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Debt and Deficits: Spending, Revenue, and Economic Growth

The Constitution provides Congress with the authority to manage the federal budget through its “power of the purse.” This In Focus summarizes federal budget and borrowing trends and discusses related issues with spending, revenues, and economic policy.

The Federal Budget Deficit

The federal government incurs a budget deficit when total spending exceeds revenues over the course of a fiscal year. A budget surplus occurs when revenues exceed outlays. Budget outcomes depend on general economic conditions. Deficits tend to decline in periods of high economic growth due to both increased revenues (through a rise in earnings and subsequent tax payments) and reduced outlays (through a decline in demand for unemployment benefits and other programs). Conversely, deficits tend to increase in periods with lower economic growth.

The federal budget has produced budget deficits in every year since FY2001. The historic economic shocks of the 2007-2009 Great Recession and COVID-19 pandemic, along with the ensuing federal responses generated the five largest real federal deficits (measured as a share of total economic output) since World War II, with real deficits averaging 9.0% of gross domestic product (GDP) in FY2009-FY2011 and 13.7% of GDP in FY2020-FY2021. The average real deficit in other years since FY2001 (3.2% of GDP), however, still exceeded the comparable amount from FY1973 through FY2001 (2.5% of GDP).

The Congressional Budget Office (CBO) May 2022 *Budget and Economic Outlook* projects a federal deficit equal to 3.7% of GDP in FY2023. Looking ahead, the CBO *2022 Long-Term Budget Outlook* projects that under current law deficits will remain higher than their historical average for the next 30 years, with deficits of 6.1% of GDP in FY2032 and 11.1% of GDP in FY2052 (see **Figure 1**).

Federal Debt

Federal debt is the accumulation of all historical government borrowing activity. Debt levels increase when there are budget deficits, net outflows for federal credit programs, or increases in intragovernmental debt. Treasury manages debt in a manner that maximizes transparency and flexibility while minimizing interest costs. The debt measurement generally of most interest to economists is publicly held debt, which excludes debt held in federal government accounts (i.e., intragovernmental debt).

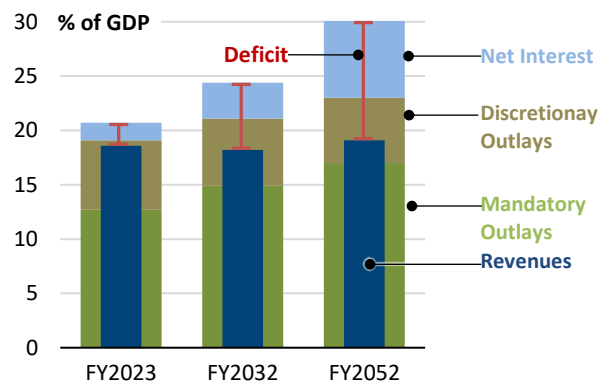
Changes in federal debt reflect implicit policy choices concerning the distribution of government activity across generations. Increases in real debt in one period may constrain the choices available in later periods. It may also lead future generations to bear the financial cost of choices

made by previous generations while realizing little to no benefit of those choices. Large and persistent debt levels may also reduce public confidence in the government’s ability to fulfill its borrowing obligations, which could increase long-term borrowing costs.

Debt levels generally have grown in recent decades. Publicly held debt is projected to be 96% of GDP at the end of FY2023, roughly triple the value recorded at the end of FY2001 (32% of GDP). CBO’s long-term forecast projects accelerated increases in publicly held debt in ensuing decades, reaching 110% of GDP by FY2032 and 185% of GDP in FY2052. Congress can control the federal debt through the statutory debt limit, which constrains the amount Treasury may borrow. The debt limit is currently set to \$31.4 trillion, which under current projections will be reached sometime in the next few months.

Trends in Spending and Revenue

Figure 1. Spending, Revenues, and the Deficit: FY2023, FY2032 and FY2052



Source: CRS graphic using Congressional Budget Office data. FY2032 and FY2052 values are baseline projections.

Mandatory Spending

Mandatory spending covers spending for entitlement and other programs not controlled by annual appropriations. It includes spending for Social Security, Medicare, Medicaid, and other health and old-age programs.

Mandatory outlays are projected to be 14.0% of GDP in FY2023 (62% of total federal spending), above the FY1973-FY2022 average of 10.9% of GDP (52% of total spending), reflecting a gradual increase in mandatory spending in recent decades. The latest CBO long-term baseline projects that mandatory spending will continue to grow under current law, equaling 14.9% of GDP in FY2032 (which would be the highest value on record) and 17.0% of

GDP in FY2052. Rising Social Security and Medicare spending explains most of those future increases.

Discretionary Spending

Discretionary spending is controlled by annual appropriations, and pays for the operations of most federal agencies and national defense programs. Discretionary spending as a share of GDP has declined gradually over time.

Discretionary outlays are projected to be 6.7% of GDP in FY2023 (30% of total federal spending), below the FY1973-FY2022 average of 8.0% of GDP (38% of total spending). Defense discretionary spending is projected to equal 3.0% of GDP in 2023, with nondefense discretionary spending projected to equal 3.7% of GDP. The CBO long-term baseline projects that discretionary spending will equal 6.2% of GDP in FY2032 and 6.0% of GDP in FY2052.

Net Interest

Net interest payments are the cost to the federal government of financing debt held by the public, and are a function of the stock of debt and prevailing interest rates. Net interest payments can shift dramatically with changes in investor sentiment, domestic and worldwide economic conditions, and monetary policy, and are much less subject to congressional control than other federal spending in the short- and medium-term.

Net interest payments are estimated to equal 1.7% of GDP in FY2023 (8% of total federal spending), slightly lower than the FY1973-FY2022 average of 2.0% of GDP (10% of total spending). The CBO *2022 Long-Term Budget Outlook* projects significant increases in future net interest payments, reaching 3.4% of GDP in FY2032 and 7.2% of GDP in FY2052.

Revenue

Federal revenues come from several sources, including individual income taxes, corporate income taxes, and excise taxes. Revenues also are collected through payroll taxes (the second largest revenue source behind individual income taxes), which are dedicated to social insurance programs. Revenues as a share of GDP have fluctuated over time.

Revenues are projected to be 18.6% of GDP in FY2023, higher than the FY1973-FY2022 average of 17.6% of GDP. Future trends in revenues depend in part on the congressional response to the expiring individual income tax reductions and other provisions in the 2017 tax revision (P.L. 115-97). The CBO long-term baseline projects that revenues will be 18.2% of GDP in FY2032, and 19.1% of GDP by FY2052. Most of the long-term increase in revenues as a share of GDP is attributable to a rise in individual income tax receipts. Revenues tend to rise relative to the size of the economy when income rises faster than inflation, pushing taxpayers into higher tax brackets.

Causes and Consequences of the Debt and Deficits

Deficits and debt are not inherently harmful to the economy. Borrowing to finance productive long-term

investments (e.g., certain infrastructure) and spending (e.g., research and development) can increase the productive capacity of the economy. However, persistent federal budget deficits and growing debt like those in CBO's long-term projections would reduce total economic growth and constrain future budget policy. Specifically, the accrual of debt

- financed from domestic sources would reduce long-term national saving and income, reducing capital investment that leads to productivity growth and higher wages;
- financed from foreign sources would increase the trade deficit and the future obligations owed to foreign investors;
- would increase the government's interest costs—constraining lawmakers' ability to encourage growth-enhancing investments, such as infrastructure;
- would limit lawmakers' ability to respond to future recessions, natural disasters, or other unforeseen events.

For example, in the early 2010s, large debt and deficits in Iceland and Greece led to financial crises where investors were unwilling to finance government borrowing without receiving very high interest rates along with commitments to reduce government deficits. Those episodes are generally believed to have significantly increased the severity and length of recessions in those countries.

Budget observers have generally increased their predicted level of real U.S. federal debt needed to trigger such an event relative to comparable predictions before the Great Recession. Such estimates, however, are subject to substantial uncertainty. The International Monetary Fund recently found the short- and medium-term risk for the United States for such an event to be low.

Magnitude of Policy Changes Required to Stabilize Long-Term Debt

The CBO long-term baseline estimated the magnitude of policy adjustments that would be required for real federal debt to equal 100% percent of GDP in FY2052—roughly its current level. If addressed beginning in FY2027, CBO projected that such a goal could be attained by reducing spending, increasing revenue, or a combination of the two by 2.8% of GDP for each of the ensuing 25 years. Such a change would be equivalent to a 15% increase in total federal revenues or an 11% reduction in total federal outlays from FY2027 through FY2052.

Long-term economic growth will affect the policy changes needed to reach certain targets. For example, though real annual *deficits* were much larger from FY1941 to FY1950 (averaging 9.3% of GDP) than from FY2011 to FY2020 (averaging 5.5% of GDP), higher economic growth in the 1940s led to real *debt* increases that were smaller over the FY1941-FY1950 period (35% of GDP) than the FY2011-FY2020 period (40% of GDP).

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