

# WNTS Insight



## CBO projects federal budget deficit of nearly \$1.5 trillion for fiscal 2011

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According to new estimates released January 26, the Congressional Budget Office (CBO) projects that the federal budget deficit will reach almost \$1.5 trillion in fiscal year (FY) 2011, which ends September 30. In dollar terms, this would be the largest deficit in history, exceeding the FY 2010 deficit of \$1.3 trillion and the FY 2009 deficit of \$1.4 trillion. The projected budget deficit amounts to 9.8 percent of gross domestic product (GDP), slightly lower than the post-World War II high of 10.0 percent for 2009 but significantly higher than the 2.8-percent average for the prior 40 years.

Tax and stimulus legislation enacted over the past two years and slow economic growth will combine to keep revenues below historical levels and spending above historical levels in 2011. Revenues as a share of GDP are projected to be 14.8 percent, well below the historical average of 18 percent. Federal spending is projected to reach 24.7 percent of GDP in 2011, well above the historical average of 20.8 percent.

Beyond 2011, CBO projects the deficit will fall as a percentage of GDP, decreasing to 3.1 percent of GDP by 2014. These baseline figures assume expiration after 2012 of the individual tax cuts enacted in 2001 and 2003, expiration after 2011 of certain expiring tax provisions and alternative minimum tax relief, continuation of military actions in Iraq and Afghanistan, and discretionary spending growth that is lower than the historical average. By contrast, assuming extension (rather than expiration of) current tax provisions, a phase-down of Iraq and Afghanistan activities, and discretionary spending growth that keeps pace with GDP growth, the deficit by 2021 would reach approximately eight percent of GDP. Under this latter scenario, the federal debt held by the public would increase from 62 percent of GDP in 2010 to 103 percent in 2021.

While the national debt has increased significantly over the past three years, historically low interest rates have kept the government's net interest payments low. However, as the economy recovers, interest rates are expected to rise. As a result, under the CBO baseline

assumptions mentioned above, net interest is projected to more than double as a share of GDP between 2011 and 2021, from 1.5 percent to 3.3 percent. Under the alternative assumptions described above, net interest would reach 4.5 percent of GDP by 2021, or nearly \$1 trillion.

### **Economic assumptions**

CBO expects the slow recovery from the recession that ended in June 2009 to continue for the next couple of years. While business investment is expected to increase over the next two years, slow growth in consumer spending will lead to moderate economic growth. Overall, real GDP will increase by 3.1 percent this year and 2.8 percent in 2012, close to the 40-year average of 2.9 percent.

The slow growth will lead to modest improvements in labor markets -- the unemployment rate is projected to fall to 9.2 percent by the fourth quarter of 2011, 8.2 percent by the fourth quarter of 2012, and 7.4 percent at the end of 2013. Domestic corporate profits, which had risen by almost 50 percent to reach 8.1 percent of GDP in 2010, are forecast to increase by 9 percent in 2011 before slowing in 2013 and beyond, averaging 2.4-percent growth through 2021.

### **Long-term outlook**

Government spending on health care is projected to increase significantly over the next 10 years and beyond. Spending on Medicare, Medicaid, and the Children's Health Insurance Program is projected to grow at an average rate of seven percent through 2021. Social Security and other programs that target retirees also will experience significant growth as the baby boomer generation leaves the job market.

Unless action is taken in coming years, these programs alone will lead to significant increases in budget deficits and federal debt levels.

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