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Reforms Will Be Needed to Fix the Worsening Budget Outlook

Introduction

In response to the severity of the COVID-19 pandemic and the economic impact of social distancing, Congress has enacted four major legislative packages providing trillions of dollars in aid. With the urgency of the immediate situation, the long-term budgetary impact has been of secondary concern. The Congressional Budget Office (CBO) has produced a preliminary rough projection of the economic shutdown and the fiscal responses showing that the deficit for this year will reach $3.7 trillion. If the pandemic continues to linger and the economy rebounds more slowly than expected, the deficits could exceed $4 trillion. In fact, real unemployment has already surpassed the 14 percent rate assumed in CBO's estimates. Moreover, lawmakers are considering a fifth round of relief that would add to the deficit. House Democrats unveiled a bill this week with a $3 trillion price tag that would nearly double CBO's deficit projections. Sooner or later, the rapidly worsening budget outlook will have to be addressed. This paper concludes with some budget reform options that lawmakers ought to consider.

Key Facts:

- **The budget outlook heading into this year was already less than rosy with the deficit over $1 trillion. CBO's preliminary, rough estimate after the COVID-19 pandemic and fiscal response projects the deficit nearly quadrupling to $3.7 trillion.**
- **There are many factors that will push actual deficits higher than projected. Unemployment rates are already surpassing the 14 percent rate used in CBO's estimate. Lawmakers are also contemplating another multi-trillion-dollar response bill.**
- **In response to the immediate health and economic crises, the budget outlook has been of secondary concern, but sooner or later lawmakers will have to address the alarming and rapidly expanding federal debt.**

The Budget Outlook Before and After COVID-19

It is astounding how much the budget outlook has changed in a few short months. Heading into the new year, the economy was expected to be in good shape. In January, CBO projected that the GDP would expand by an inflation-adjusted 2.2 percent in 2020 "largely because of continued strength in consumer spending and a rebound in business fixed investment."[1]

On the other hand, the budget picture was less than rosy even before this crisis. CBO had projected that deficits would top $1 trillion this year and, over the next ten years, more than $13 trillion would be added to the federal debt. NTUF expected that the ten-year deficit figures would actually be larger because CBO is required to build its baseline on a projection of spending and revenues under current law. Using alternative, more realistic assumptions based on the policies that Congress tends to enact would see lower revenues and higher outlays, understating the deficit by billions of dollars.[2] The current law baseline does not account for the fact that many tax breaks and spending programs which are set to expire under law tend to be extended.

When CBO released its January outlook, NTUF was disappointed that it did not include a discussion of alternative fiscal scenarios.[3] In each budget baseline over the past decade CBO's annual reports have included a consideration of budgetary outcomes based on alternative assumptions of spending and revenues, including projections assuming that current policies would be continued. And while CBO's outlooks also typically warn that the occurrence of natural disasters or unforeseen economic developments could lead to outcomes much different than the projections, there is no way an alternative fiscal scenario could have hinted at what was to come with the COVID-19 pandemic.

Since January's outlook, Congress has enacted four legislative packages to address the pandemic and to provide fiscal relief.

- March 4: H.R. 6074, the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020, provided $8.3 billion in emergency spending.
- March 18: H.R. 6201, the Families First Coronavirus Response Act, increased outlays by $97.4 billion and reduced revenues by $94 billion.[4]
- March 27: H.R. 748, the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act), increased outlays by $1.3 trillion and reduced revenues by $408 billion.[5]
- April 24: H.R. 266, Paycheck Protection Program and Health Care Enhancement Act, supplemented programs in the CARES Act with an additional $483 billion in spending.[6]

CBO has produced a preliminary estimate of the economy and deficit for 2020 and 2021 based on impacts of the economic shutdowns across the states and the fiscal response enacted by Congress. Under the projection, unemployment will rise to 14 percent and the GDP will contract by 12 percent in the second quarter of 2020. Unfortunately, reality is already outpacing the

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[1] Congressional Budget Office. "The Budget and Economic Outlook: 2020 to 2030." January 28, 2020,. https://www.cbo.gov/publication/56020.
[2] Brady, Demian. "The Budget Outlook Is Even Worse than Advertised." National Taxpayers Union, January 28, 2020. https://www.ntu.org/foundation/detail/the-budget-outlook-is-even-worse-than-advertised.
[3] Ibid.
[4] Congressional Budget Office. "H.R. 6201, Families First Coronavirus Response Act." April 2, 2020. https://www.cbo.gov/publication/56316.
[5] Congressional Budget Office. "H.R. 748, CARES Act, Public Law 116-136," April 16, 2020. https://www.cbo.gov/publication/56334.
[6] Congressional Budget Office. "CBO Estimate for H.R. 266, the Paycheck Protection Program and Health Care Enhancement Act as Passed by the Senate on April 21, 2020." April 22, 2020. https://www.cbo.gov/system/files/2020-04/hr266.pdf.

already dire projections: unemployment is now at 14.7 percent and could rise to 20 percent.[7] The deficit for this year is on track to quadruple the January estimate of $1 trillion. CBO's latest projection sees the deficit swelling to $3.7 trillion this year and $2.1 trillion in 2021. A deficit of $3.7 trillion is a staggering sum:

- A $3.7 trillion deficit would be 17.9 percent of GDP, nearly doubling the worst year of this century's economic recession (9.8 percent in 2009) and the highest level since 1945 when the deficit was 21 percent of GDP;[8]

- Cost per household: $28,776;

- Over five times greater than the initially-projected defense spending for 2020 ($689.6 billion);[9]

- Greater than *all* nominal spending levels for the Department of Agriculture from 1962 through 2020 ($3.6 trillion);[10]

- Greater than the nominal spending through Medicare for its first 40 years ($3.6 trillion from 1967 through 2005);[11]

- Greater than the GDP of any single state, and over two times larger than the GDP of New York ($1.8 trillion); and[12]

- Larger than the nominal GDP of all but three other countries, China ($14.1 trillion), Japan, ($5.2 trillion), and Germany ($3.9 trillion).[13]

Factors that Could Alter the Deficit Projection

This estimate was based on data available to CBO as of April 23. Given the unprecedented nature of the crisis there are many uncertainties involved that could significantly alter the economic and budgetary outlook. CBO Director Phillip Swagel did note that CBO's forecast is within the broad range of private-sector forecasts but is closer to those that see greater economic weakness.[14]

Lingering concern over the pandemic could further weaken the economic recovery. CBO had produced a "rule of thumb" and interactive workbook to approximate budgetary impact of alternate assumptions of changes in the labor force.[15] The agency found that if labor force growth was 0.1 percent less per year over the next decade than its January projection, the deficit would increase by $162 billion. Correspondingly, if the growth was 0.1 percent higher per year, the deficit would improve by $163 billion. This was done before the economic collapse so the results may no longer be applicable. As noted above, unemployment rates have already risen higher than CBO projected and concerns are growing that many of these jobs won't come back for years.

CBO also projects that interest rates will remain low through 2021 due to actions taken by the Federal Reserve so far this year. Under the projection, the interest rate on 10-year Treasury notes

[7] White, Ben. "Political Fantasy Battles Economic Reality after Tens of Millions of Jobs Lost." *Politico*, May 8, 2020. https://www.politico.com/news/2020/05/08/when-will-jobs-return-243925.
[8] White House Office of Management and Budget (2020). "Historical Tables." Retrieved from: https://www.whitehouse.gov/wp-content/uploads/2020/02/hist_fy21.pdf.
[9] Ibid.
[10] Ibid.
[11] Ibid.
[12] Ibid.
[13] Silver, Caleb, "The Top 20 Economies in the World," Investopedia, March 18, 2020. https://www.investopedia.com/insights/worlds-top-economies/.
[14] Congressional Budget Office. "CBO's Current Projections of Output, Employment, and Interest Rates and a Preliminary Look at Federal Deficits for 2020 and 2021." April 24, 2020. https://www.cbo.gov/publication/56335.
[15] Congressional Budget Office. "Workbook for How Changes in Economic Conditions Might Affect the Federal Budget, February 2020," February 6, 2020. https://www.cbo.gov/publication/56097.

will be 1.6 percent lower than in the January forecast, reducing the costs on the borrowing the Treasury will need to take on to finance the deficit. Under CBO's earlier rule of thumb, a 0.1 percent increase in interest rates would increase deficits by $185 billion over ten years.
The Manhattan Institute's budget expert Brian Riedl estimated that the initial legislative responses and the COVID-19 recession will add $8 trillion to the debt over the next decade, "pushing the debt held by the public to $41 trillion within a decade, or 128 percent of the economy."[16]

Additional legislation from Congress could further deepen deficits. Members have been debating a fifth legislative response that could easily exceed $1 trillion. The National Governors Association is requesting $500 billion in fiscal relief for the states.[17] House Speaker Nancy Pelosi (D-CA) has released the text of a massive 1,800-page proposal that was drafted without any hearings that includes a reported $3 trillion in new spending including nearly $1 trillion for state and local governments. Similar to the bill that House Democrats used to hold up the CARES Act, it includes budget boosts for many programs that have nothing to do with the immediate crisis, such as highway funding, wildlife grants, museum services, and geological surveys. President Trump has stated that he wants to see a payroll tax cut included in any additional relief legislation. At the end of March, the Tax Foundation had estimated that payroll tax holiday for the rest of the year would cost around $950 billion.[18]

Some members of Congress are also pushing for additional rounds of the rebates included in the CARES Act, which provided payments of $1,200 for individuals earning up to $75,000 and couples up to $150,000 and $500 for children under than 17. CBO estimated the rebates will cost $151 billion.[19] The new proposal mentioned above from House Democrats proposal would provide an additional $1,200 refundable credit for each "single taxpayer ($2,400 for joint filers), in addition to $1,200 per dependent up to a maximum of 3 dependents."[20] Legislation introduced by Representatives Tim Ryan (D-OH) and Ro Khanna (D-CA) would provide payments to individuals totaling $2,000 per month for at least six months or until labor force participation returns to pre-COVID levels of over 60 percent.[21]

There are other massive shortfalls on the fiscal horizon from entitlement programs that lawmakers have been putting off addressing. Before accounting for the current COVID-19 crisis, a report indicated that starting in 2035 there will be insufficient funds in Old Age, Survivors, and Disability Insurance trust to cover full Social Security benefits promised under current law. The Medicare Hospital Insurance Trust Fund will be unable to pay promised benefits after 2026.[22] Worse, Truth in Accounting estimates that long-term unfunded liabilities amount to $37.6 trillion for Social Security and $52.7 trillion for Medicare.[23]

Looming Debt Crunch

The Bipartisan Budget Act (BBA) of 2019 undid spending restraints that were set in place in 2011 and added $322 billion in higher base spending for FYs 2020 and 2021.[24] To accommodate

[16] Riedl, Brian. "Coronavirus Budget Projections Escalating Deficits and Debt." Manhattan Institute, April 29, 2020. https://www.manhattan-institute.org/coronavirus-cbo-budget-deficit-projection.
[17] Axelrod, Tal. "Governors Call on Congress to Allocate $500B for States to Make up Budget Shortfalls.", *The Hill*, April 11, 2020. https://thehill.com/homenews/state-watch/492335-governors-call-on-congress-to-allocate-500-billion-for-states-to-make-up.
[18] Watson, Garrett and Li, Huaqun. "A History and Analysis of Payroll Tax Holidays." *Tax Foundation*, March 31, 2020. https://taxfoundation.org/trump-payroll-tax-history-of-payroll-tax-holidays/.
[19] Congressional Budget Office. "H.R. 748, CARES Act, Public Law 116-136." April 16, 2020. https://www.cbo.gov/publication/56334.
[20] Summary of the HEROES Act, accessed May 12, 2020 at https://www.politico.com/f/?id=00000172-09a9-dc3e-aff6-0dbd032c0000&nname=playbook-pm&nid=0000015a-dd3e-d536-a37b-dd7fd8af0000&nrid=0000015f-90e6-d73f-a97f-f8ef08910000&nlid=964328.
[21] Office of Rep. Ro Khanna. "Representatives Ro Khanna and Tim Ryan Introduce Legislation to Send Americans Additional Cash Payments." April 14, 2020, https://khanna.house.gov/media/press-releases/release-representatives-ro-khanna-and-tim-ryan-introduce-legislation-send.
[22] Social Security Administration (2020). "Status of the Social Security and Medicare Programs: A Summary of the 2020 Annual Report." https://www.ssa.gov/oact/trsum/.
[23] Truth In Accounting. "Financial State of the Union 2020." April 7, 2020. https://www.truthinaccounting.org/news/detail/financial-state-of-the-union-2020.
[24] Brady, Demian. "Rest In Peace, Budget Control Act: New Budget Deal Wipes Out 40 Percent of Landmark Law's Savings." National Taxpayers

the higher spending the BBA also suspended the statutory limit on federal debt through July 31, 2021. The limit will be reinstated on August 1, 2021 at a level accounting for the increased levels of federal borrowing during the suspension. Before the suspension, the federal ceiling on federal debt was $21.988 trillion. When the limit is reinstated next August, it could be boosted upwards by at least $4 trillion. This would easily pass the previous largest single bump in a debt increase ceiling. In August 2011, the ceiling was increased by $2.1 trillion ($2.39 trillion in current dollars) which allowed room for federal-deficit spending until the ceiling was increased again in February 2013.[25]

When the level of federal debt reaches the statutory ceiling, the Treasury is prohibited from borrowing to finance the government's deficit spending. In previous instances when the limit was reached, the Treasury was able to temporarily implement what it termed "extraordinary measures" for several months in order to meet the government's day-to-day obligations, buying additional time for Congress and the White House to agree on a further increase in the ceiling. In the absence of a debt ceiling increase, the Treasury could default on obligations which could risk the government's credit rating, incur penalties and fines, increase the cost of financing deficit spending.

Many have called for eliminating the debt ceiling, arguing that by enacting laws, Congress has already knowingly obligated spending levels in excess of projected revenues. They further argue that frequently revisiting the issue through politically perilous debt ceiling votes risks harm to the government's credit rating. On the other hand, continuous deficit spending (except for a brief period of surpluses from 1998 through 2001) and the accumulation of ever increasing levels of federal debt is unfair to future generations of taxpayers who will ultimately pay the bill through higher taxes and a stunted economy as government debt crowds out private investment. The debt ceiling provides a check on the practice and provides an opportunity to enact budget enforcement reforms. This is precisely what happened in 2011. The Budget Control Act of 2011 allowed for an increase in the debt ceiling but also imposed sequestration and, ultimately, spending caps.

Conclusion

Congress may decide to enact more fiscal relief, but lawmakers should abide by the important principles of ensuring that such spending is temporary, timely, and targeted. While many states are facing daunting budget gaps exacerbated by coronavirus, the fact is that many were headed for fiscal crises even prior to the pandemic due to overly-generous and unaffordable pension plans for state and local employees. Additional fiscal relief should not bail out states for decades of bad policy unrelated to the current crisis.

CBO and others project that the economy will begin to rebound again in the 3rd quarter. Enacting pro-growth policies such as permanent full expensing would be a boon for businesses. As the economy improves and tax revenues begin to increase for federal, state, and local governments, Congress will need to find common ground to rein in federal spending and tackle the massive debt.

A first step in that process should be enacting spending reductions that the political right and left can agree upon. Last month, NTUF joined with the U.S. Public Interest Research Group Education Fund to produce a report called "Toward Common Ground," which contained nearly $800 billion in recommendations to trim federal spending.[26] Implementing such an efficiency plan could make a significant dent in paying for the COVID-related spending Congress has enacted

Union Foundation, July 31, 2019. https://www.ntu.org/foundation/detail/rest-in-peace-budget-control-act-new-budget-deal-wipes-out-40-percent-of-landmark-laws-savings.

[25] The Congressional Research Service. "The Debt Limit Since 2011." August 29, 2019. https://fas.org/sgp/crs/misc/R43389.pdf.

[26] Brady, Demian and Cross, R.J. "Toward Common Ground: Bridging the Political Divide with Deficit Reduction." National Taxpayers Union Foundation and U.S. Public Interest Research Group, April 23, 2020. https://www.ntu.org/library/doclib/2020/04/Toward-Common-Ground-2020.pdf.

in recent weeks. Additionally, Congress should look to the work of the CBO, the Government Accountability Office, and agency Inspectors General, among others, to help identify additional targets for spending reduction.
The urgency of the task suggests that Congress should seriously consider re-establishing a Joint Committee on Reduction of Non-Essential Expenditures, a body that existed from 1941-1974 with the goal of trimming federal spending.[27] Harnessing the power of incentives for vigorous exercise of committee jurisdiction for the purpose of reducing expenditures, for a change, could identify new efficiencies. And if Congress does take the step of standing up such a body, it should grant it full legislative power rather than confining it to the role of a study committee.

Senate Budget Committee Chairman Mike Enzi (R-WY) and Ranking Member Sheldon Whitehouse (D-RI) have introduced important and sorely needed legislation to reform the budget process. Their Bipartisan Congressional Budget Reform Act (BCBRA) of 2019 was the first major bipartisan reform package approved by the Committee in nearly 30 years. It would bolster budgetary enforcement and hold the various committees accountable for addressing unauthorized funding and improving program performance and oversight. Combined with a revived committee on non-essential expenditures, and other procedural reforms to prioritize and streamline consideration of deficit reduction proposals, budget process overhaul would help focus Congress on restoring the budget to a sustainable path.

While the specific steps taken will be determined in the coming months, the stark reality facing Congress is that fiscal reform is a “today” problem, not a “tomorrow” one. Once the risk of COVID-19 subsides, Congress should immediately turn its attention to shoring up the federal government’s crumbling finances.

About the Authors

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[27] Congressional Research Service. “History of the Joint Committee on Reduction of Non-Essential Federal Expenditures (1941-1974), with Observations on Oversight Today.” October 26, 2020. https://fas.org/sgp/crs/misc/R41465.pdf.

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