Insight

Congress Already Spent the Low-Interest Rate Windfall

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On Tuesday, the Congressional Budget Office released its Budgetary and Economic Outlook. The "January baseline" is particularly interesting because it reflects CBO's economic forecast for a new 10-year horizon or "budget window." Typically, CBO updates its forecast twice a year – once in January and once in August. For budget observers, the January baseline is kind of a big deal. The economic forecast will underpin CBO's cost estimates throughout the year.

The economic forecast substantially affects the budgetary outlook. CBO always does a crosswalk (table a-1) from one budget and economic outlook to another, so observers and policymakers can clearly follow how legislative, economic, and technical factors have changed since the prior budget outlook.

In a healthy economy, growing wage and capital income enhance revenue collection. Higher interest rates typically follow from higher growth. But that linkage is less sound as interest rates fall globally. In its January *Outlook*, CBO slightly marked down growth, but more substantially reduced its interest rate forecast. Given the sheer magnitude of U.S. debt, federal interest costs are quite sensitive to interest rates. According to CBO, the downward revision in interest rates reduced CBO's deficit estimates by $530 billion over the next decade – the single largest change in the agency's budget estimates since August.

Essentially, all else equal, the federal budget enjoyed a half-trillion-dollar windfall due to lower interest rates. Unfortunately, this "found" money has already been spent.

The second-largest change CBO recorded since its last estimate was for $505 billion in new spending and tax cuts that Congress enacted largely as part of its end-of-year budget deal.

The upshot is that Congress and the administration eliminated the windfall from the incremental reduction in interest rates. If the federal budget were on a sustainable course, this wouldn't be so troubling. Given that the United States is running large primary deficits, even low interest rates don't preclude a significant accumulation in debt over the next decade.

The low interest rate environment has set off a reconsideration of the potential risks from high levels of debt among some economists. Indeed, some have argued that the federal government should be more heavily indebted, given the low cost. But this critique ignores that the United States is still adding to the debt even with low interest rates and that Congress has already spent what budgetary room the latest interest rate revision granted to taxpayers.