The Daily Dish

Unforgiving Budget Math

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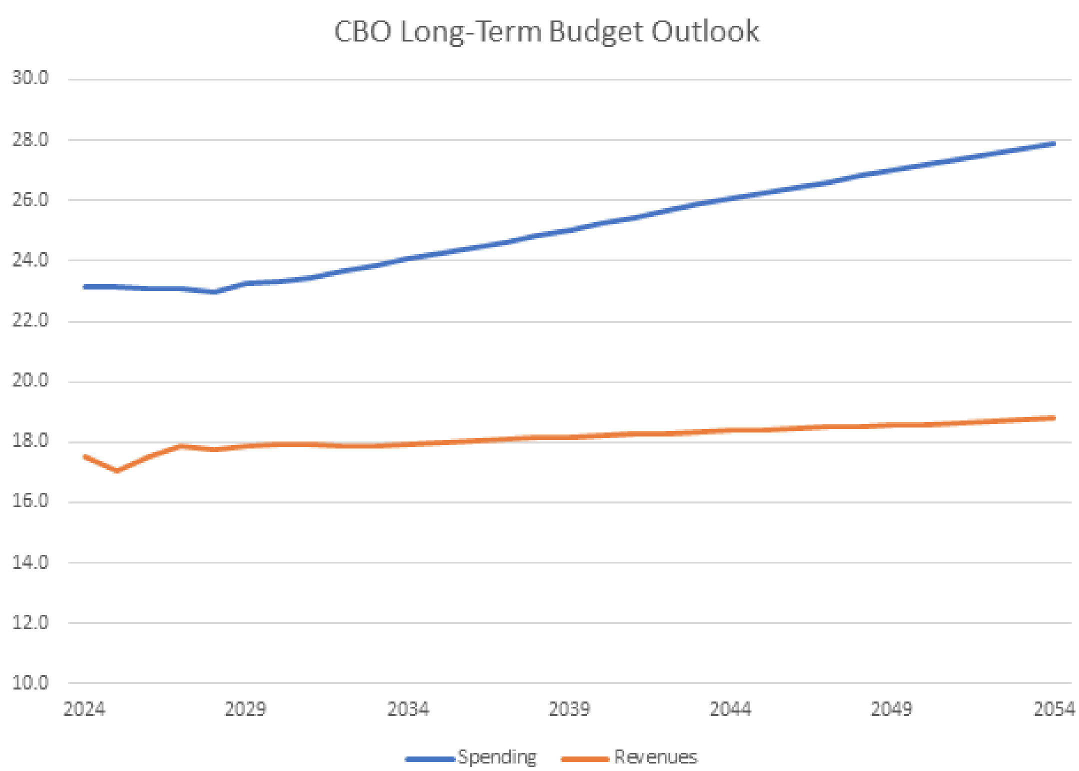
The House of Representatives is out this week, which means it will return the week of February 26. Last time Eakinomics checked, the continuing resolution funding part of the government runs only until March 1. Even though this year February has 29 days, that means there is no time to pass an appropriation bill for fiscal 2024. Get ready for a legislative high-wire act.

As Eakinomics has repeatedly stressed, despite the great attention and high political stakes, 2024 appropriations are a sideshow from the perspective of the structural problems facing the federal budget. The basic picture (below) is taken from the February 2024 long-term budget outlook by the Congressional Budget Office (CBO). (Presented as a percentage of gross domestic product, GDP).



The basic picture is pretty simple. First, spending (blue) is much higher than revenues (orange). That is a problem. But the second problem is that the growth rate of spending is much higher than the growth rate of revenues (the blue line is steeper than the orange line).

Now, to Eakinomics' eye, nobody is paying any attention to the long-term federal budget threats. But to the extent that deficits enter the policy discussion, the vast majority of "solutions" offered are on the tax side of the ledger. Soak the rich, adopt a wealth tax, hammer large corporations, and myriad others are quickly put on the table.

The only problem is that it won't work.

That's because a tax hike solves problem number one – it raises revenues toward spending – but it cannot address problem number two. In the long run, revenues will grow at only a tad more than the pace of the economy. If the United States gets 2 percent real growth and returns inflation to the 2 percent target, that pace is 4 percent per year. Unless spending growth is brought down to 4 percent, the lines will continue to diverge as far as the eye can see.

This is illustrated below. Specifically, revenues are raised by $500 billion in 2024. In budget parlance, that would be a $5 trillion tax increase over 10 years – a massive increase. Moreover, for simplicity, the graph assumes that there is no effect of the tax increase on the growth of the economy. That is far from the reality.

In addition to the fact that this tax increase is politically quite unlikely, and its lack of impact economically impossible, it does not solve the federal budget problem. The only real solutions are those that address the growth rate of spending, specifically on large entitlement programs such as Social Security and Medicare. That's the real budget arithmetic.