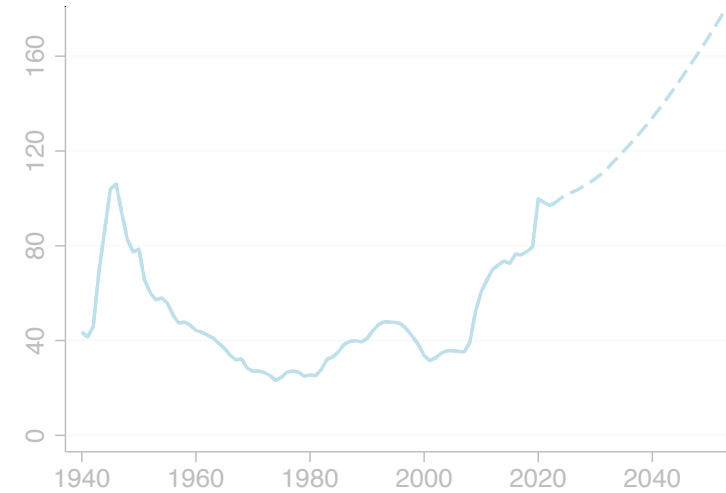


Deficits, Debt, and Difficult Decisions



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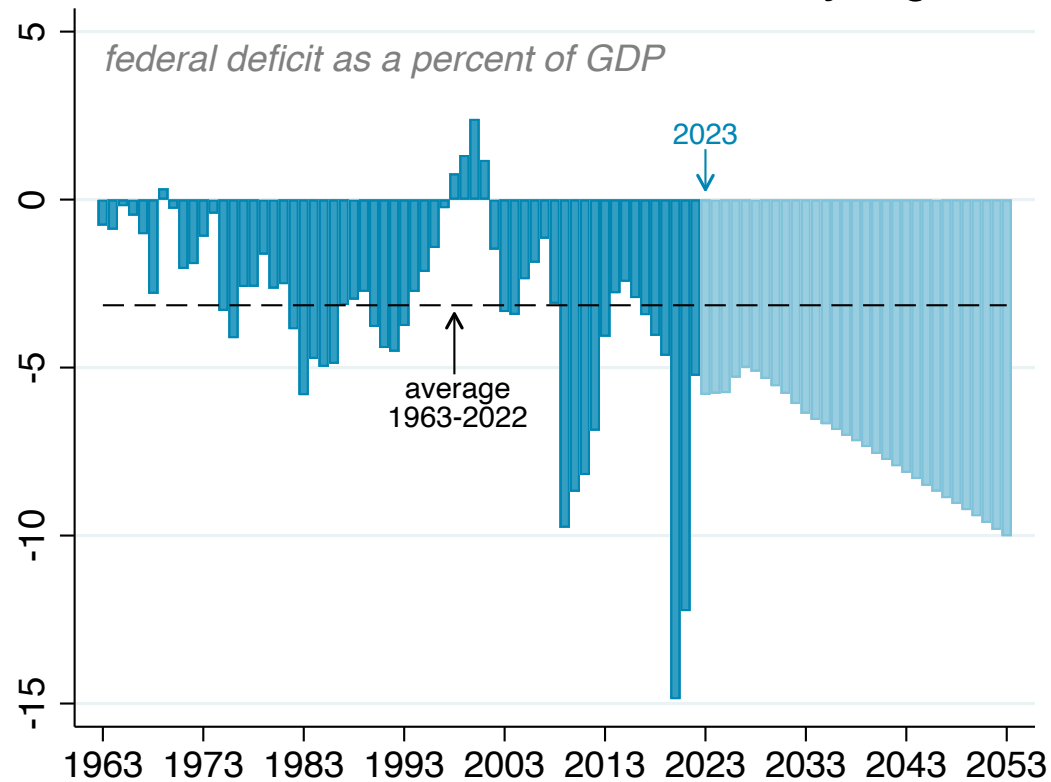
NABE ASSA Session

US Debt and Deficits: Is the Path Sustainable?

January 5, 2024

Under current policy, the path of federal debt is *not* sustainable

The federal deficit is projected to nearly double from a level that is already high



Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Last data point: 2053.

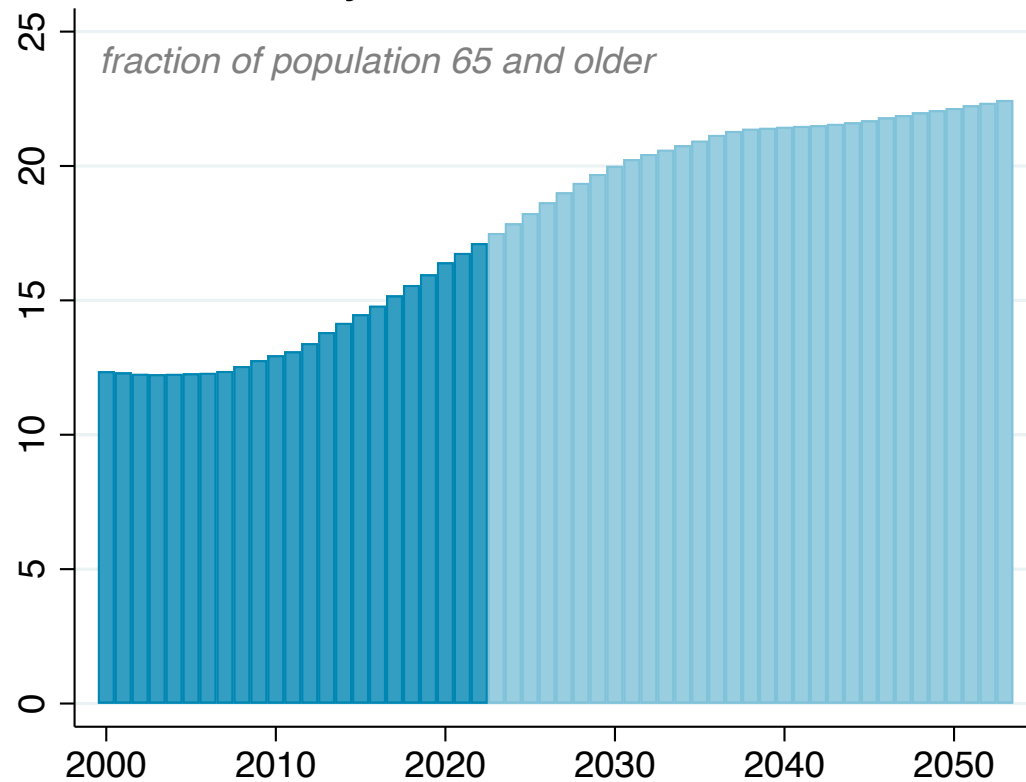
Federal debt is projected to soar to unprecedented levels



Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Dashed line shows projection. Last data point: 2053.

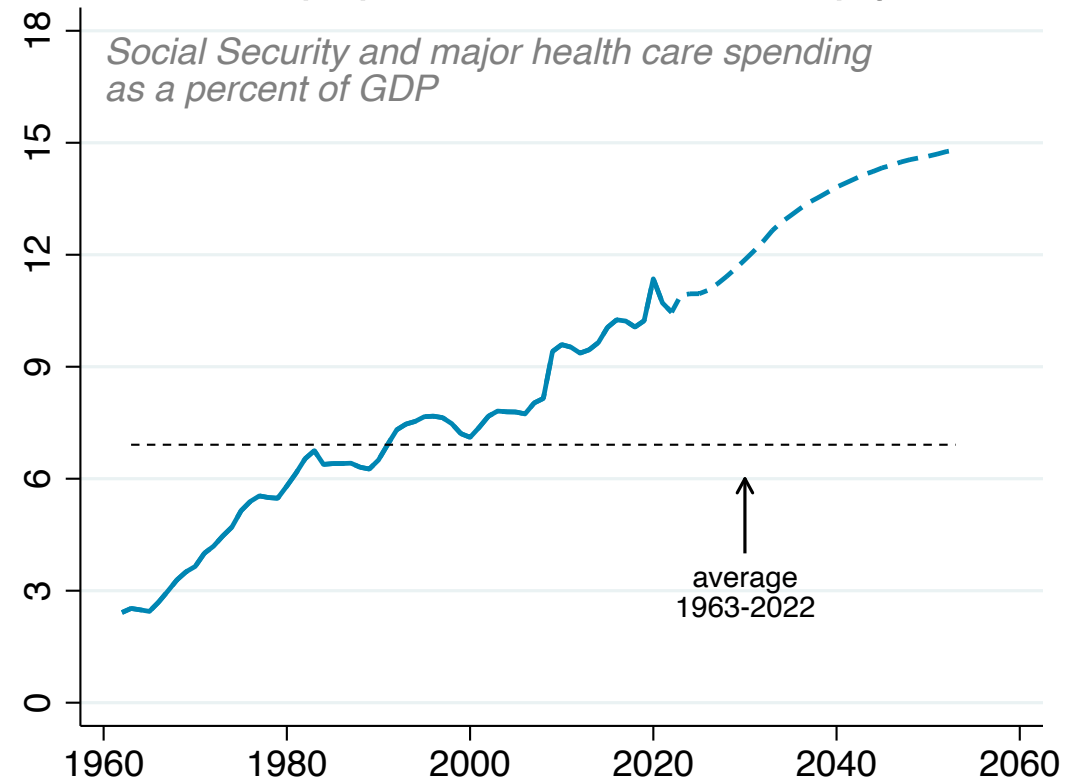
The underlying driver of higher debt is spending related to the aging population

The older population is projected to grow considerably further



Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Last data point: 2053.

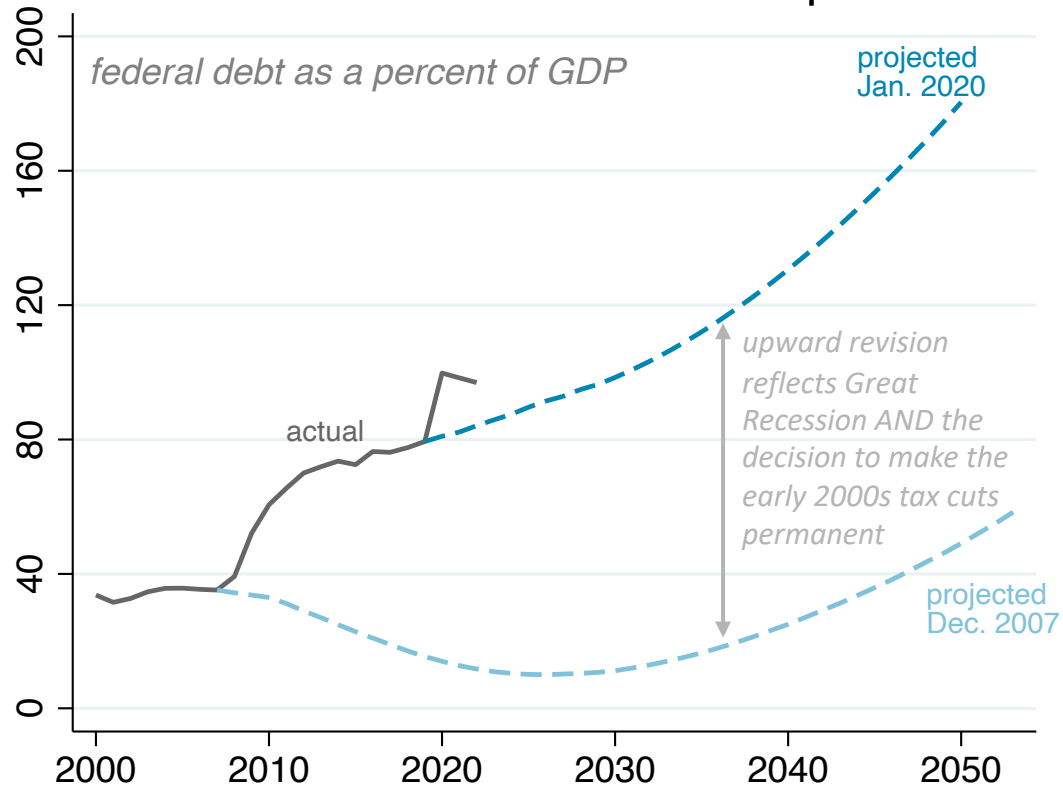
Under current policy, spending to support the older population will rise sharply



Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Dashed line shows projection. Last data point: 2053.

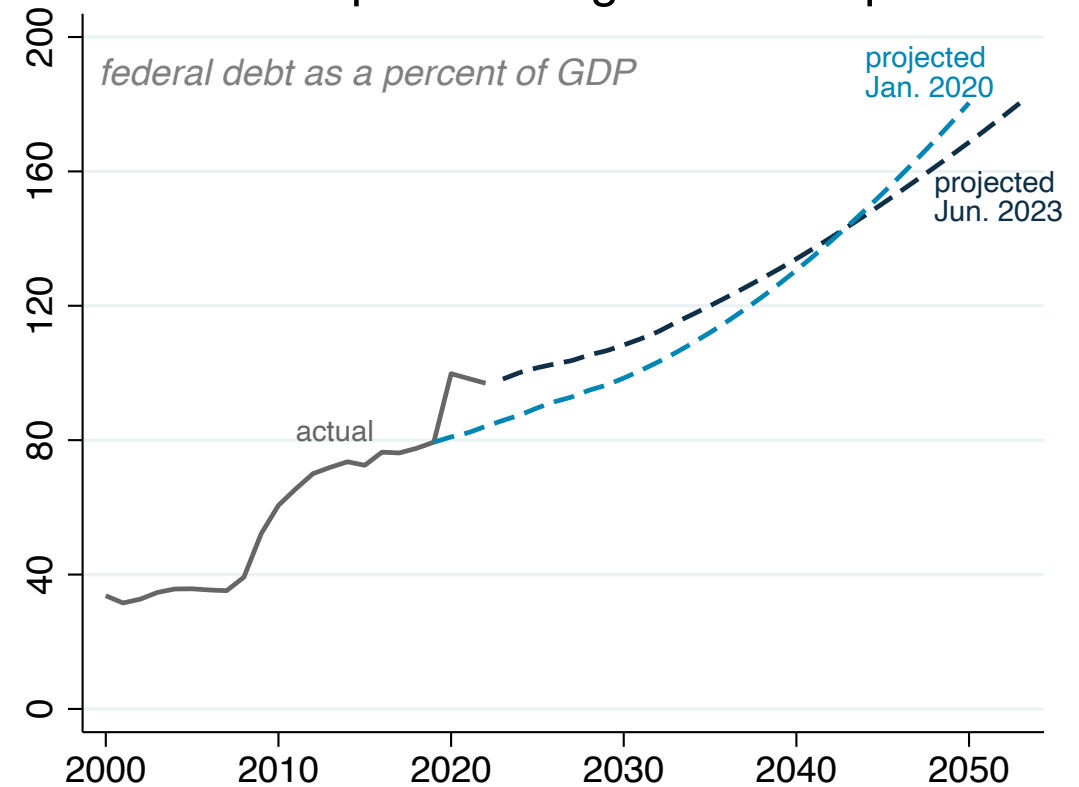
Shocks and past policy choices have put debt on a higher path than it would otherwise be on

Projected debt was revised sharply up between the financial crisis and pandemic



Data source: Congressional Budget Office Long-term Budget Outlooks.
Dashed line shows projection. Last data point: 2053.

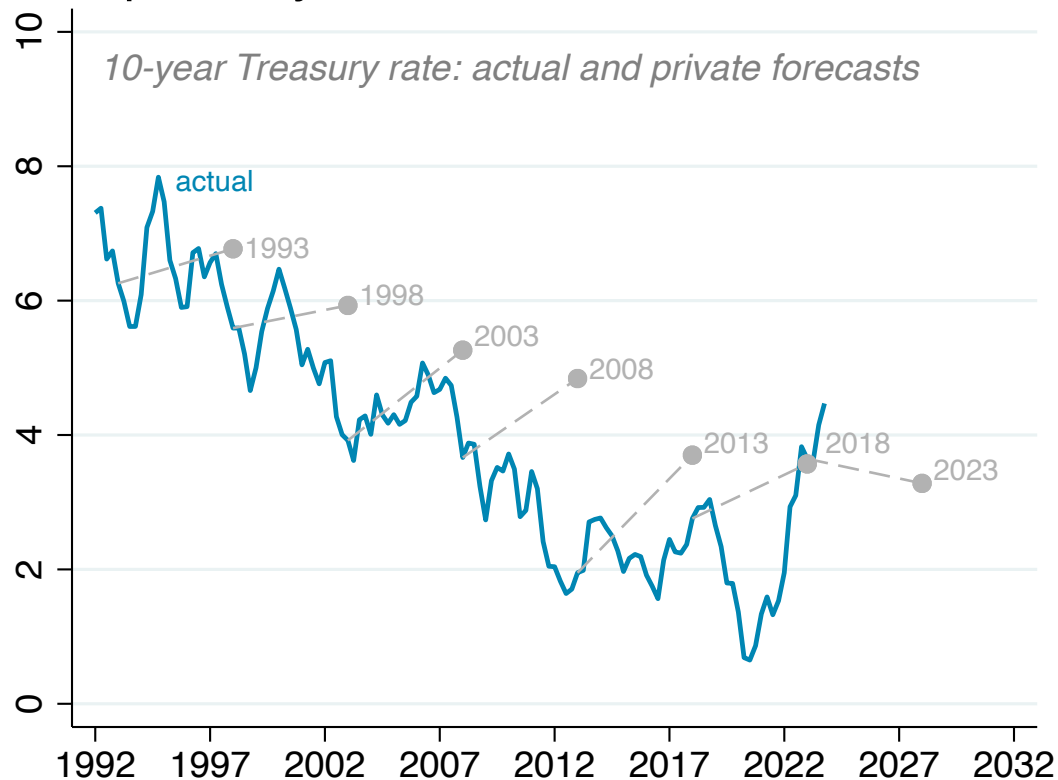
The post-pandemic upward revision was smaller despite the large fiscal response



Data source: Congressional Budget Office Long-term Budget Outlooks.
Dashed line shows projection. Last data point: 2053.

Not all shocks have been bad ones

Interest rates surprised to the downside repeatedly in the 1990s, 2000s, and 2010s



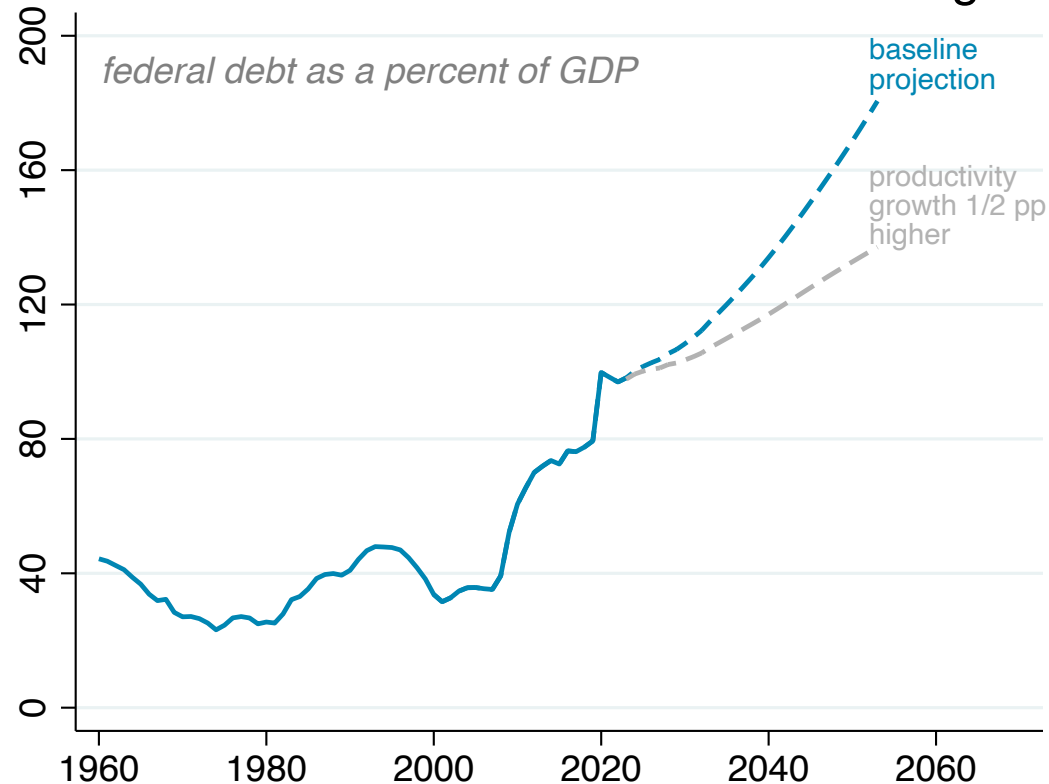
Data source: Federal Reserve and Survey of Professional Forecasters. Dots show 10-year expected average plotted five years after forecast date. Last data point for actual is 2023:Q4 average.

One striking fact that highlights the importance of the decline in interest rates is that **net interest costs** in the decade following CBO's 2007 projection **turned out to be lower than projected despite the upward surprise to debt**

Of course, 10-year borrowing rates are now more than 2 percentage points higher than pre-pandemic; CBO's baseline assumes some rise (eventually to 4.5 percent) but **how much upside risk is there?**

Good luck with economic outcomes is unlikely to save us

Even with higher productivity growth,
debt rises well above the historical range



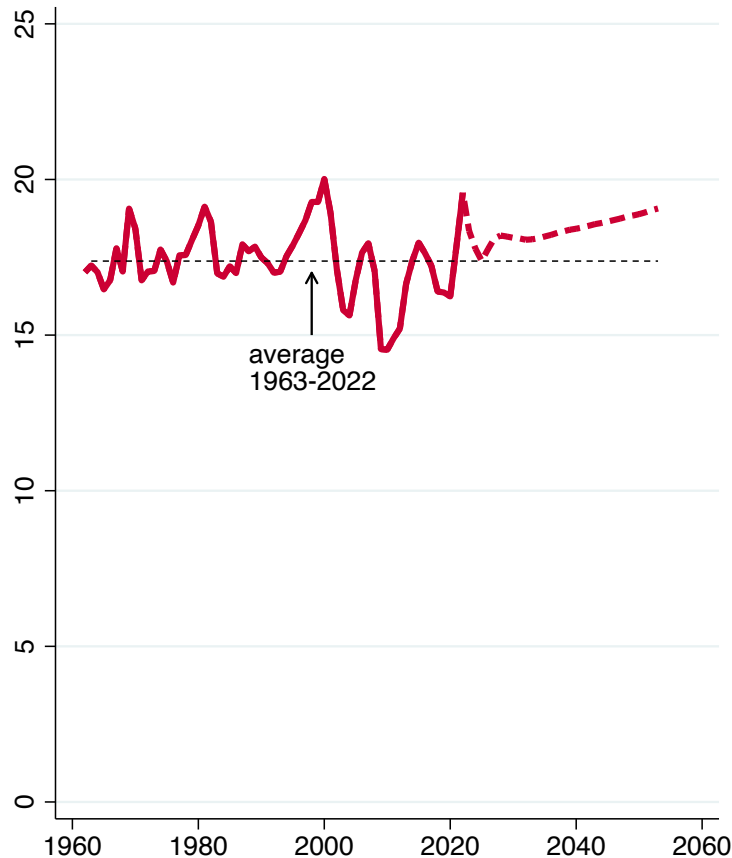
Data source: Congressional Budget Office 2023 Long-term Budget Outlook under Alternative Scenarios
Dashed line shows projection. Last data point: 2023.

Some **AI optimists argue for a much larger increase in productivity growth** than in the alternative scenario; all else equal, that would help the debt outlook

But all else might not be equal if outsized AI gains **also lead to large-scale displacement of workers**, leading to massive spending on social programs and political dysfunction

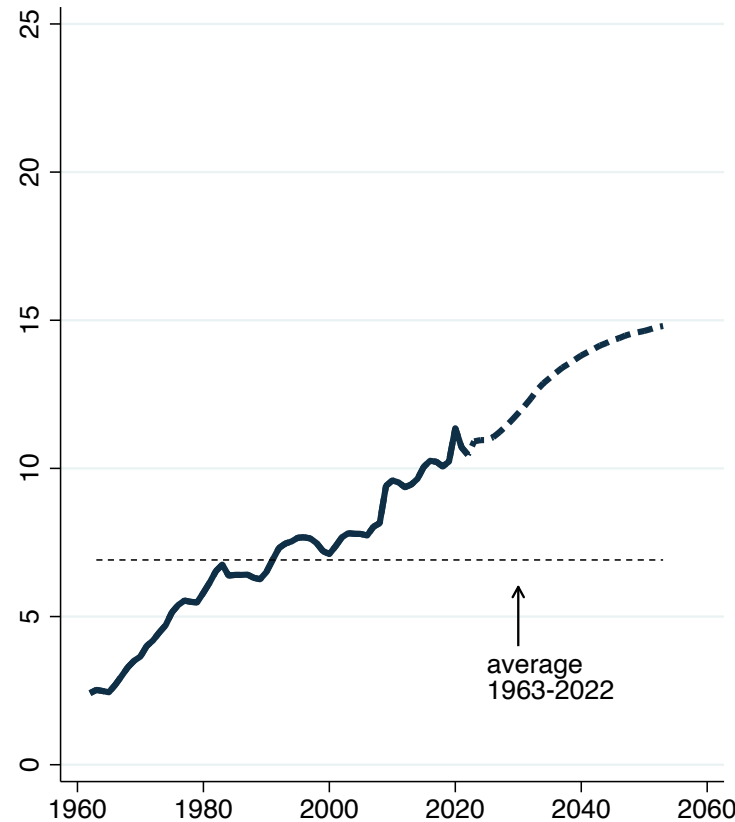
We will *need* to adjust policy to address unsustainable debt, but the decisions will be difficult

Tax Revenues
Percent of GDP



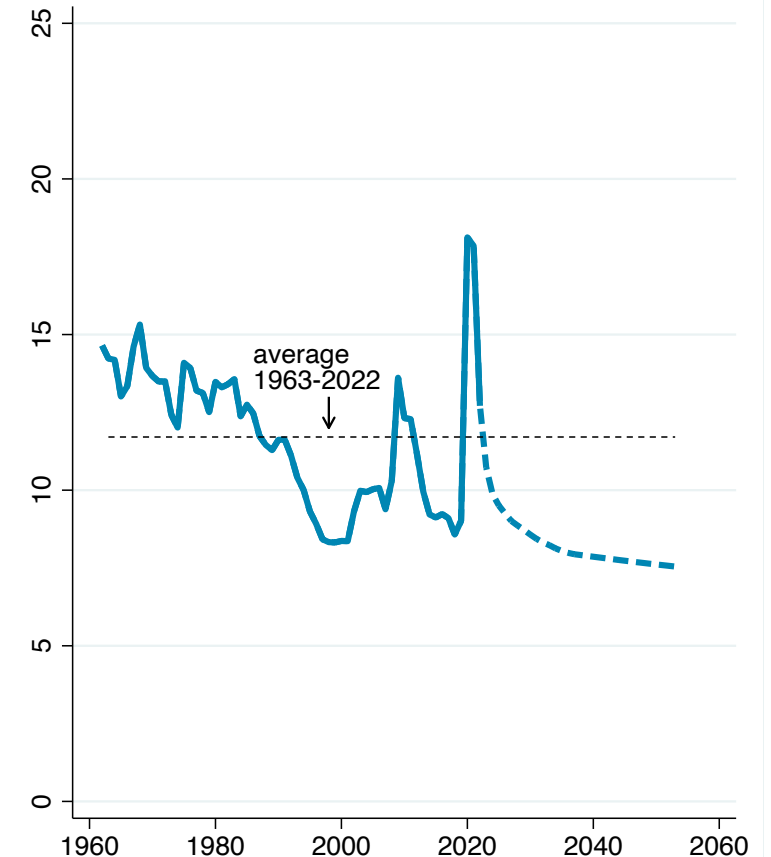
Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Dashed line shows projection. Last data point: 2053.

Social Security and Major
Health Care Spending
Percent of GDP



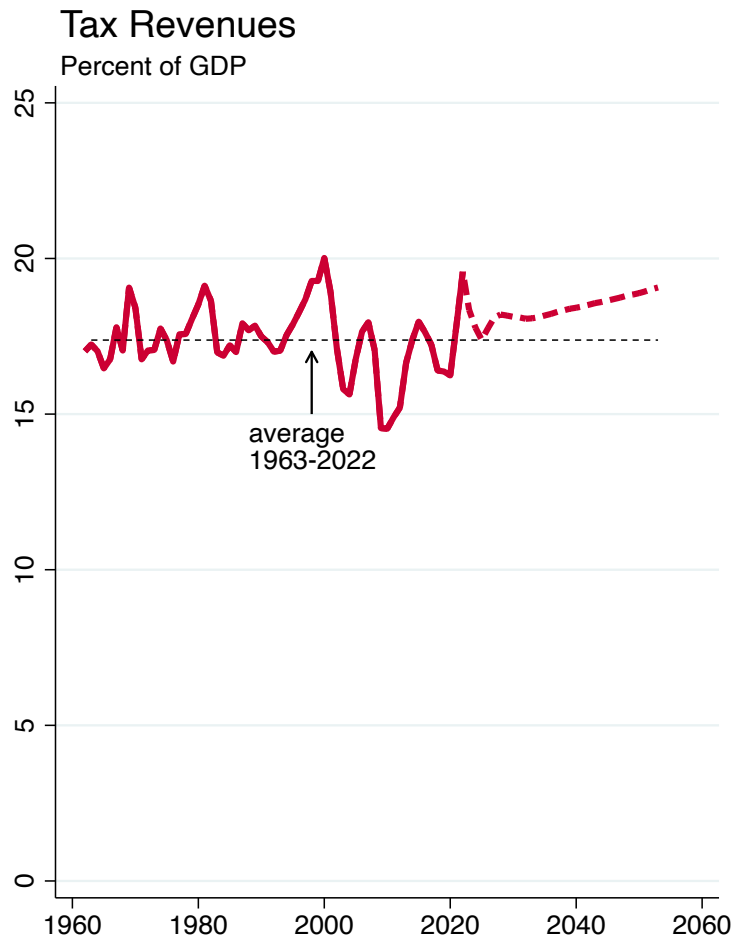
Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Dashed line shows projection. Last data point: 2053.

Other Noninterest Spending
Percent of GDP

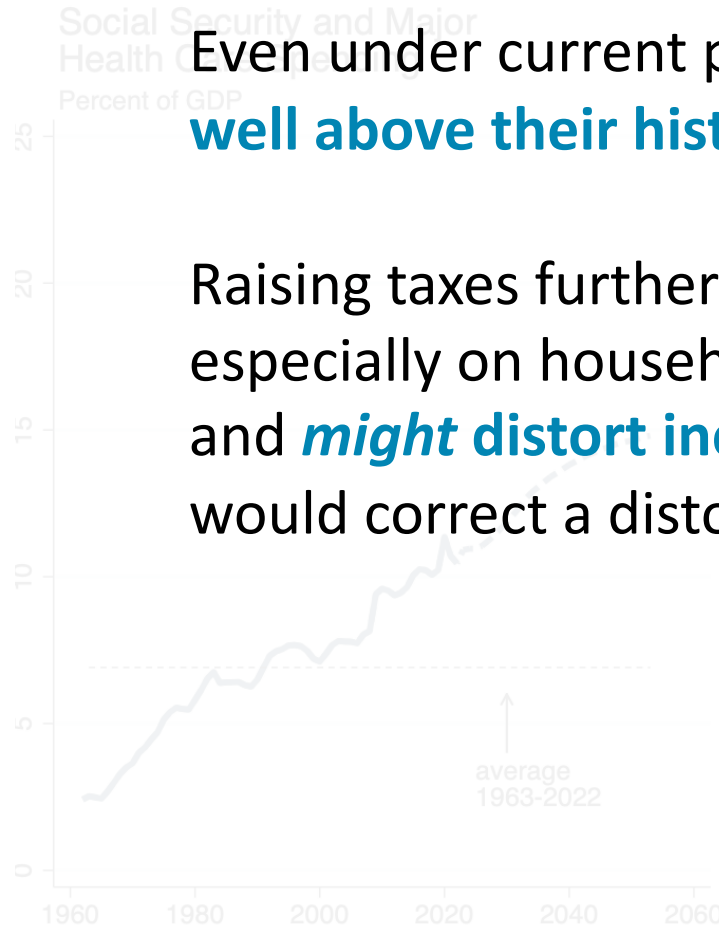


Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Dashed line shows projection. Last data point: 2053.

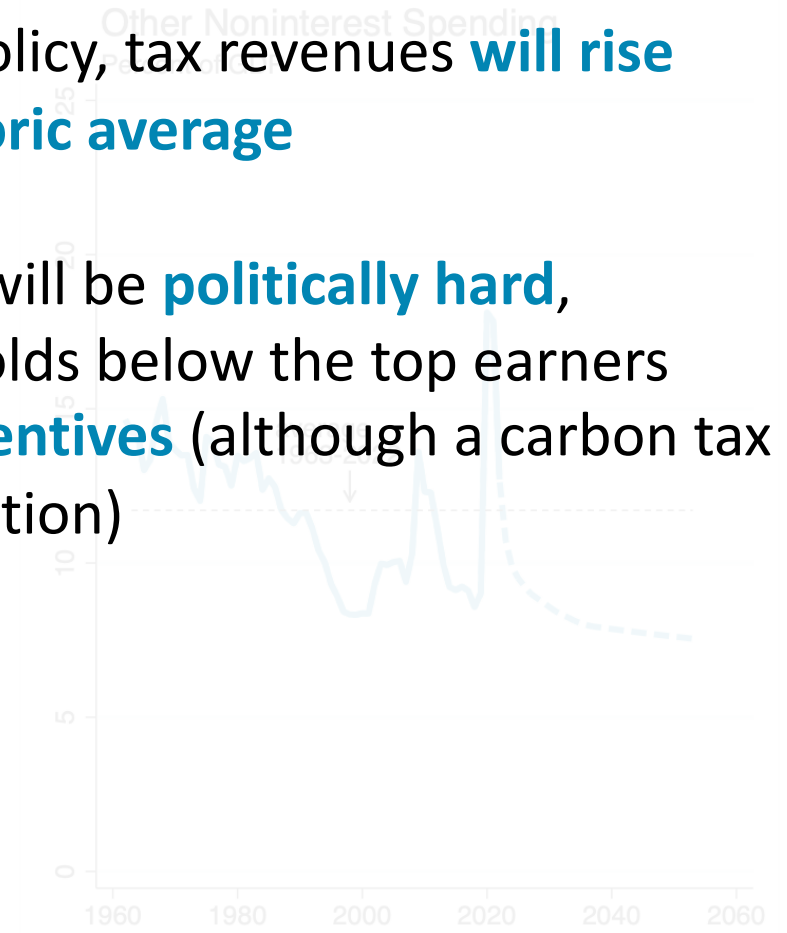
We will need to adjust policy to address unsustainable debt, but the decisions will be difficult



Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Dashed line shows projection. Last data point: 2053.



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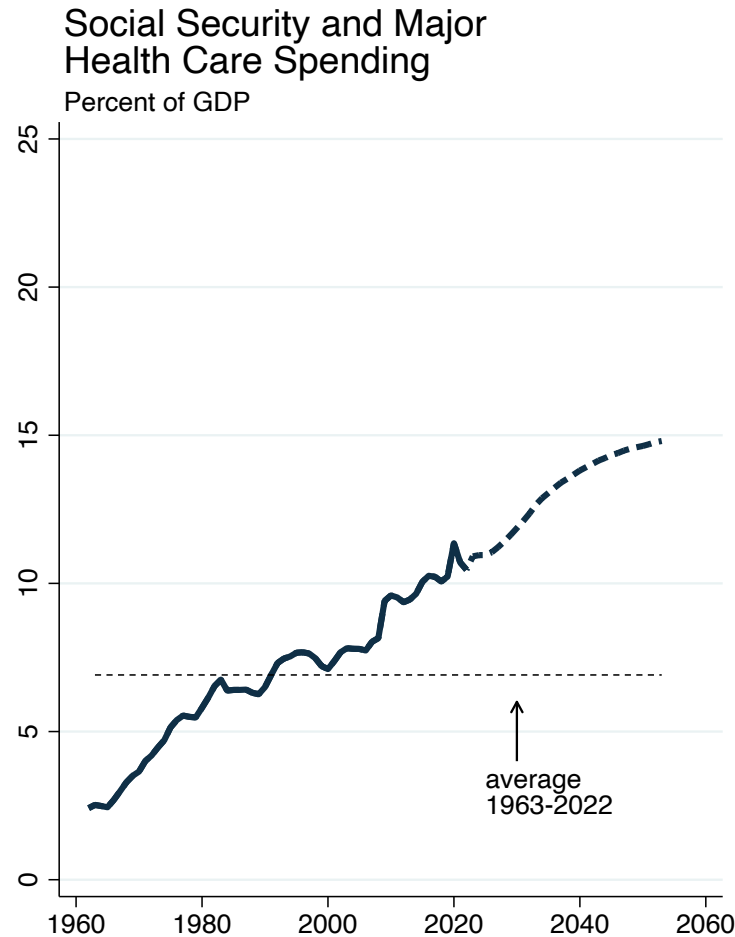
Even under current policy, tax revenues **will rise well above their historic average**

Raising taxes further will be **politically hard**, especially on households below the top earners and **might distort incentives** (although a carbon tax would correct a distortion)

We will need to adjust policy to address unsustainable debt, but the decisions will be difficult

The underlying driver of higher Social Security and health care spending—population aging—cannot be changed

Cutting these programs will be **politically hard**



Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Dashed line shows projection. Last data point: 2053.

And there are **technical challenges**:

- how to adjust Social Security without creating more hardship in the older population
- how to contain health care spending without sacrificing quality of care
- more generally, how to assess what is “fair”

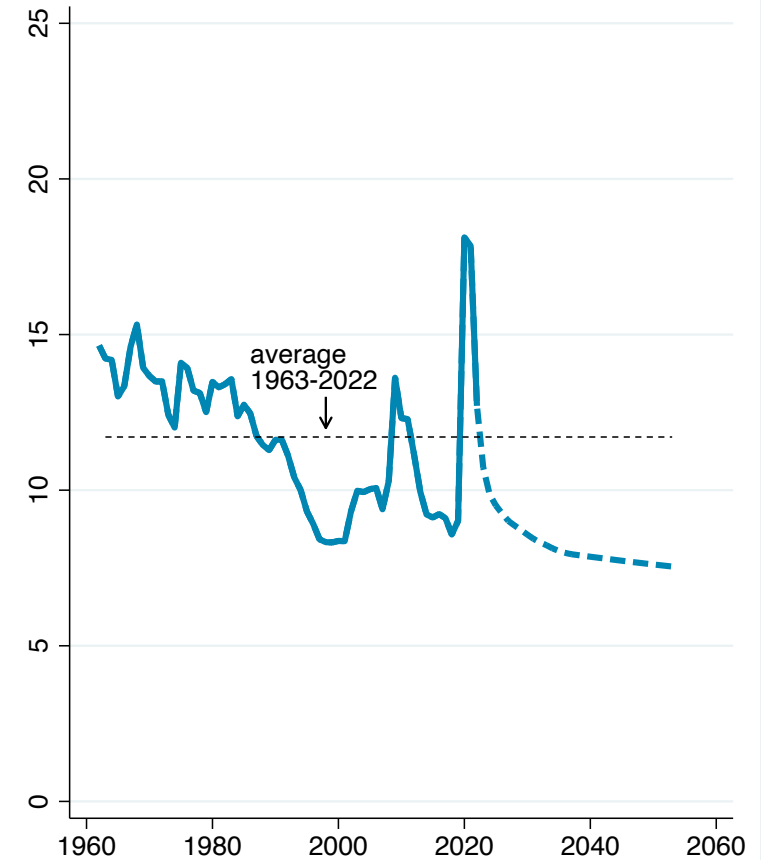
Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Dashed line shows projection. Last data point: 2053.

We will need to adjust policy to address unsustainable debt, but the decisions will be difficult

Other spending—which includes crucial items like national defense, infrastructure, support for poor kids and other investments in people—and under current policy will **sink to its lowest level in decades under current policy**

Cutting discretionary government spending can seem appealing in the abstract—but politicians historically have found such cuts to be much less appealing when specific choices need to be made

Other Noninterest Spending
Percent of GDP



Data source: Congressional Budget Office 2023 Long-term Budget Outlook.
Dashed line shows projection. Last data point: 2053.

6 points about deficits, debt, and difficult decisions

1. Under current policy, the path of federal debt is not sustainable
2. The underlying driver of higher debt is spending related to the aging population
3. Shocks and past policy choices have put debt on a higher path than it would otherwise be on
4. Not all shocks have been bad ones
5. Good luck with economic outcomes is unlikely to save us
6. We will need to adjust policy to address unsustainable debt, but the decisions will be difficult