

The Economy and the Budget

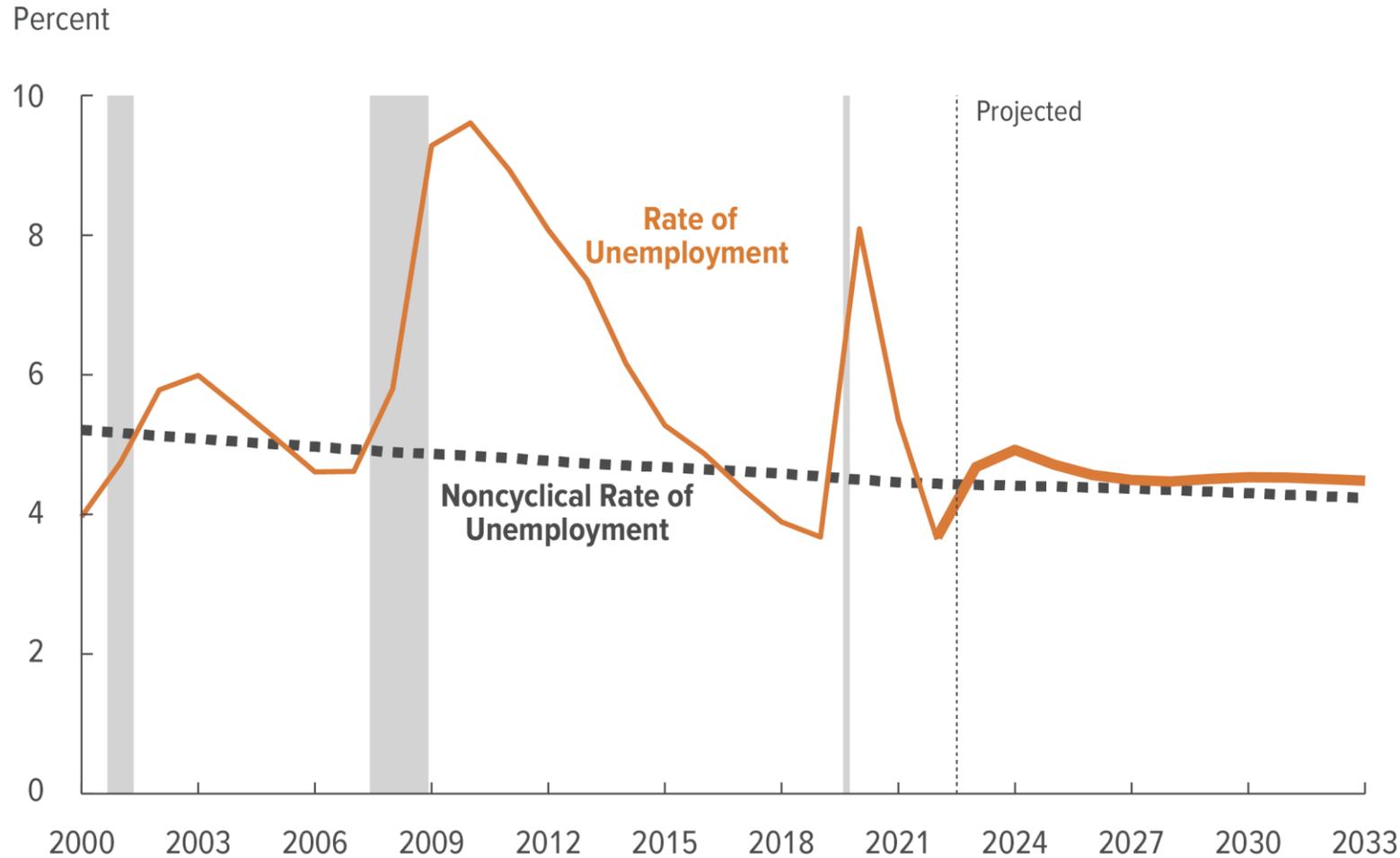
March 23, 2023

A Presentation to the Prosperity Caucus

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The Economy

Unemployment



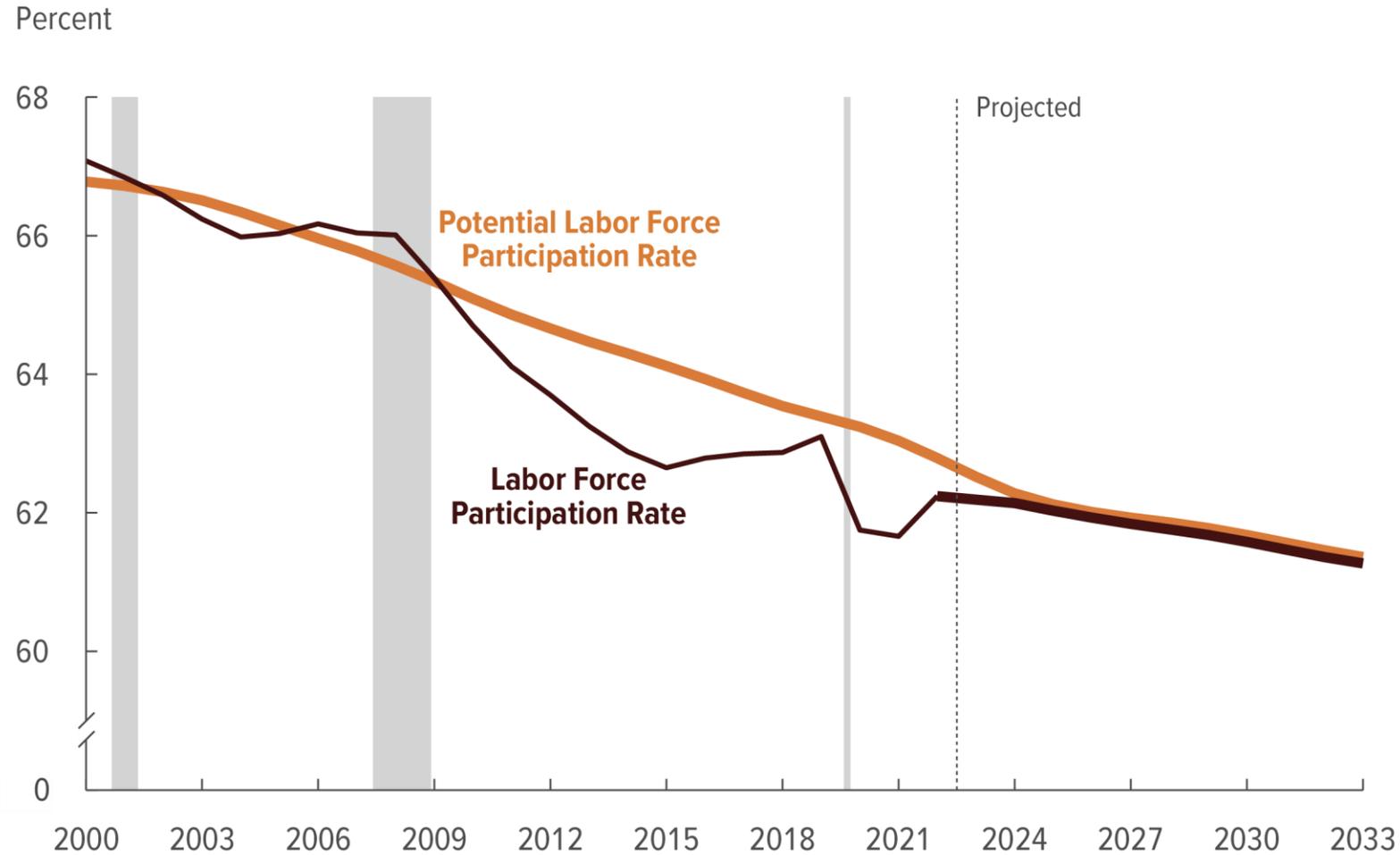
Conditions in the labor market were tight throughout much of 2022.

The unemployment rate rises through early 2024 in CBO's projections, reflecting a slowdown in economic growth.

The unemployment rate is the number of people not working who are available for work and are either seeking work or expecting to be recalled from a temporary layoff, expressed as a percentage of the labor force.

The noncyclical rate of unemployment is the rate that results from all sources except fluctuations in aggregate demand, including normal turnover of jobs and mismatches between the skills of available workers and the skills necessary to fill vacant positions.

Labor Force Participation



The labor force participation rate declines after 2023 as the negative effects of the aging of the population offset the short-term effects of the expanding economy.

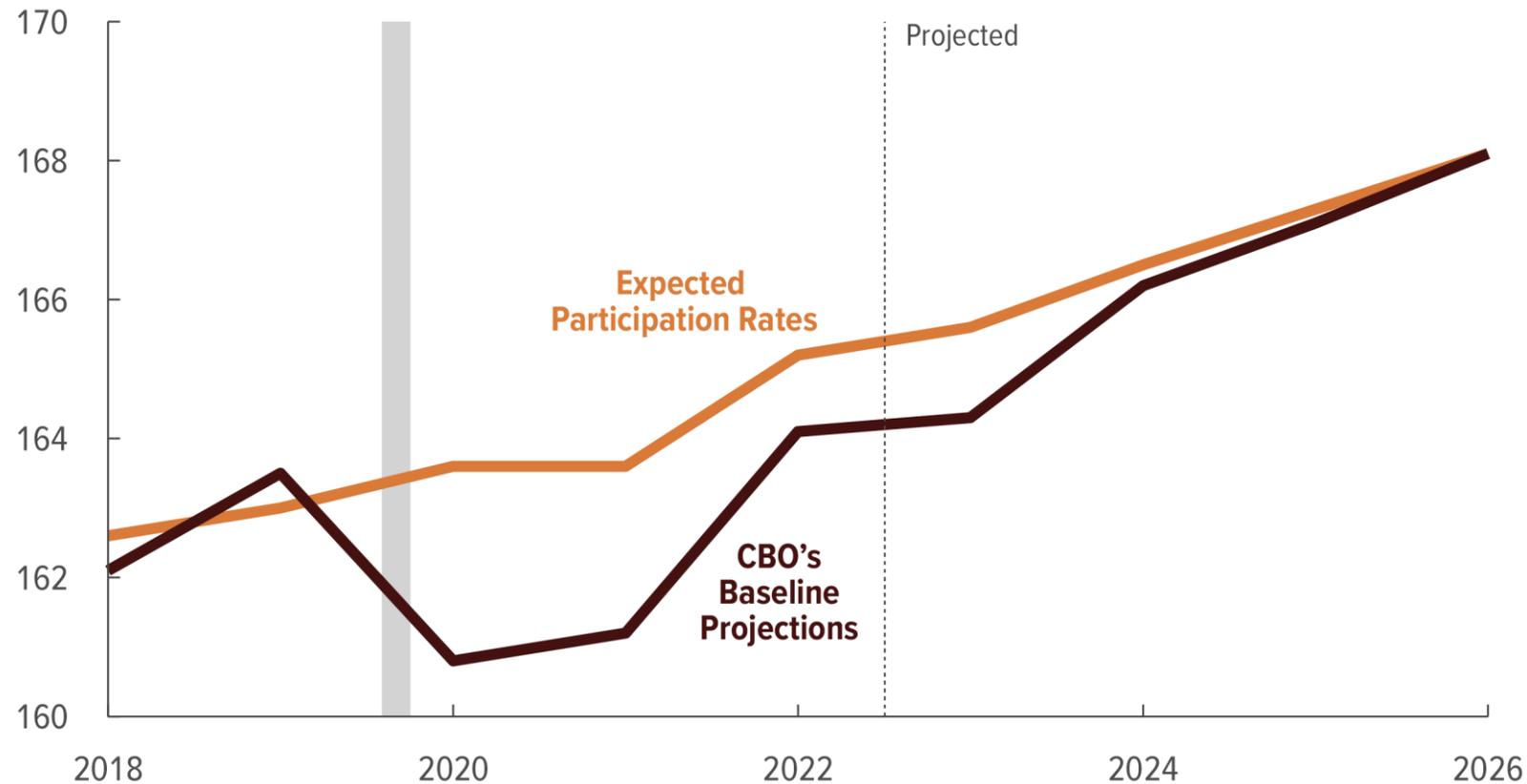
The labor force participation rate is the share of the civilian noninstitutionalized population age 16 or older that has jobs or that is available for work and is either seeking work or expecting to be recalled from a temporary layoff.

The potential labor force participation rate is CBO's estimate of the rate that would occur if economic output and other key variables were at their maximum sustainable amounts.



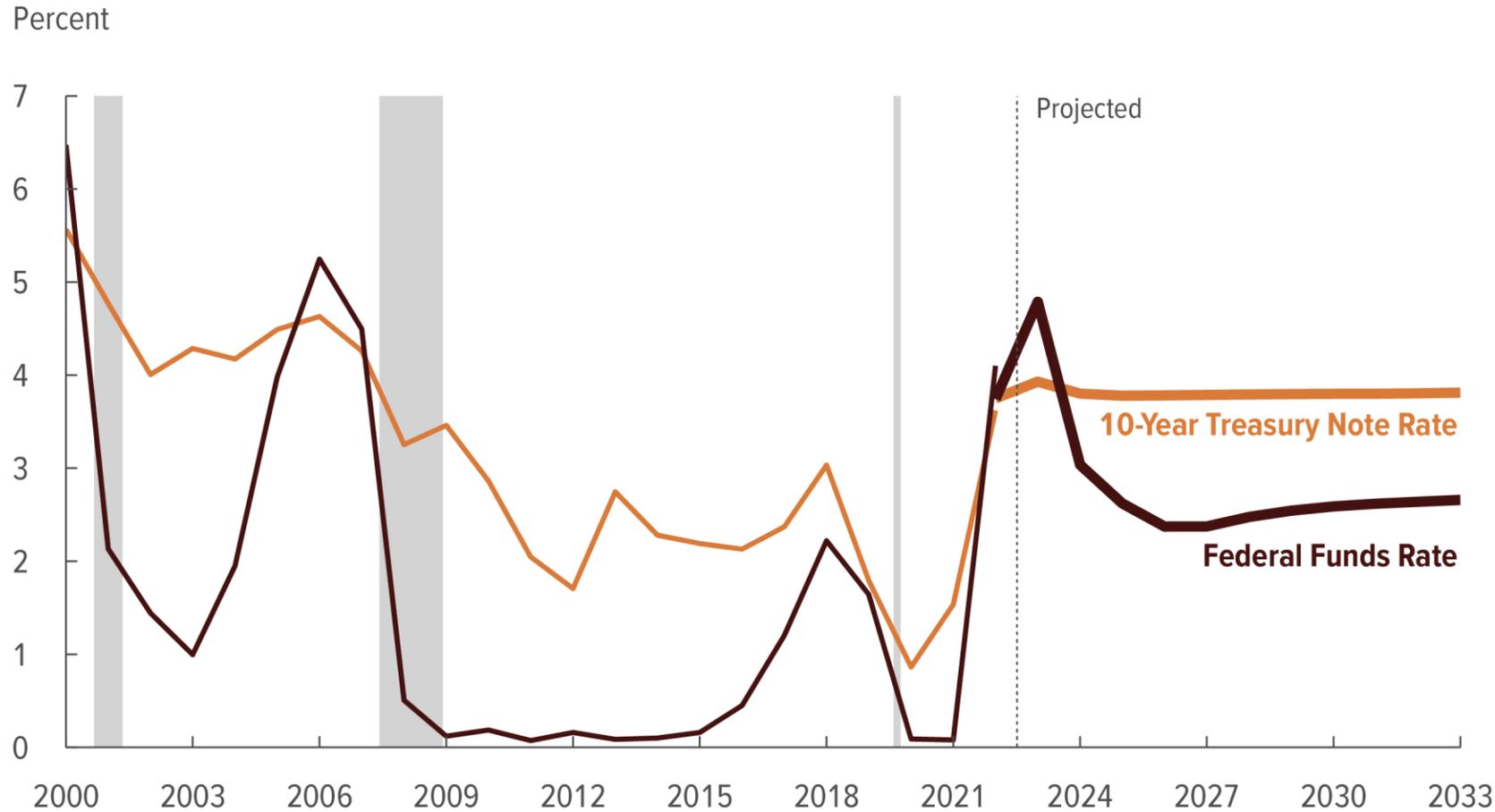
Size of the Labor Force

Millions of People



In CBO's current projections, the number of missing labor force participants—the difference between the expected and projected numbers—increases in 2023 and then gradually declines over the next several years as participation by older people with more education increases.

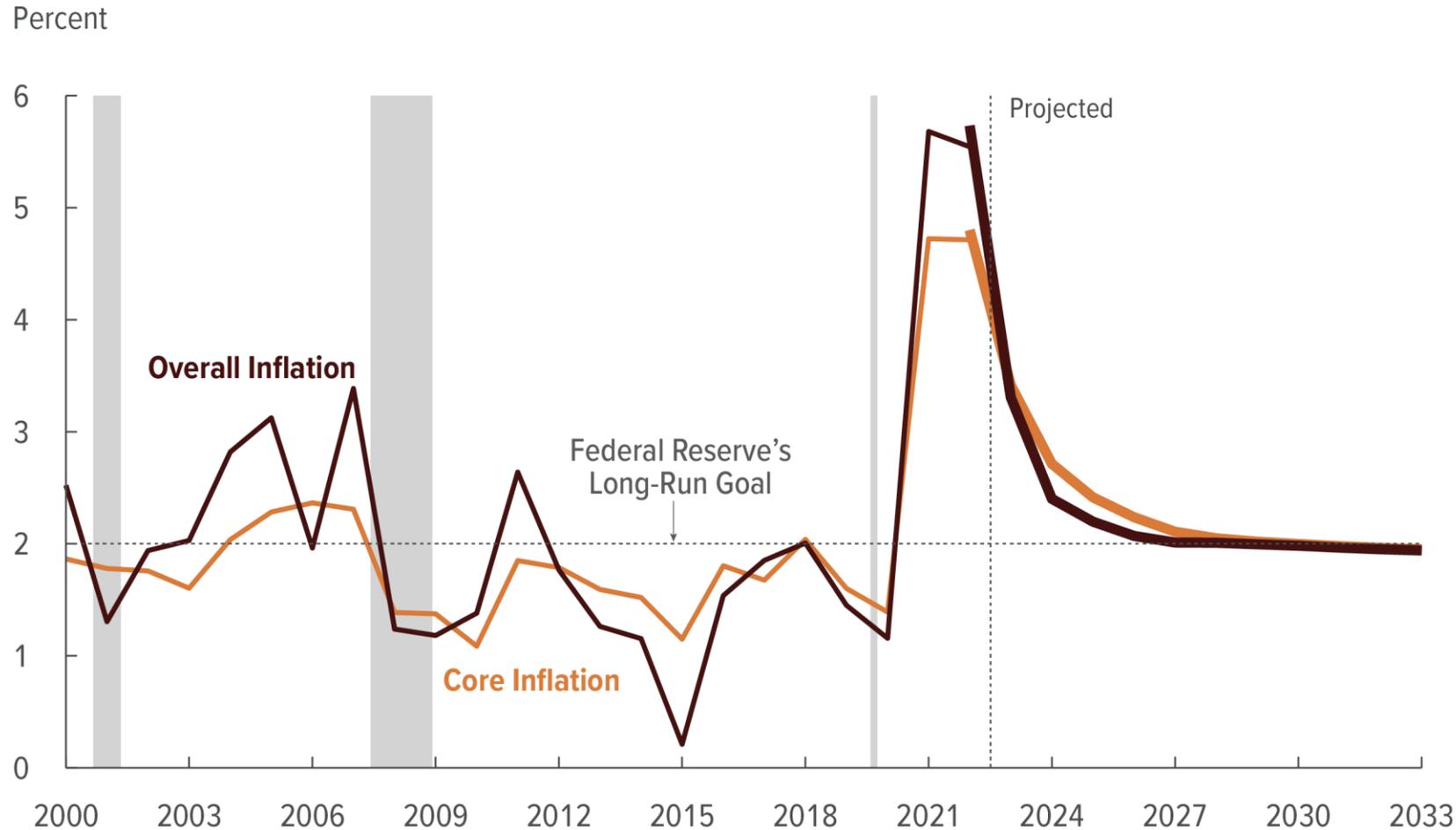
Interest Rates



In CBO's projections, the Federal Reserve further increases the target range for the federal funds rate in early 2023 to reduce inflationary pressures in the economy. That rate is projected to fall in 2024, as inflation slows and unemployment rises.

The interest rate on 10-year Treasury notes, however, remains at 3.8 percent from 2024 to the end of the projection period.

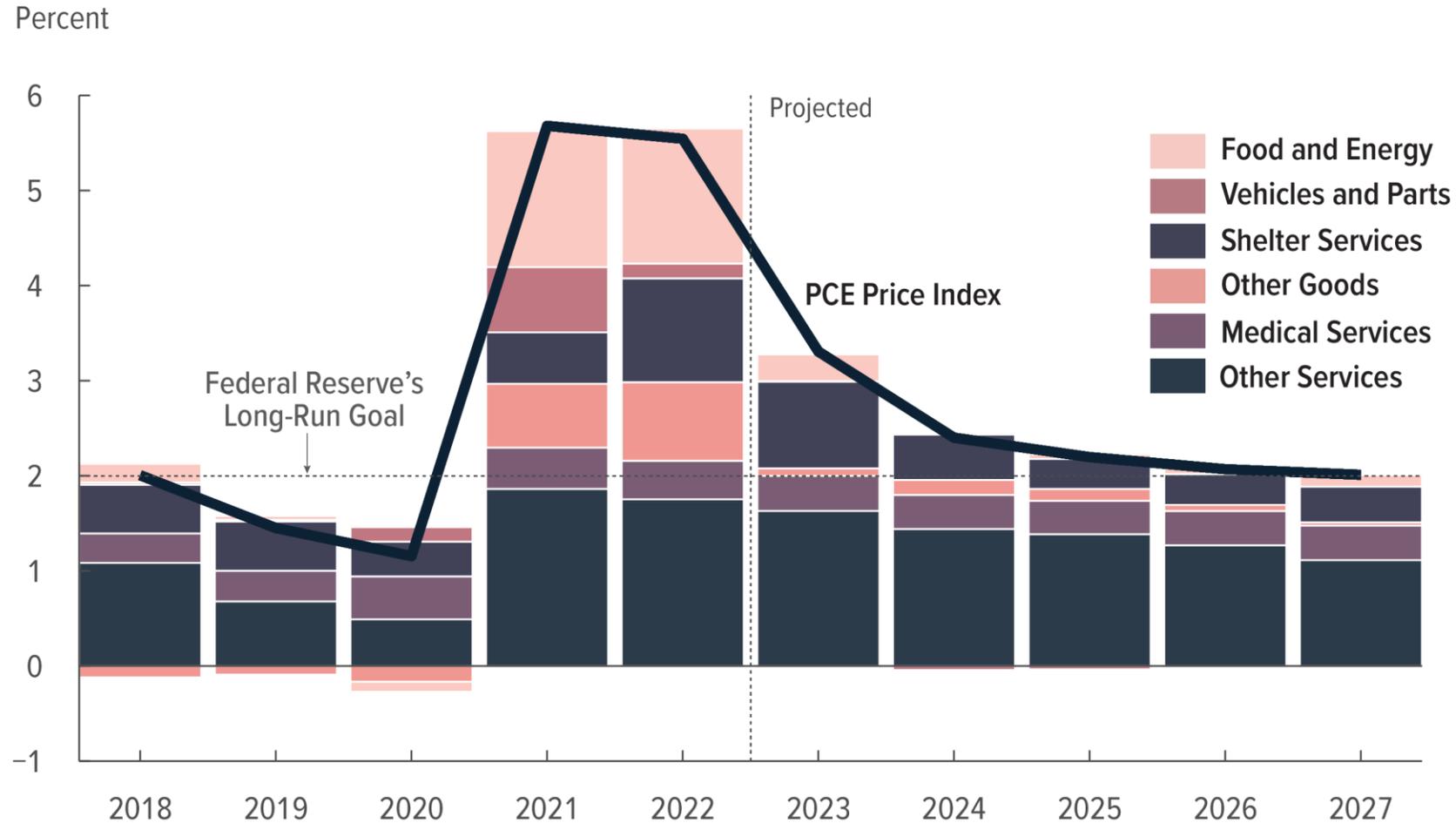
Inflation



In CBO's projections, inflation declines in 2023 as pressures ease from factors that, since mid-2020, have caused demand to grow more rapidly than supply.

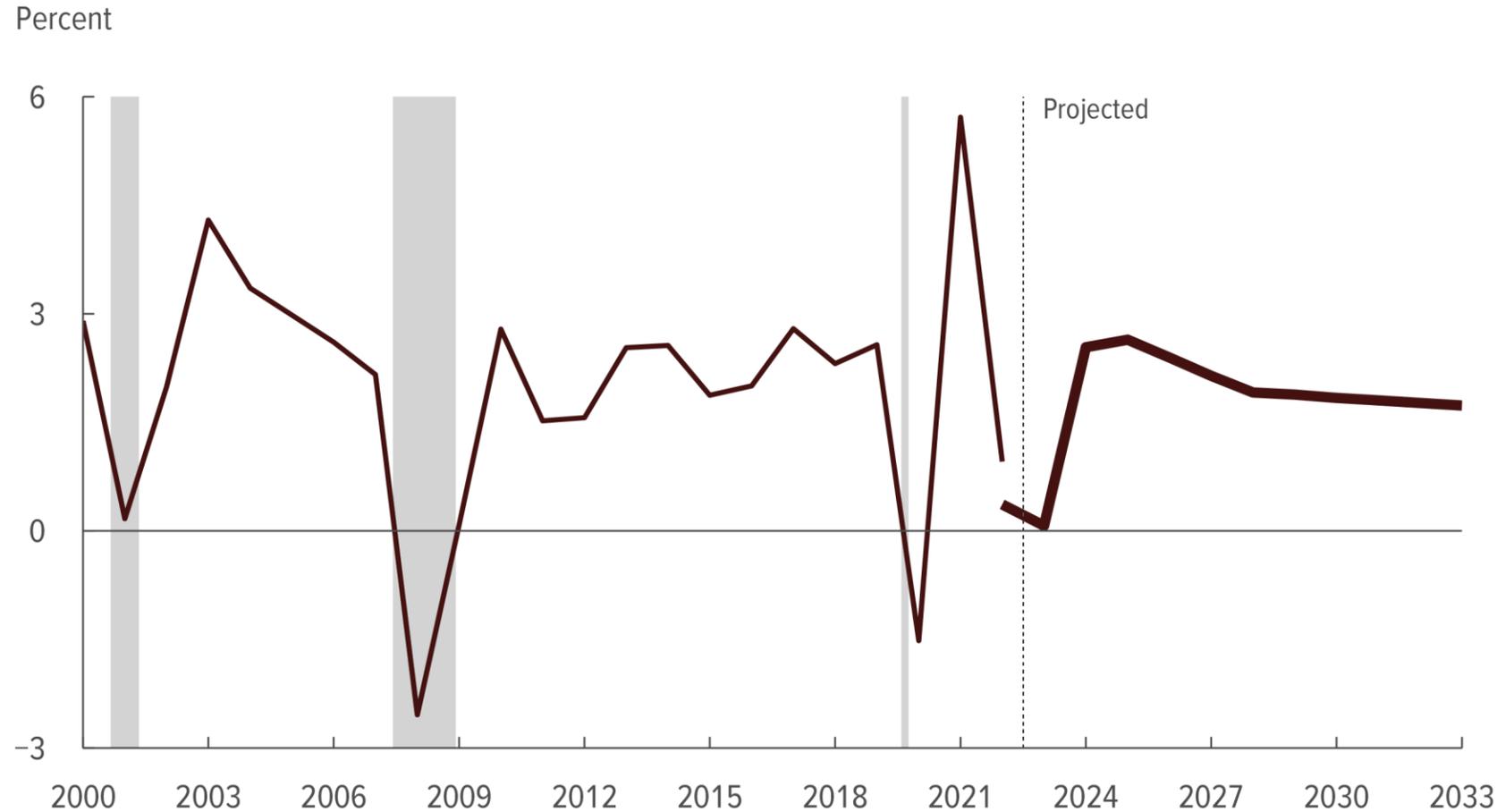
That decline continues until 2027, when the rate of inflation reaches the Federal Reserve's long-run goal. (Inflation is measured by the price index for personal consumption expenditures.)

Contributions to Overall Inflation



The alleviation of upward pressure on the prices of food, energy, and other goods and the downward pressure on prices in shelter services are the two main causes of falling inflation in 2023 and 2024.

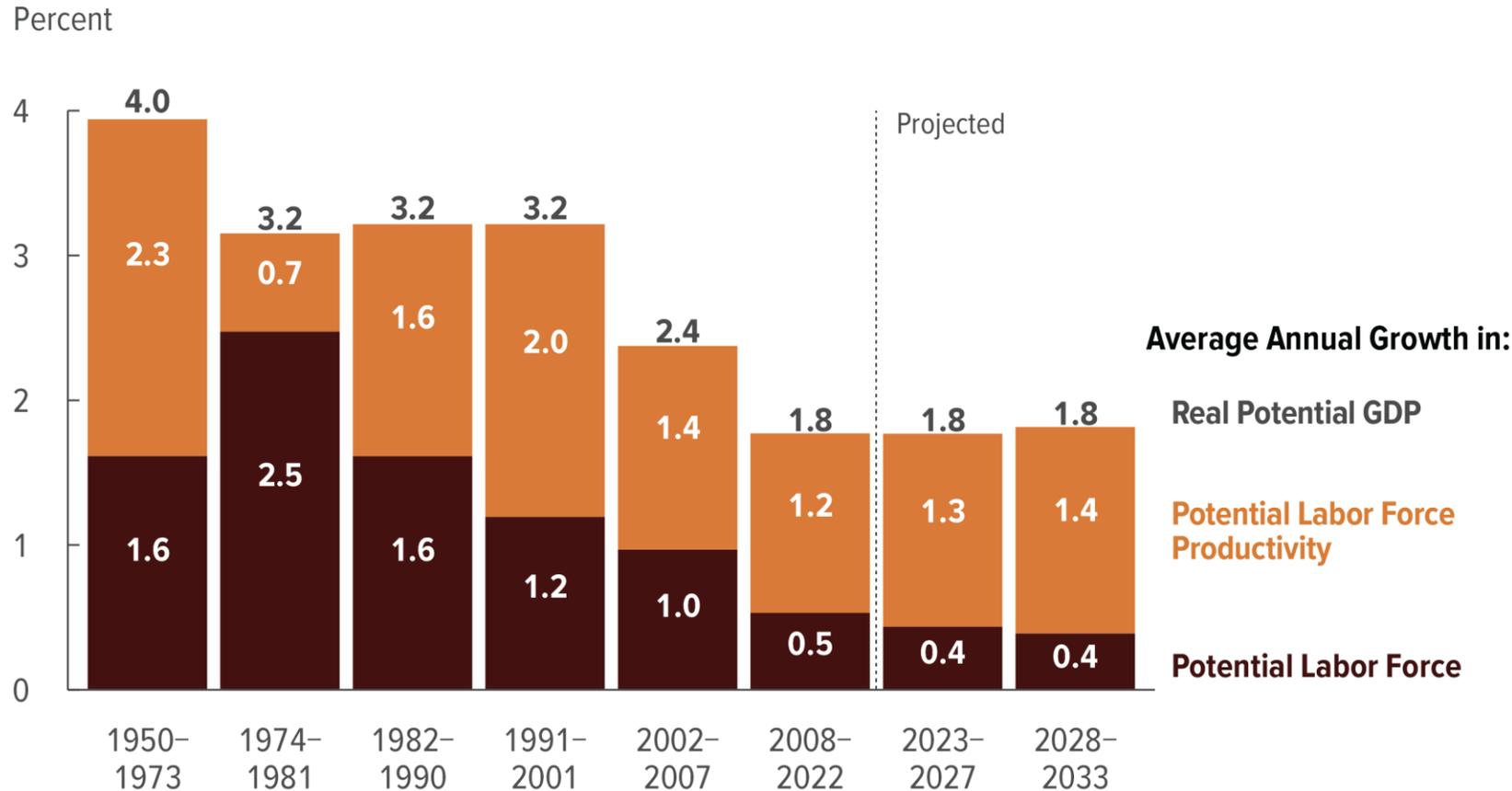
Growth of Real Gross Domestic Product



In CBO's projections, output growth comes to a halt in 2023 in response to the sharp rise in interest rates during 2022.

Then, as falling inflation allows the Federal Reserve to reduce the target range for the federal funds rate, the growth of real GDP rebounds, led by the interest-sensitive sectors of the economy.

Composition of the Growth of Real Potential Gross Domestic Product



In CBO’s projections, real potential GDP grows during the next five years at a rate similar to its growth rate since the 2007–2009 recession.

Because of the aging of the population, the potential labor force grows more slowly than it has in previous periods. But that slower growth is offset by faster growth in potential labor force productivity.

Growth in real potential GDP (that is, the maximum sustainable output of the economy) is the sum of growth in the potential labor force and growth in potential labor force productivity.

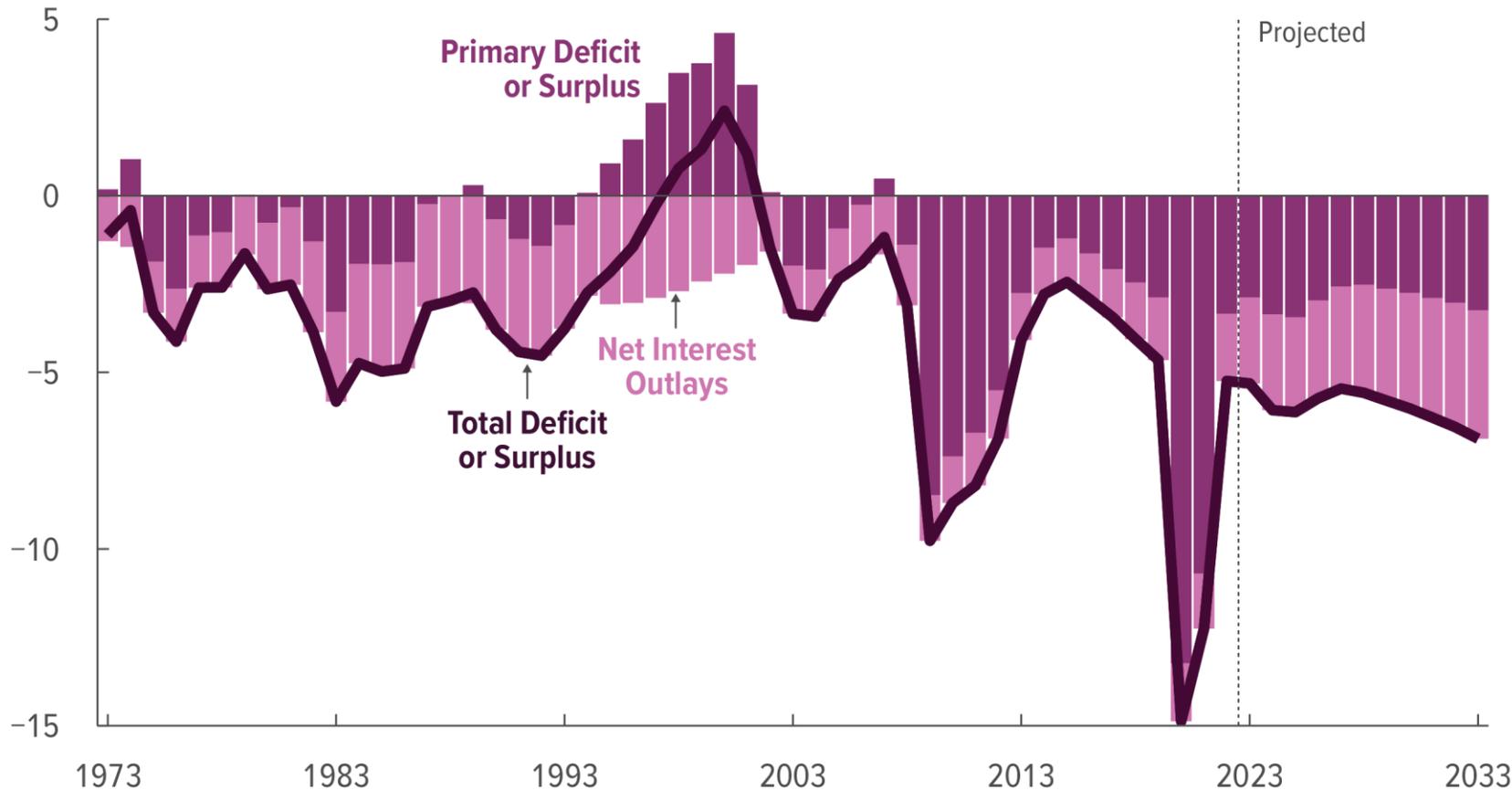
The potential labor force is CBO’s estimate of the size of the labor force that would occur if economic output and other key variables were at their maximum sustainable amounts.

Potential labor force productivity is the ratio of real potential GDP to the potential labor force.

The Budget

Total Deficits, Primary Deficits, and Net Interest Outlays

Percentage of Gross Domestic Product

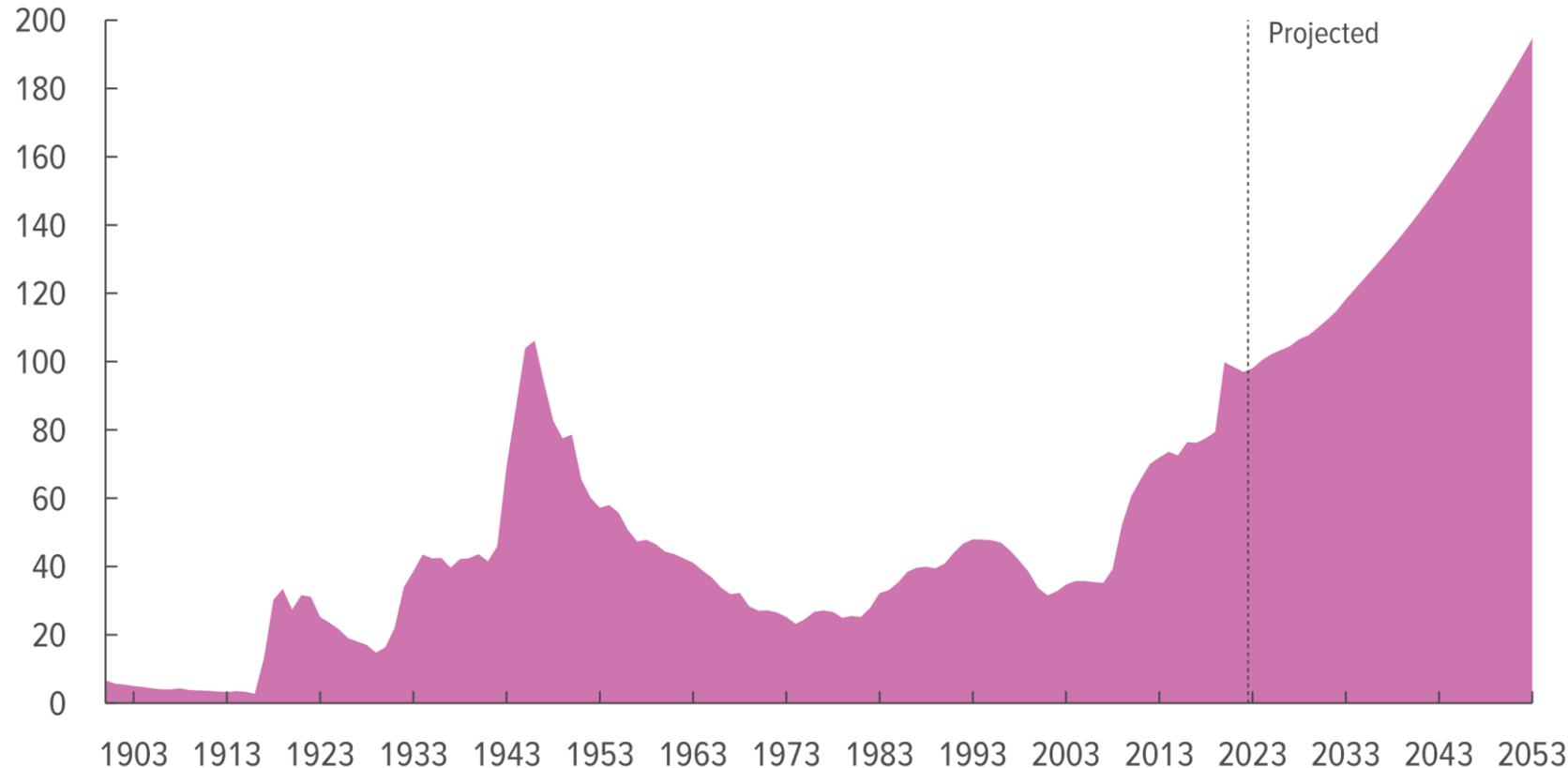


In CBO's projections, primary deficits (that is, revenues minus noninterest outlays) average 3.0 percent of GDP from 2024 to 2033, about double their average over the past 50 years, and total about \$10 trillion.

Net interest outlays average 3.1 percent of GDP during the projection period and also total roughly \$10 trillion.

Federal Debt Held by the Public

Percentage of Gross Domestic Product

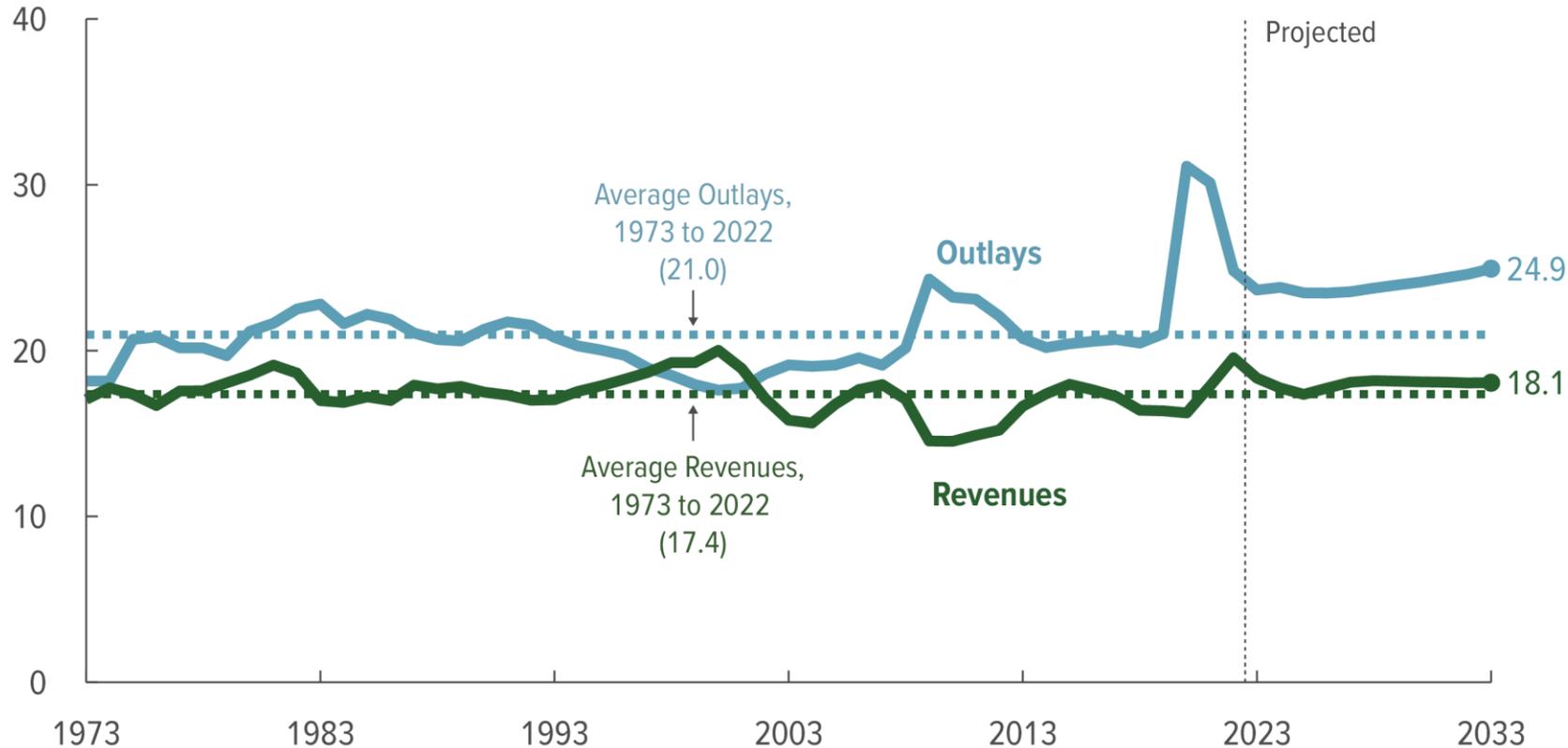


Federal debt held by the public is projected to increase in each year of the projection period and to reach 118 percent of GDP in 2033—higher than it has ever been.

In the two decades that follow, growing deficits are projected to push federal debt higher still, to 195 percent of GDP in 2053.

Total Outlays and Revenues

Percentage of Gross Domestic Product

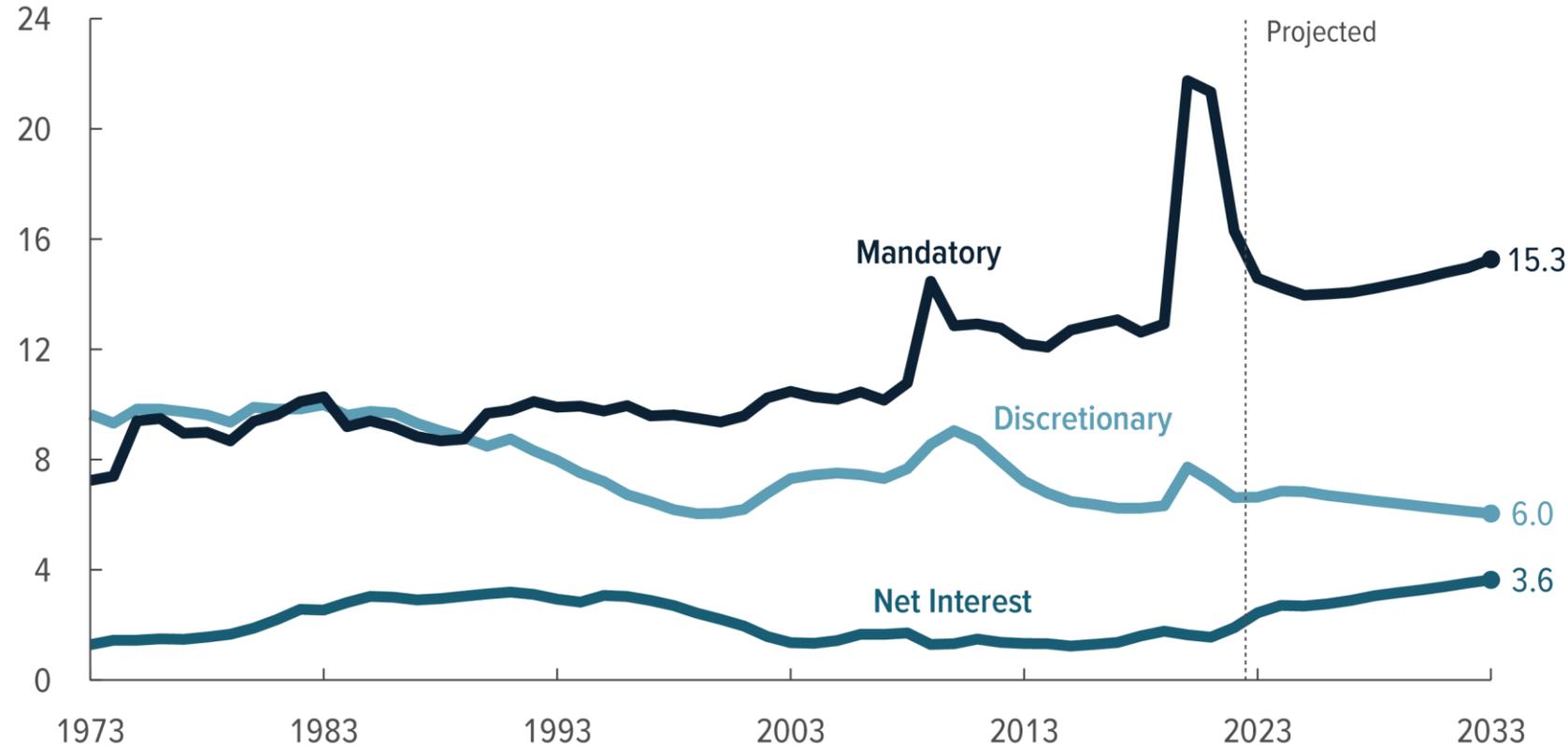


Measured as a percentage of GDP, projected outlays remain about the same for the next several years, as growth in outlays for interest payments and mandatory spending is offset in part by waning pandemic-related spending.

Outlays and revenues equal or exceed their 50-year averages in each year of the 2024–2033 period.

Outlays

Percentage of Gross Domestic Product

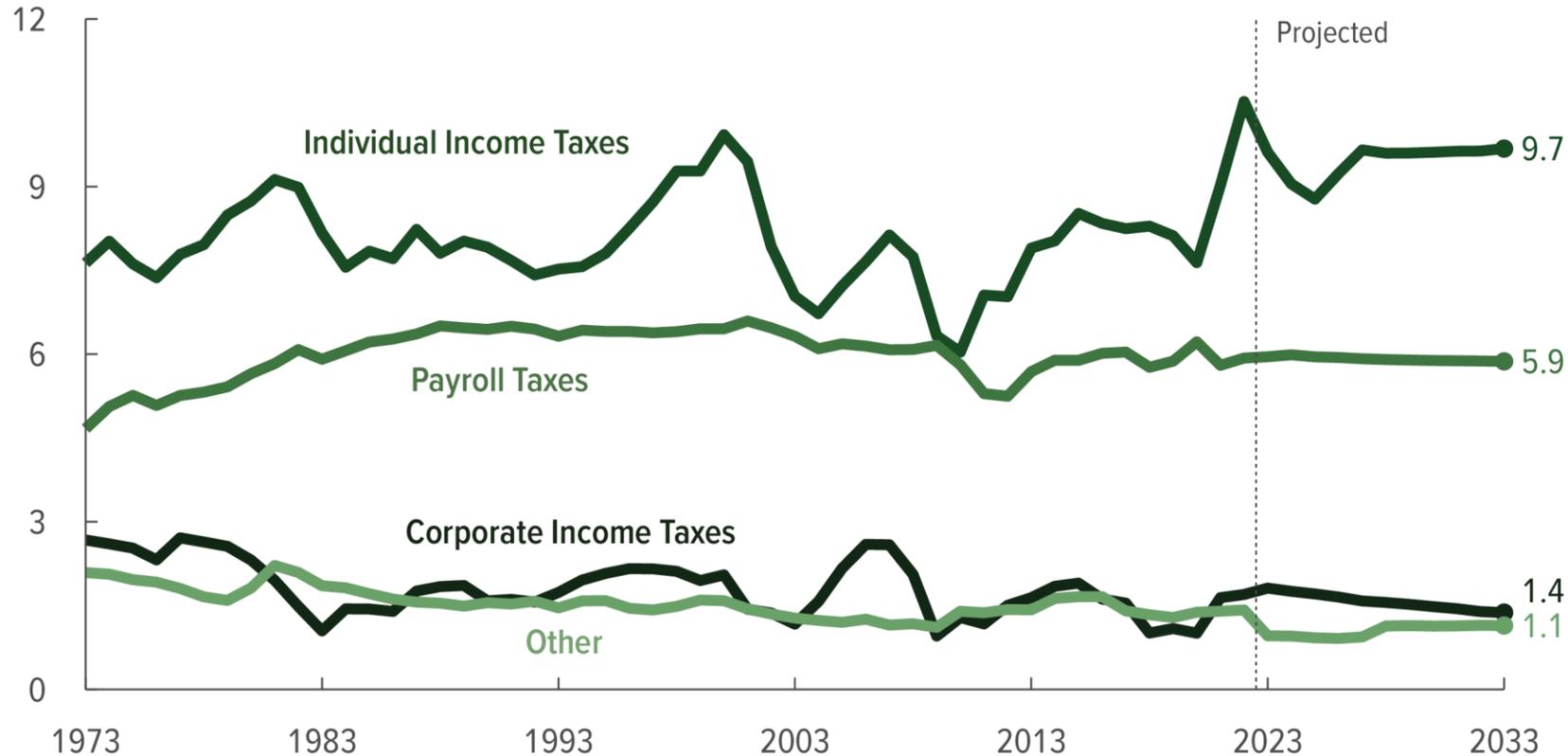


In CBO's projections, rising spending on Social Security and Medicare boosts mandatory outlays, but total discretionary spending falls in relation to GDP.

As the cost of financing the nation's debt grows, net outlays for interest increase substantially and, beginning in 2030, exceed their previous peak.

Revenues

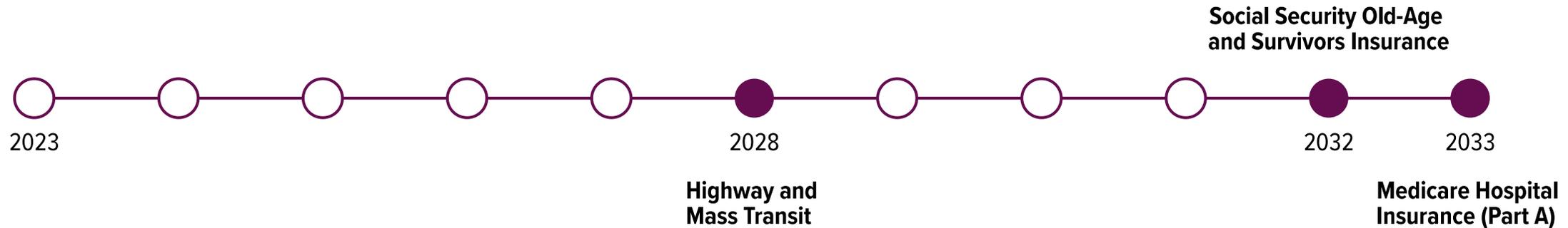
Percentage of Gross Domestic Product



After reaching a historic high in 2022, receipts from individual income taxes are projected to fall in 2023 because collections from taxes on capital gains realizations and other sources, which have been strong in recent years, fall in CBO's projections.

Receipts are projected to rise again after 2025 because of the scheduled expiration of certain provisions of the 2017 tax act.

Trust Fund Exhaustion Dates



The trust funds would not have the authority to make payments in excess of receipts if their balances were depleted. Excise, income, and payroll taxes designated for the funds would continue to be collected, and the funds would continue to make payments using those receipts.

For example, most Social Security benefits would be smaller by one-quarter, CBO projects, if outlays were limited to what was payable from annual revenues after the trust fund's exhaustion in 2032.

For additional information about trust funds, see CBO, *The Budget and Economic Outlook: 2022 to 2032* (May 2022), Appendix B, www.cbo.gov/publication/57950. For the agency's most recent estimates, see CBO, "10-Year Trust Fund Projections," www.cbo.gov/data/budget-economic-data#5. CBO's baseline budget projections follow provisions in section 257 of the Deficit Control Act, which requires the agency to project spending for certain programs—including Social Security and Medicare—under the assumption that they will be fully funded and thus able to make all scheduled payments, even if the trust funds associated with those programs do not have sufficient resources to make full payments.

Projected Savings From Options for Reducing the Deficit

Billions of Dollars

Option	Title	Savings, 2023–2032
1	Establish Caps on Federal Spending for Medicaid	501 to 871
2	Limit State Taxes on Health Care Providers	41 to 526
3	Reduce Federal Medicaid Matching Rates	68 to 667
4	Increase the Premiums Paid for Medicare Part B	57 to 448
5	Reduce Medicare Advantage Benchmarks	392
6	Reduce Tax Subsidies for Employment-Based Health Insurance	500 to 893
7	Reduce Social Security Benefits for High Earners	40 to 184
8	Set Social Security Benefits to a Flat Amount	270 to 593
9	Increase the Maximum Taxable Earnings That Are Subject to Social Security Payroll Taxes	670 to 1,204
10	Reduce Spending on Other Mandatory Programs	580
11	Reduce the Department of Defense’s Annual Budget	995
12	Reduce Nondefense Discretionary Spending	332
13	Increase Individual Income Tax Rates	502 to 1,329
14	Eliminate or Limit Itemized Deductions	541 to 2,507
15	Impose a New Payroll Tax	1,136 to 2,253
16	Impose a Tax on Consumption	1,950 to 3,050
17	Impose a Tax on Emissions of Greenhouse Gases	571 to 865

The range of savings for an option reflects the effects of different policy specifications for that option. See CBO, *Options for Reducing the Deficit, 2023 to 2032—Volume I: Larger Reductions* (December 2022), Table 1, www.cbo.gov/publication/58164. For a related discussion, see Phillip L. Swagel, “Options for Reducing the Deficit,” *CBO Blog* (March 6, 2023), www.cbo.gov/publication/58981.

Key Points

CBO's projections suggest that, over the long term, changes in fiscal policy would need to be made to address the rising costs of interest and mitigate other adverse consequences of high and rising debt.

- In coming decades, the aging of the population and rising health care costs will put increasing pressure on the federal budget.
- Revenues under current law will not keep pace with spending.
- Major trust funds will be exhausted within 10 years, reducing benefits for vulnerable people.
- Changes to both spending and revenues could be made in many ways.
- Undertaking new initiatives that were paid for would not improve the fiscal trajectory.
- The longer action is delayed, the larger the policy changes would need to be.

CBO's Projections

Budget Outlook, by Fiscal Year

	Percentage of Gross Domestic Product					Billions of Dollars			
	Average, 1973–2022	Actual, 2022	2023	2024	2033	Actual, 2022	2023	2024	2033
Revenues, Total	17.4	19.6	18.3	17.7	18.1	4,896	4,812	4,838	7,098
Individual income taxes	8.0	10.5	9.6	9.0	9.7	2,632	2,523	2,467	3,803
Payroll taxes	6.0	5.9	6.0	6.0	5.9	1,484	1,562	1,633	2,307
Corporate income taxes	1.8	1.7	1.8	1.8	1.4	425	475	479	539
Other	1.6	1.4	1.0	1.0	1.1	356	251	260	449
Outlays, Total	21.0	24.8	23.7	23.8	24.9	6,208	6,206	6,493	9,799
Mandatory, subtotal	10.9	16.3	14.6	14.3	15.3	4,076	3,825	3,885	5,997
Social Security	4.4	4.8	5.1	5.3	6.0	1,213	1,336	1,450	2,355
Major health care programs	3.3	5.6	5.7	5.6	6.7	1,404	1,508	1,528	2,629
Medicare, net of offsetting receipts	2.0	2.8	3.1	3.3	4.1	710	820	894	1,623
Medicaid, CHIP, and marketplace subsidies	1.2	2.8	2.6	2.3	2.6	695	688	634	1,005
Other	3.2	5.8	3.7	3.3	2.6	1,459	981	908	1,014
Discretionary, subtotal	8.0	6.6	6.6	6.9	6.0	1,657	1,741	1,869	2,373
Defense	4.3	3.0	3.1	3.1	2.8	746	800	848	1,105
Nondefense	3.8	3.6	3.6	3.7	3.2	910	941	1,022	1,269
Net interest	2.0	1.9	2.4	2.7	3.6	475	640	739	1,429
Deficit, Total	-3.6	-5.2	-5.3	-6.1	-6.9	-1,312	-1,394	-1,655	-2,702
Deficit, Primary	-1.5	-3.3	-2.9	-3.4	-3.2	-837	-755	-916	-1,273
Debt Held by the Public	46.9	97.0	98.0	100.4	118.2	24,257	25,716	27,370	46,445

See CBO, *The Budget and Economic Outlook: 2023 to 2033* (February 2023), Chapter 1, www.cbo.gov/publication/58848. When October 1 falls on a weekend, certain payments that would have ordinarily been made on that day are instead made at the end of September and thus are shifted into the previous fiscal year. Mandatory outlays, discretionary outlays, and deficits have been adjusted to exclude the effects of those timing shifts.

Economic Outlook, by Calendar Year

Percent

	Actual, 2022	2023	2024	2025	Annual Average	
					2026– 2027	2028– 2033
			Change From Year to Year			
Real (Inflation-adjusted) GDP	2.1	0.3	1.8	2.7	2.4	1.8
Inflation						
PCE price index	6.2	3.8	2.7	2.2	2.1	2.0
Consumer price index	8.0	4.8	3.0	2.2	2.1	2.3
			Annual Average			
Unemployment Rate	3.6	4.7	4.9	4.7	4.5	4.5
Payroll Employment (Monthly change, in thousands)	427	9	66	97	80	67
Interest Rates						
3-month Treasury bills	2.0	4.5	3.2	2.5	2.2	2.3
10-year Treasury notes	3.0	3.9	3.8	3.8	3.8	3.8
Tax Bases (Percentage of GDP)						
Wages and salaries	43.8	44.3	44.5	44.5	44.3	44.0
Domestic corporate profits (Estimated value for 2022)	9.7	7.9	7.5	7.9	8.2	8.0

See CBO, *The Budget and Economic Outlook: 2023 to 2033* (February 2023), Table 2-1, www.cbo.gov/publication/58848. Actual values for 2022 reflect data available from the Bureau of Economic Analysis and the Bureau of Labor Statistics in early February 2023. The data contain values for the fourth quarter of 2022, which were not available when CBO developed its current projections.