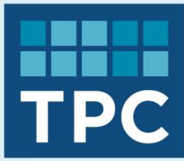

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THE PANDEMIC AND PRESIDENT-ELECT BIDEN'S OPPORTUNITY TO CHART A NEW COURSE

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How much has the COVID-19 pandemic changed America's fiscal future and affected President-elect Biden's opportunity to set a new course for fiscal policy? Largely as a consequence of the pandemic, the Congressional Budget Office (CBO) in September projected a deficit of more than $3 trillion for 2020, three times higher than the original projection of $1 trillion made earlier this year. Yet even before the pandemic, the growth in spending scheduled by this and previous Congresses already exceeded, and by ever-larger margins, the growth in revenues that could finance that spending. That unsustainable course, much more than the temporary effect of the pandemic, creates huge obstacles for charting any new long-term course for fiscal policy. Yet without major reform, programs aimed at investing in workers, children, and the young will garner ever-declining shares of government resources as spending on health, Social Security, and interest on the debt continue to swamp everything in their path.

BACKGROUND

This brief analyzes the extent to which the pandemic has changed the budget outlook for the federal government. Our analysis is based on the budget update released by CBO in September 2020 (CBO 2020a), which provided a mid-pandemic-adjusted update to CBO's original, pre-pandemic, projections from January 2020 (CBO 2020b). While this brief does not capture the effect of any relief or stimulus bills enacted in late 2020 and early 2021, only major legislative reforms directed to the long-term path of government fiscal policy would likely affect our conclusions.

The late 2020 CBO analysis projects the highest federal budget deficits in history, reaching over $3 trillion in fiscal year 2020 alone, a growth of roughly $2 trillion from the earlier projection. As expected, most of this growth relates directly to the pandemic and the ensuing economic crisis, though some recent legislative provisions, such as a one-year delay in required withdrawals from retirement accounts that will reduce income tax revenues, seem poorly targeted to that crisis. At the same time, almost all pandemic-related relief legislation, such as for increased unemployment insurance benefits, aid to small businesses, and support for vaccines, are temporary. Much larger temporary budget deficits leave

open the question of how these legislative changes, along with projected changes in the condition of the economy, will affect the longer-term size of America's debt, revenues, future deficits, future spending, and the ways that spending is allocated.

To address that question, we first compare the recent pandemic-adjusted estimate of fiscal year 2030 spending and financing sources with actual 2019 figures. Then we examine how much that level of change compares to a similar pre-pandemic exercise that compares 2030 projections to actual 2019 budget results. The difference neatly tells us how much the pandemic, the resultant change in the economy, and legislation enacted after January have altered the fiscal course of the federal government. As it turns out, except for the size of the national debt, the fiscal path was not altered a lot. The differences are generally small.

Our analysis focuses mainly on *changes* in levels of spending, taxes, and deficits, largely because these changes point to where the government is heading, rather than to the levels it has or will attain. Congress itself largely legislates by focusing on incremental changes to spending and tax policies, tweaking and modifying the budget as it deems necessary, not on enacting a budget from scratch.

On the financing side, new revenues derive not only from new legislation but also from the growth in revenues that accompanies economic growth. Additional borrowing itself is a major means of financing government operations. The sum of changes in financing sources equals the sum of all additional spending.

Many changes in the budget, such as the automatic growth in annual Social Security benefits, are entrenched long before any negotiations among policymakers take place. Steuerle and Quakenbush (2016) used this basic idea to develop a new framework for analyzing budgets and fiscal initiatives. Their framework starts off with an initial baseline, which is equivalent to federal spending and financing as projected under current law. It then distinguishes between *passive* and *active* changes. Passive changes are those changes built into current law that lawmakers essentially accept by not actively reforming them. By contrast, active changes are any new changes to the existing budgetary framework. In some analyses, such as when President Trump presented his budget (Kolasi and Steuerle, 2020), we separate out proposed active changes from the passive ones. In briefs such as this one, we merely present the passive changes already built into the nation's fiscal policy—those that would largely take place if Congress makes no significant legislative changes. Current law, as amended between now and the time that the President-elect Biden takes office, provides the base against which he will operate if he attempts to chart a new fiscal course.

We analyze the federal budget over a lengthy time horizon, such as 2030 versus 2019, because many federal programs take years to implement and produce a significant effect, and to distinguish long-term from temporary effects. By looking at changes from current levels, we can quickly measure which budget categories are growing, which are remaining stable, and which are getting smaller.

We also use an "income statement" approach for analyzing the budget, because the total change in spending must equal the total change in financing: resources raised by taxes and borrowing. Finally, we adjust our results for inflation, putting all figures into constant dollars. Unfortunately, almost all budget presentations, including those by the Administration and CBO, do not make such an adjustment. To understand the confusion this creates, consider a defense budget that grows nominally by 20 percent over an 11-year period when inflation averages 2 percent a year. Because inflation has increased by more than 20 percent over that period, this hypothetical defense budget would decline in real terms. Only by converting to real (inflation-adjusted) dollars can we get a sense of the budget's overall direction.

FEDERAL BUDGET UNDER CURRENT LAW

Table 1 compares the actual budget figures from 2019 with the projected numbers in 2030 from CBO's September 2020 report. All numbers shown are in constant 2020 dollars. Under current law, CBO estimates that real or inflation-adjusted total federal spending would be about $1.4 trillion higher in 2030 relative to the 2019 spending levels (CBO 2020b). In 2019, spending on mandatory programs and interest on the debt—programs built into the law that for the most part require no appropriation by Congress—comprised about 70 percent of total spending. By contrast, spending on mandatory programs and interest on the debt would reach 75 percent of total spending by 2030, leaving about 25 percent for all discretionary spending programs (what most Americans think of government activities and operations). The interest payment component of that spending growth has become quite large, even with low interest rates, largely because the federal government continues to collect much less tax revenue than necessary to cover its spending, even in the best years.

These figures become starker still when we look to see how needs identified in the current pandemic, such as investing in underserved populations and improving preparation for pandemics and other emergencies, extend beyond the immediate crisis itself. Social Security would comprise about 34 percent of the total growth in real spending between 2019 and 2030. Medicare would represent about 32 percent of total growth, interest on the debt, 12 percent, and Medicaid along with other health care subsidies, about 13 percent. By comparison, other spending shares very little in the overall growth. Other mandatory spending would rise by about $6 billion in real terms, while nondefense discretionary spending would increase by $68 billion. (Remember that we are comparing to 2019, not the temporarily high levels of 2020.) Defense spending also would get a limited boost in real spending during this period, rising by roughly $58 billion. However, the figures for these categories reflect a significant decline in spending as a share of GDP, since real GDP is expected to be about 20 percent higher in 2030 relative to 2019.

TABLE 1

Changes in Real Spending and Financing, 2019 vs 2030 (September 2020 Assumptions and Projections)

Billions of 2020 dollars

	2019	2030	Total change	Share of change (%)
Spending				
Social Security	1,048	1,532	484	34.0
Mandatory health	1,137	1,769	632	44.4
Medicare	650	1,102	452	31.8
Medicaid	413	590	174	12.2
ACA Marketplace subsidies	56	61	5	0.4
Children's Health Insurance Program	18	16	(2)	(0.1)
Other mandatory	576	582	6	0.4
Defense discretionary	683	741	58	4.1
Nondefense discretionary	667	735	68	4.8
Net interest	380	554	174	12.3
Total spending	4,491	5,913	1,422	100.0
Financing				
Total revenues	3,497	4,555	1,058	74.4
Borrowing (deficits)	994	1,358	364	25.6
Total financing	4,491	5,913	1,422	100.0

Sources: Authors' estimates based on *An Update to the Budget and Economic Outlook: 2020 to 2030* (CBO 2020a).
Note: ACA Marketplace subsidies refer to health insurance provided by the Marketplaces established under the Affordable Care Act. Components may not sum to totals because of rounding. We use the same inflation rates, which come from changes in the GDP price index, assumed by the Congressional Budget Office.

Next, we compare how these mid-pandemic estimates of real dollar changes from 2019 to 2030 differ from what had been projected pre-pandemic (table 2). For the most part, the table shows fairly modest differences. Interest costs provide one exception, though they often bounce around significantly from projection to projection due to changes in projected interest rates. Interest costs still rise significantly under the September 2020 projections, but by about $100 billion less than the figure projected in January 2020, largely reflecting CBO's forecast of a lower interest rate environment due to Federal Reserve policy and the effect of a world-wide recession on saving and investment. These lower interest rate forecasts more than offset the effects of the higher level of debt in determining interest costs as late as 2030. To be clear, lower interest costs due to a world-wide recession and slower projected economic growth are not good news, and we do not address here the risks associated with that higher debt.

A number of other factors come into play as CBO adjusted its estimates, such as a smaller overall economy, technical adjustments, and legislative changes that occurred between January and September. The slightly higher defense and non-defense discretionary spending numbers may reflect a higher 2020 baseline of spending in those categories from which projections are made. Under CBO conventions, future spending amounts under current law for discretionary parts of the budget are largely projected based on an assumption that they would increase by the rate of inflation, except when Congress has mandated other changes.[1]

TABLE 2

Changes in Real Spending and Financing 2019 vs 2030 (September vs January 2020 Projections)

Billions of 2020 dollars

Spending	Projection mid-pandemic	Projection pre-pandemic	Difference
Social Security	484	514	(30)
Mandatory health	632	678	(46)
Medicare	452	498	(46)
Medicaid	174	181	(7)
ACA Marketplace subsidies	5	1	(4)
Children's Health Insurance Program	(2)	(2)	
Other mandatory	6	3	3
Defense discretionary	58	51	7
Nondefense discretionary	68	49	19
Net interest	174	286	(102)
Total spending	1,422	1,581	(159)
Financing			
Total revenues	1,058	1,162	(104)
Borrowing (deficits)	364	419	(55)
Total financing	1,422	1,581	(159)

Sources: Authors' estimates based on *The Budget and Economic Outlook: 2020 to 2030* (CBO 2020b) and *An Update to the Budget and economic Outlook: 2020 to 2030* (CBO 2020a).

Note: ACA Marketplace subsidies refer to health insurance provided by the Marketplaces established under the Affordable Care Act. Components may not sum to totals because of rounding. We use the same inflation rates, which come from changes in the GDP price index, assumed by the Congressional Budget Office.

Referring back to table 1, in late 2020 Social Security, health, and interest on the debt by themselves are projected to comprise 91 percent of the total growth in spending. They would also absorb 122 percent of the total growth in revenues, which is likely an understatement since current tax law assumes expiration well before 2030 of some of the tax cuts enacted in 2017. For the January 2020 pre-pandemic projections shown in table 2, Social Security, health, and interest on the debt would constitute a very similar 94 percent of the projected total growth in spending and 127 of the total growth in revenues.

BEYOND THE CURRENT CRISIS

Although annual deficits by 2030 are large and growing, under current law they fall close to the pre-pandemic projections. Of course, the accumulated debt will be much larger by that point. Thus, the long-term impact of the pandemic and the nation's adaptations to it, so far seems mainly to reinforce and accelerate pre-existing budgetary trends when it comes to where spending is directed and the ever-larger shortfall of revenues.

The first priority of the new president is addressing the pandemic and the current economic downturn, probably resulting in further changes along the lines that we have seen in 2020. Yet, it remains an open question whether the economic and policy shortcomings revealed by the pandemic will accelerate or delay long-term adjustments to how we spend money and allocate resources. Higher federal debt levels alone may make it harder for the president-elect to make major shifts in the nation's fiscal path. What seems clear is that absent major reforms that significantly reduce

built-in growth rates in health and retirement programs, raise revenues, or both, our current fiscal trajectory may become more locked in than ever.

CONCLUSION

The economic crisis caused by the coronavirus pandemic may end up reinforcing the fiscal and budgetary trends that dominated before 2020. Though the current crisis adds quite significantly to debt, some reprieve is projected in the form of lower interest costs for the medium-term. These lower interest costs largely reflect the impact on interest rates of, and monetary policy's reaction to, a world-wide recession. However, the share of federal spending for anything other than health, Social Security, and interest on the debt will continue to shrink post-recession and almost certainly continue to do so without major budgetary reform.

All these factors provide powerful headwinds against any presidential effort to shift federal priorities long-term, even while the current pandemic and recession highlight the need for government to start focusing more on other needs of American families, including better preparation for future pandemics and emergencies.

NOTE

[1] Note that the 2019 base for making comparisons was adjusted modestly between January and September. The January 2020 changes in spending and financing shown here use the January 2020 (not the September 2020) estimates both for the 2019 base and the 2030 changes from that base.

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