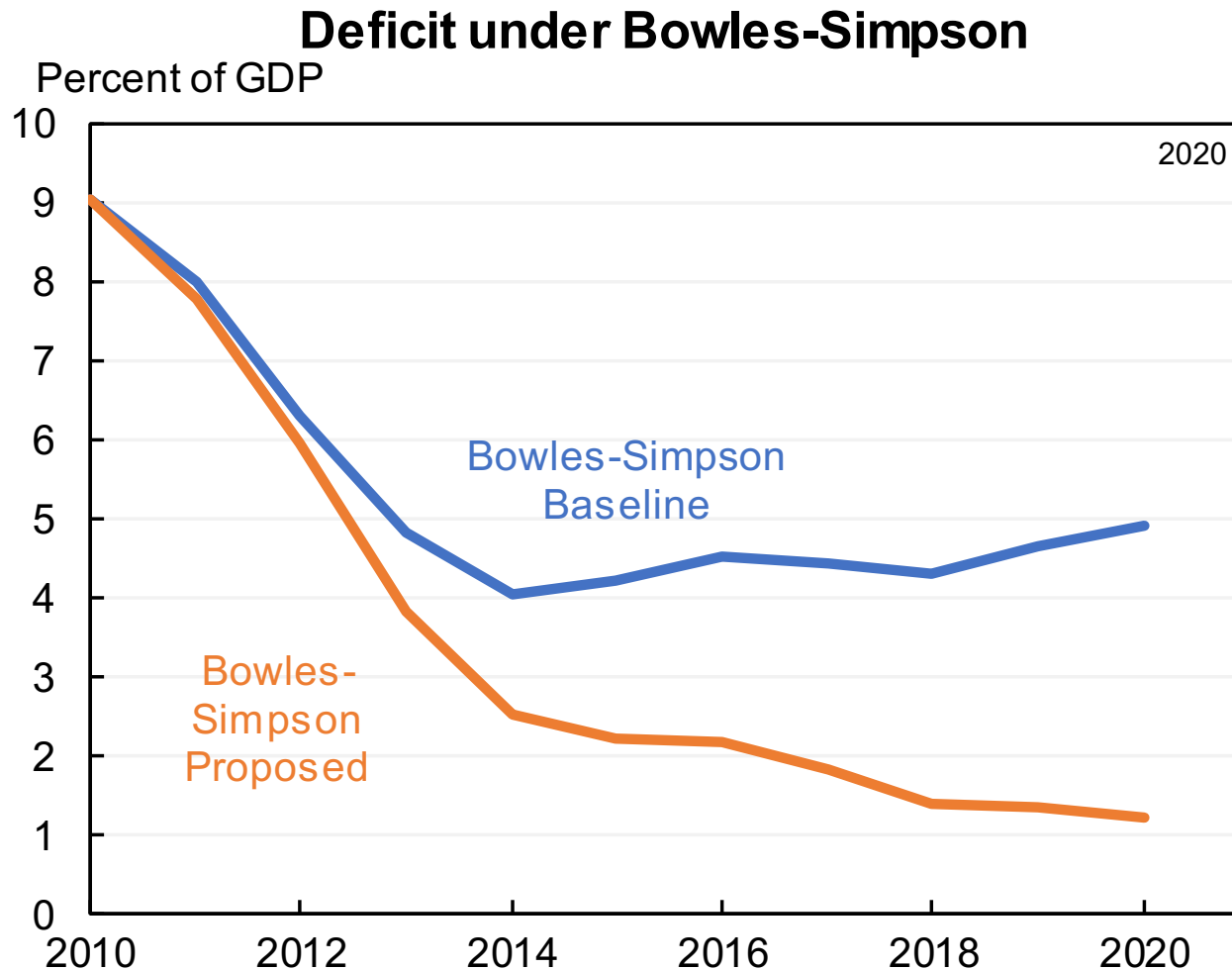


At the Time of Bowles-Simpson the Deficit Was Never Projected to Fall Below 4 Percent of GDP



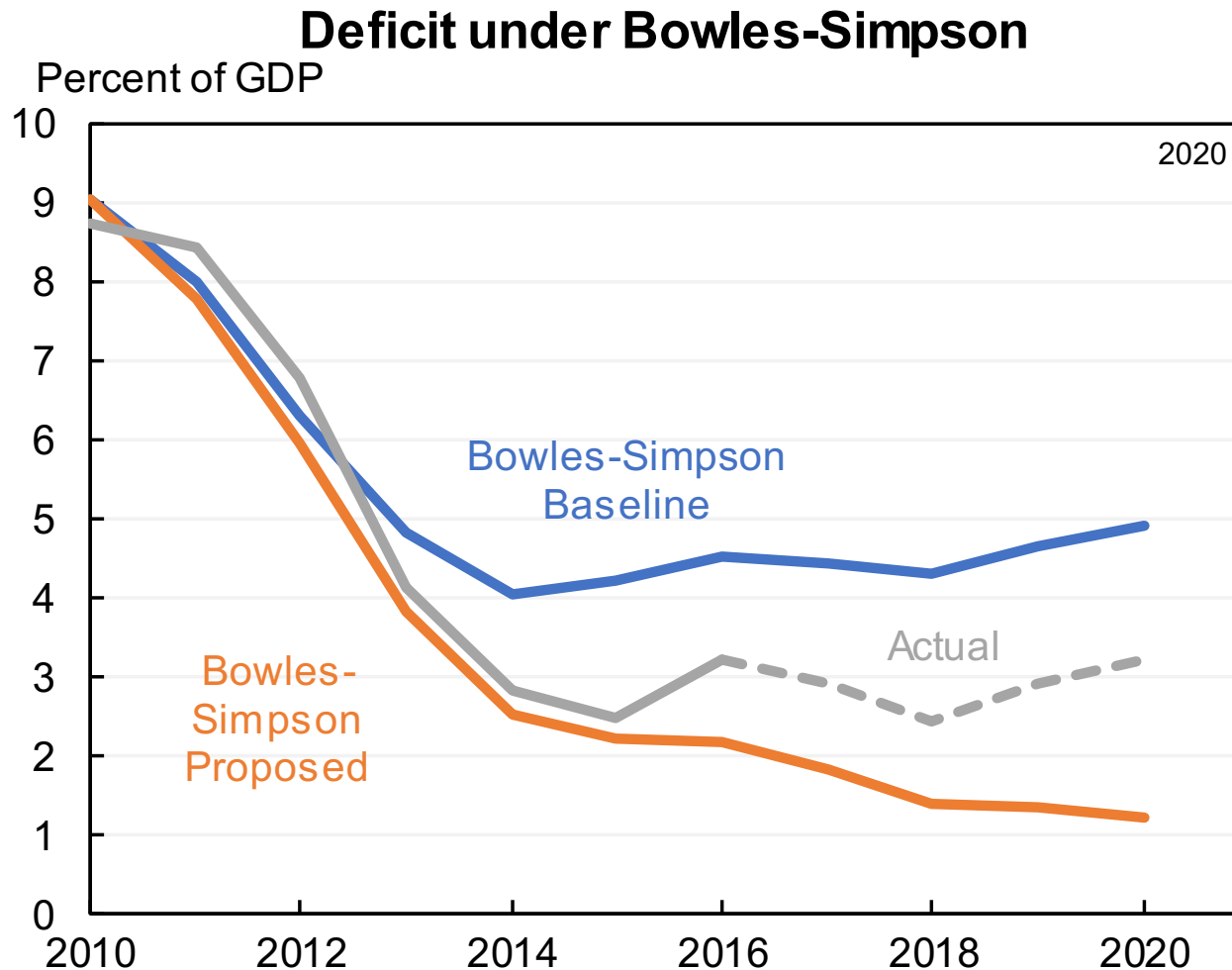
Note: GDP estimates from Bowles-Simpson were adjusted to reflect revisions to the calculation of nominal GDP since 2010.
Source: National Commission on Fiscal Responsibility and Reform; Congressional Budget Office; author's calculations.

Bowles-Simpson Proposed to Cut the Deficit to 1 Percent of GDP



Note: GDP estimates from Bowles-Simpson were adjusted to reflect revisions to the calculation of nominal GDP since 2010.
Source: National Commission on Fiscal Responsibility and Reform; Congressional Budget Office; author's calculations.

The Deficit Has Fallen But Not As Much As Bowles-Simpson Proposed



Note: GDP estimates from Bowles-Simpson were adjusted to reflect revisions to the calculation of nominal GDP since 2010. Dashed line indicates latest CBO projection.
Source: National Commission on Fiscal Responsibility and Reform; Congressional Budget Office; author's calculations.

The Main Source of Higher Deficits is Because Revenue is Below the Bowles-Simpson Proposal



Difference Between Actual Spending and Bowles-Simpson Proposal, 2017

	Assuming Bowles-Simpson Was Targetting Nominal Dollars	Assuming Bowles-Simpson Was Targetting Percent of GDP
Revenue	-\$673B	-2.2 p.p.
Mandatory Outlays	-\$142B	0.1 p.p.
Discretionary Outlays	\$14B	0.5 p.p.
Net Interest	-\$358B	-1.7 p.p.
Deficit	-\$187B	-1.1 p.p.

Note: Percentage points denoted p.p.

Source: National Commission on Fiscal Responsibility and Reform; Congressional Budget Office; author's calculations.

What Would Bowles-Simpson Look Like Going Forward?



Policy Changes Needed for the Current 10-Year Budget (2018-27) to Get Back to the Original Bowles-Simpson Proposed Levels

Taxes: \$6 to \$11 trillion increase

Discretionary spending: \$300 billion to \$1.3 trillion cut

Mandatory spending: \$1 trillion cut to \$2 trillion *increase*

Note: numbers vary depending on whether Bowles-Simpson targets are interpreted as nominal dollars or percent of GDP



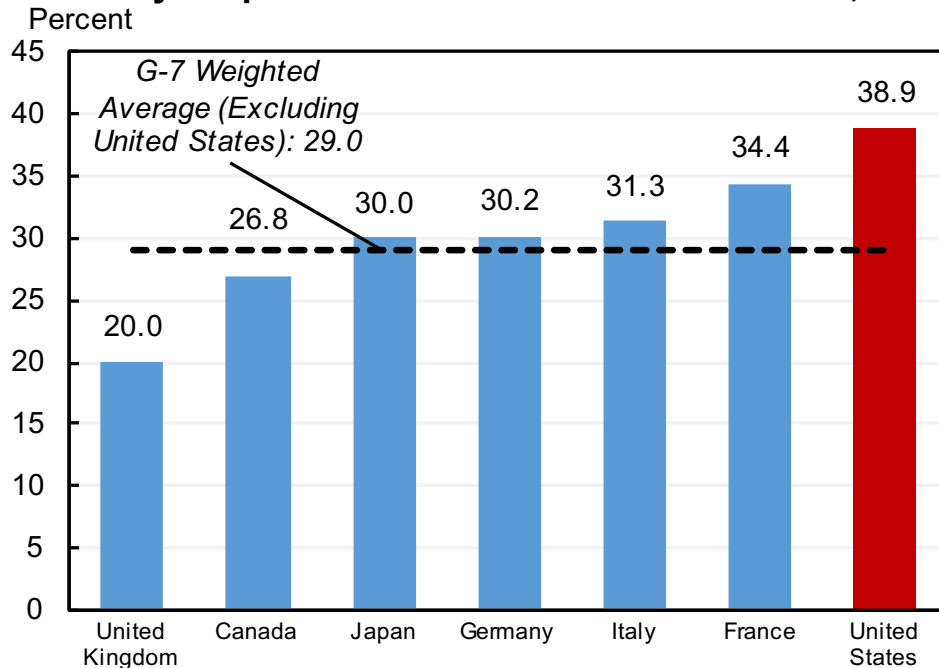
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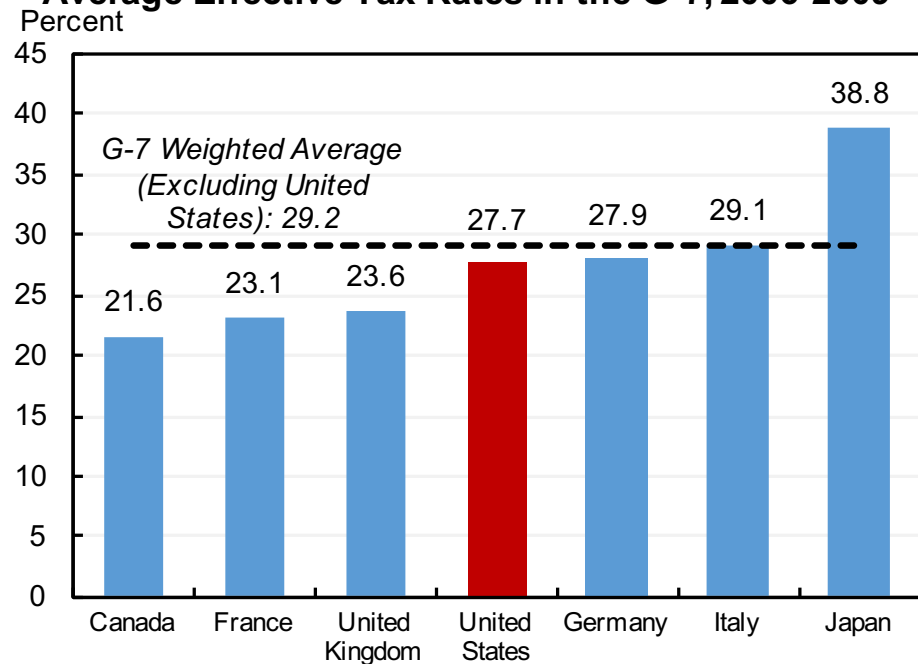


1. The Way We Collect Taxes—E.g. A High Statutory Rate for Corporations

Statutory Corporate Income Tax Rates in the G-7, 2016



Average Effective Tax Rates in the G-7, 2006-2009



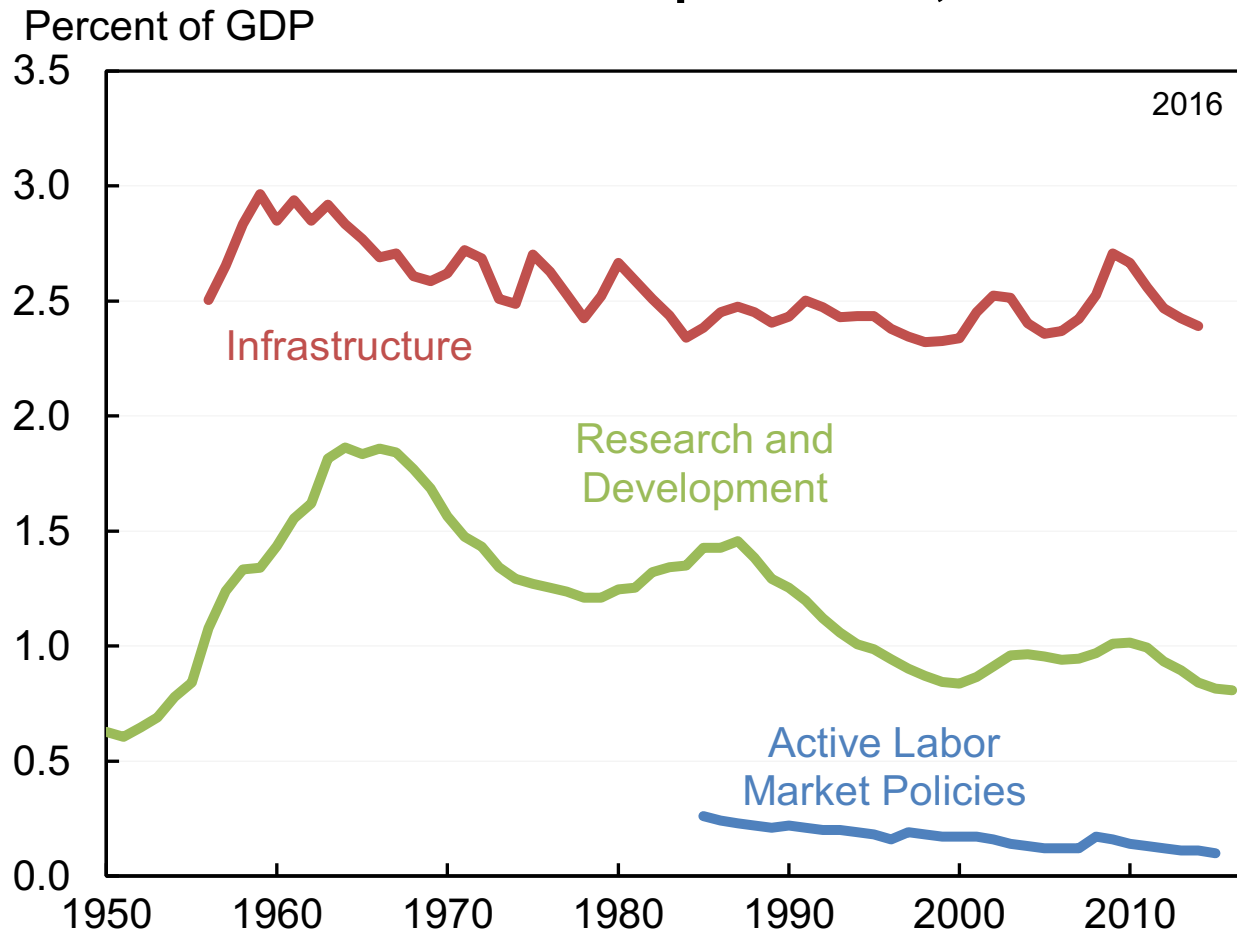
Note: Combined central and sub-central (statutory) corporate income tax rate given by the central government rate (less deductions for sub-national taxes) plus the sub-central rate. G-7 average is calculated using gross domestic product (in current U.S. dollars) as weights.

Source: Organisation for Economic Co-operation and Development; national sources via Haver Analytics; author's calculations; Council of Economic Advisers (2015).



2. The Composition of Spending—E.g. Too Little Investment

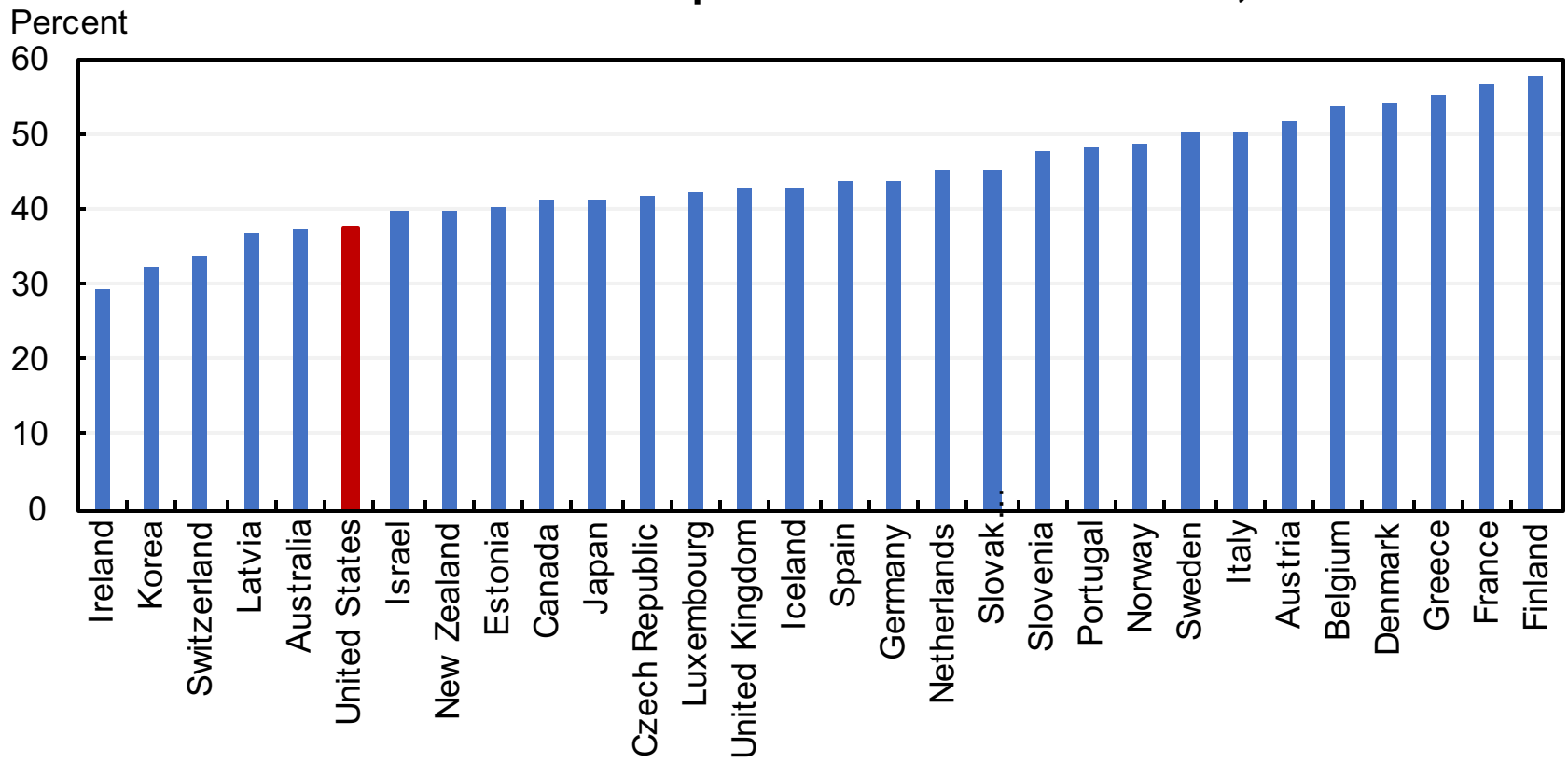
Selected U.S. Public Expenditures, 1950-2016





3. The Level of Spending—United States is Low in Comparative Perspective

General Government Expenditures as Share of GDP, 2015

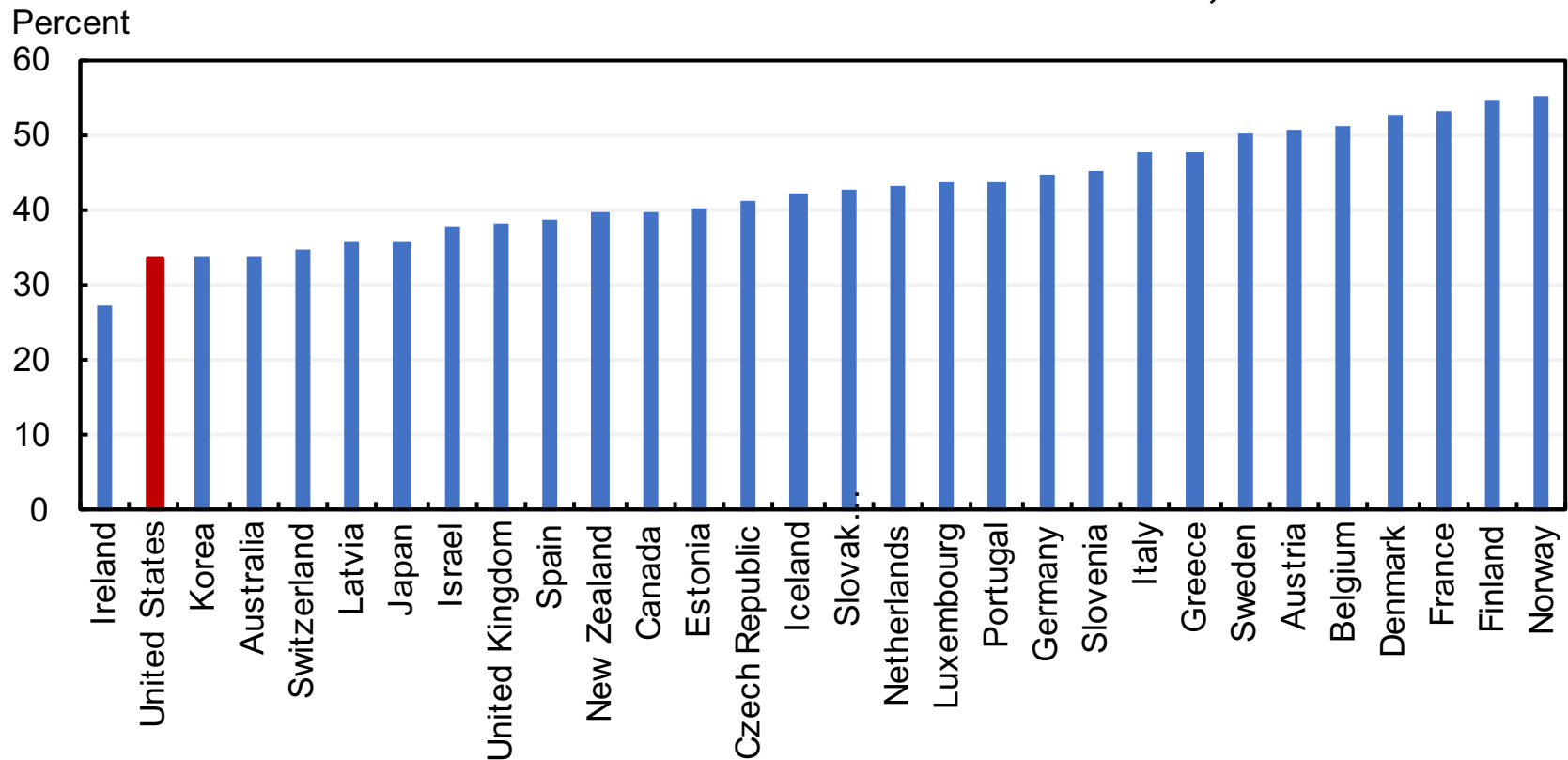


Source: Organisation for Economic Co-operation and Development.



3. The Level of Taxes—United States is Low in Comparative Perspective

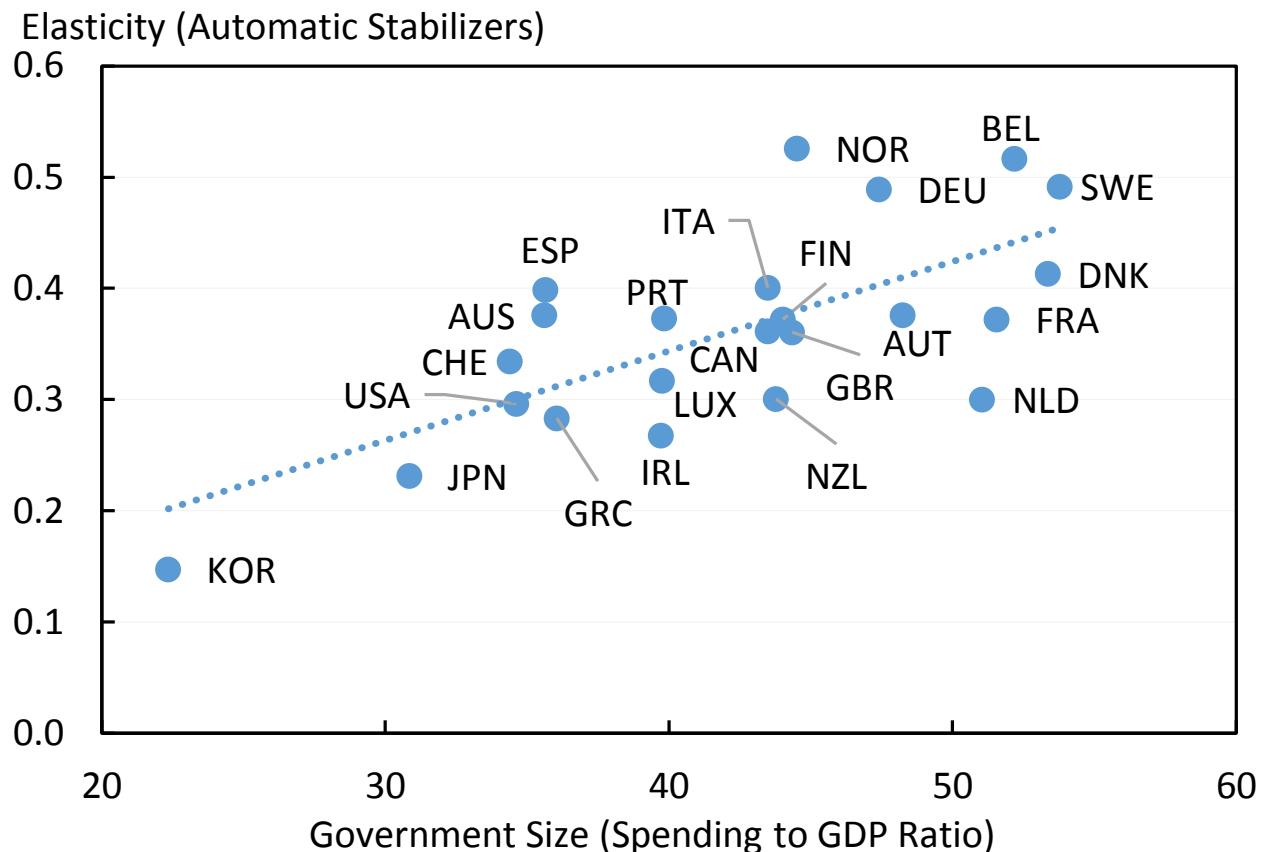
General Government Revenues as Share of GDP, 2015



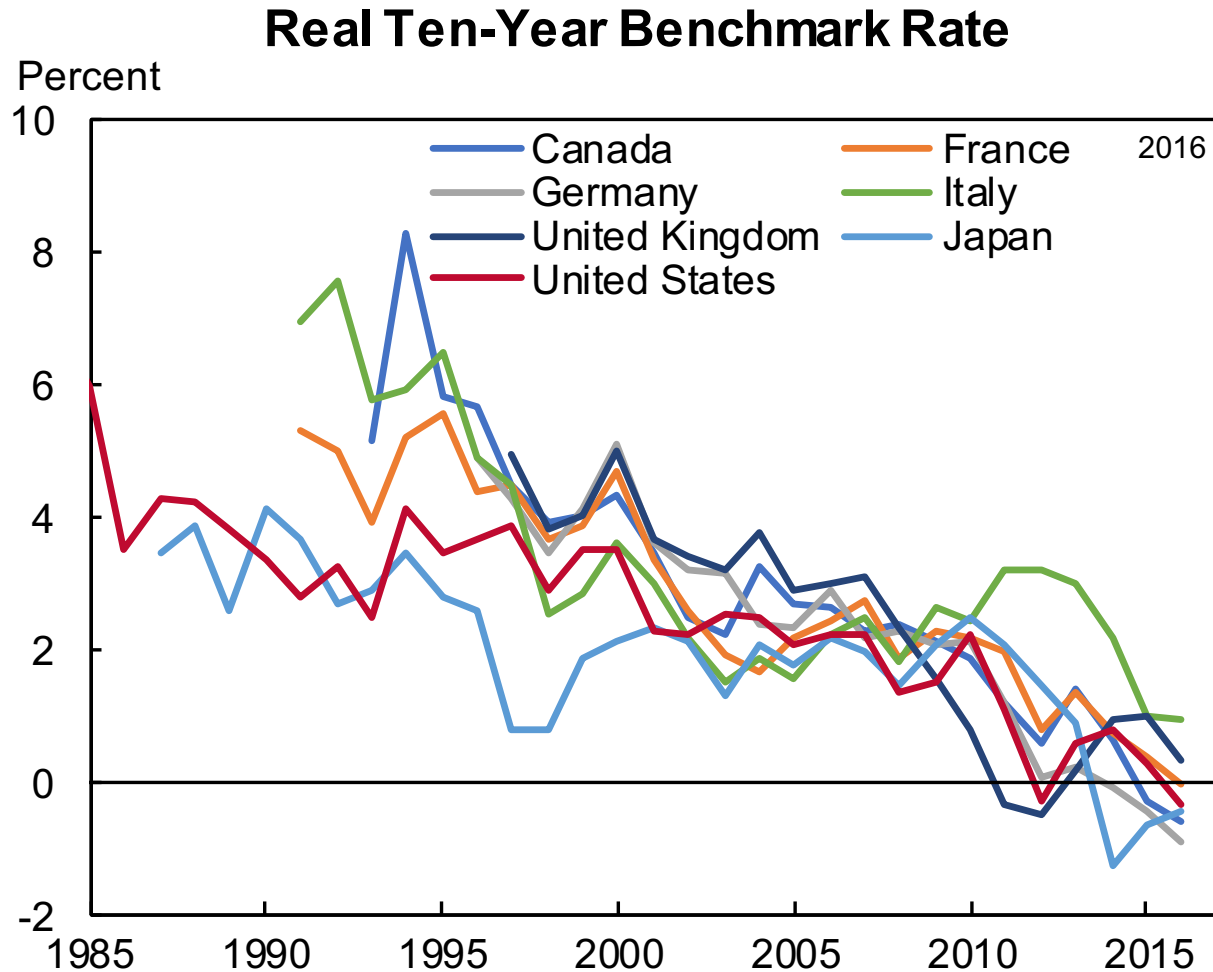


4. Countercyclical Policy: The Difference Between Taxes and Spending in Recessions

Government Size and the Cyclical Semi-Elasticity of Automatic Stabilizers

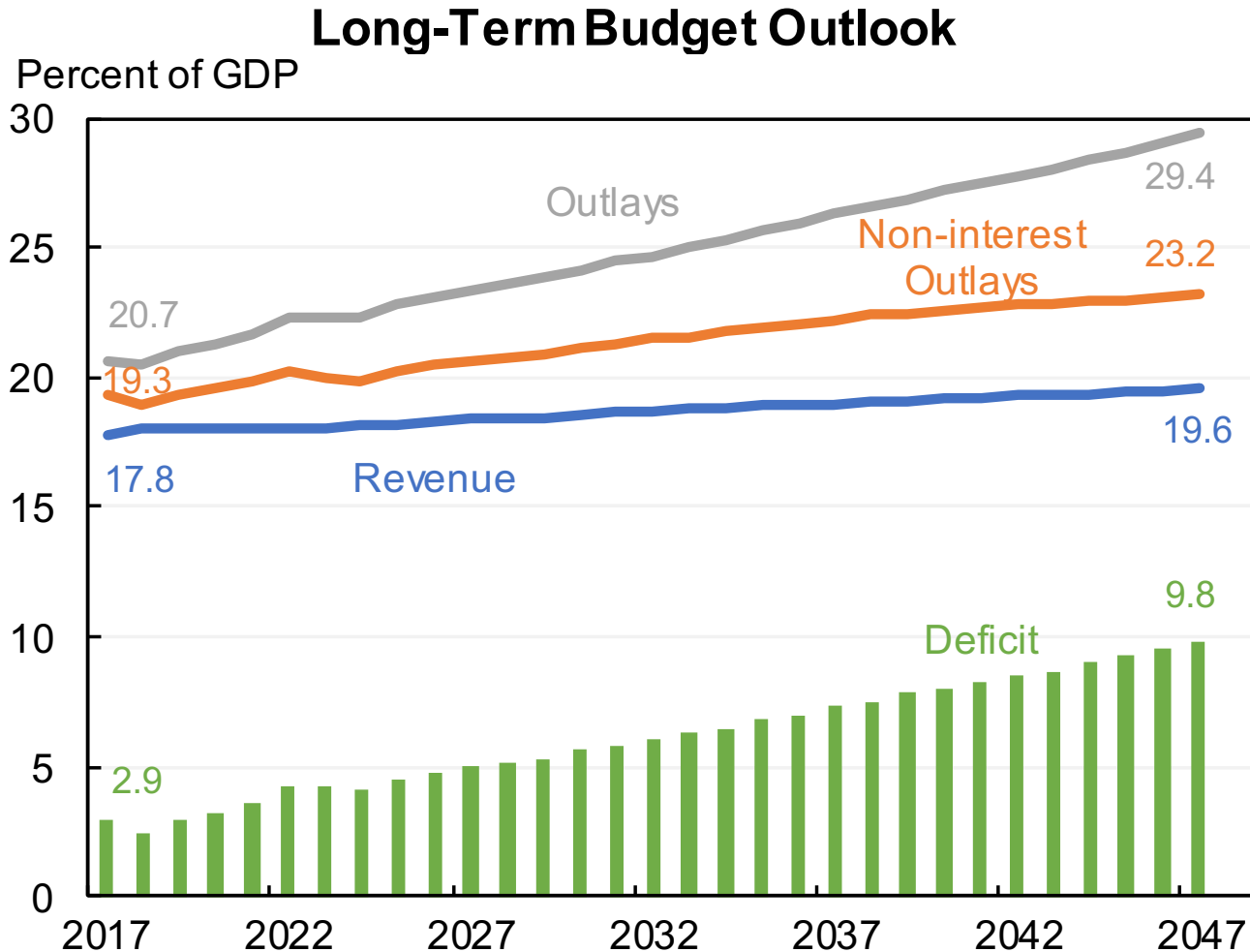


4. The “New View” is that Fiscal Policy is More Important Today Given Less Scope for Conventional Monetary Policy



Note: Inflation measured by one-year changes in the core consumer price index.
Source: National sources via Haver Analytics; author's calculations.

5. The Difference Between Taxes and Spending in the Medium and Long Run





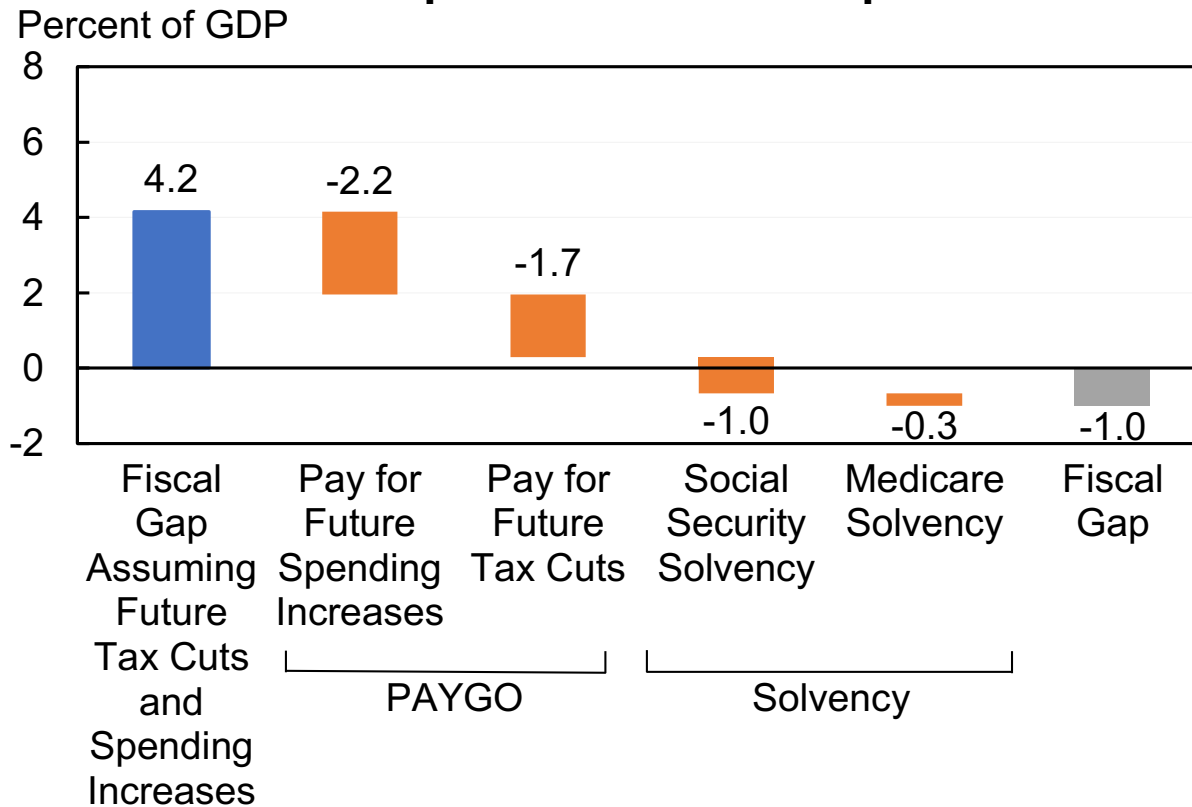
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Fiscal Approach: Do No Harm (i.e., PAYGO) & Ensure Solvency for Social Security and Medicare Hospital Insurance

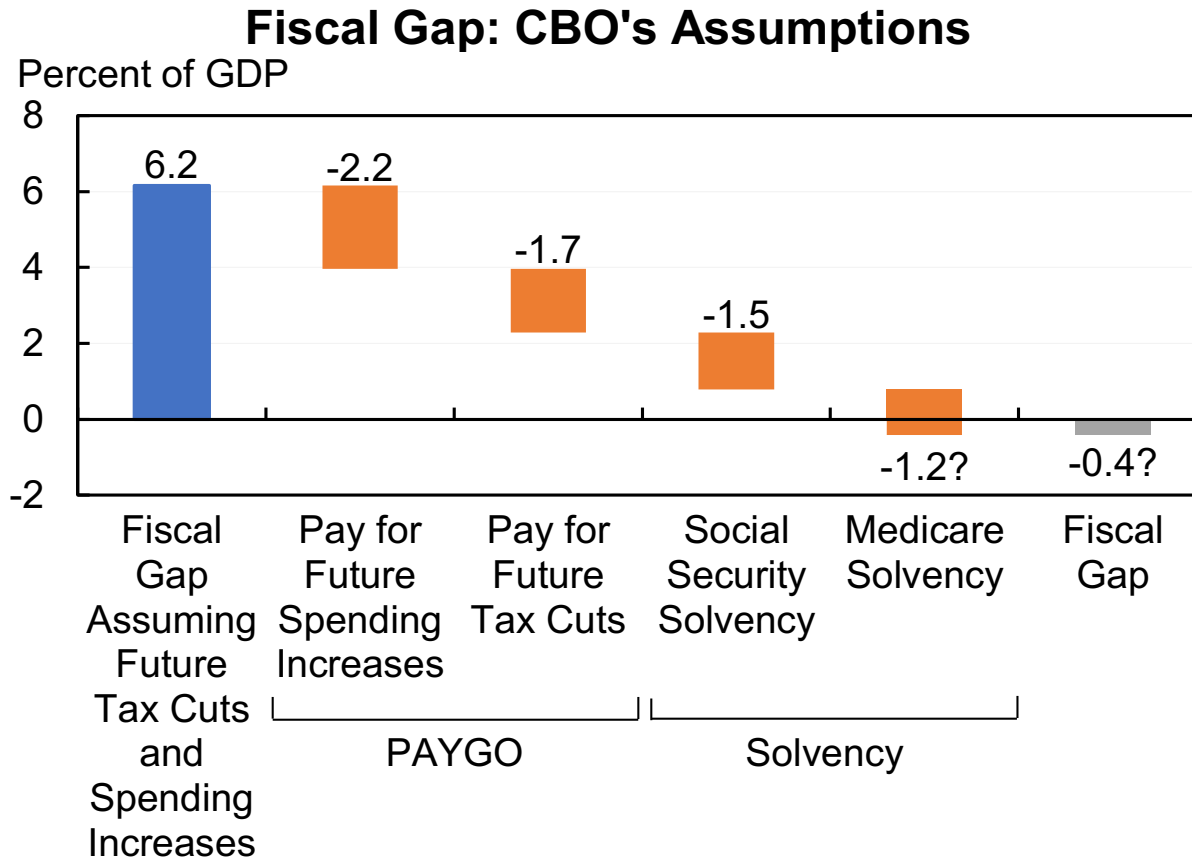


Fiscal Gap: Trustees' Assumptions





Do No Harm & Maintain Solvency Assuming the More Pessimistic CBO Assumptions





Advantages of This Approach

- 1. Grounded in broad existing agreement.** Everyone from Sam Johnson to Bernie Sanders, for example, agrees on Social Security solvency.
- 2. Feasible but meaningful line to draw and defend.** Feasible to pay for departures from the CBO baseline since the big issues are resolved.
- 3. Agnostic on debates over the size/role of government.** Treats taxes/spending symmetrically both in PAYGO and for solvency.
- 4. Allows solution to be reached in stages.** E.g. could continue to address Medicare solvency through periodic legislation drawing on new lessons.
- 5. Automatically adjusts as uncertainty is resolved.** Solvency projections are updated annually, so more/less adjustment if the problem is more/less severe.

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