CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Keith Hall, Director

August 11, 2015

Honorable Bernard Sanders
Ranking Member
Committee on the Budget
United States Senate
Washington, DC 20510

Re: The Macroeconomic Effects of Eliminating Automatic Reductions to Discretionary Spending Caps

Dear Senator:

The Budget Control Act of 2011 created caps on discretionary budget authority for each year through 2021.[1] That act also provided for automatic reductions in those caps that would be triggered under certain conditions. At your request, the Congressional Budget Office has analyzed the macroeconomic effects of eliminating those automatic reductions for fiscal years 2016 and 2017.

Fully eliminating the reductions would allow for an increase in appropriations of $90 billion in 2016 and $91 billion in 2017. According to CBO's estimates, such an increase would raise total outlays above what is projected under current law by $53 billion in fiscal year 2016, $76 billion in fiscal year 2017, $30 billion in fiscal year 2018, and a cumulative $19 billion in later years.[2]

Those changes in spending would have the following macroeconomic effects:[3]

- Over the course of calendar year 2016, on average, CBO estimates that the spending changes would make real (inflation-adjusted) gross domestic product (GDP) 0.4 percent larger than projected under current law. They would also increase full-time-equivalent employment by 0.5 million. Those effects would result chiefly from two partly offsetting forces. First, the increase in federal spending would lead to more aggregate demand than under current law. Second, monetary policy would tighten slightly in response to the slightly stronger economic growth and to the slight increase in inflationary pressure that would result. That tighter monetary policy would begin to dampen the positive effects on output and employment.

[1] Budget authority is the authority provided by law to incur financial obligations that will result in immediate or future outlays of federal funds. Discretionary budget authority is provided and controlled by appropriation acts.

[2] Defense discretionary outlays would be $34 billion higher in fiscal year 2016, $45 billion higher in fiscal year 2017, and $16 billion higher in fiscal year 2018; nondefense discretionary outlays would be $19 billion higher in fiscal year 2016, $31 billion higher in fiscal year 2017, and $15 billion higher in fiscal year 2018. As is the case with most discretionary appropriations, not all of the funds that would be made available to agencies would be spent.

[3] For a general explanation of how CBO analyzes the macroeconomic effects of fiscal policy changes, see Congressional Budget Office, *How CBO Analyzes the Effects of Changes in Federal Fiscal Policies on the Economy* (November 2014), www.cbo.gov/publication/49494.

- Over the course of calendar year 2017, on average, CBO estimates that the spending changes would make real GDP 0.2 percent larger than projected under current law. They would also increase full-time-equivalent employment by 0.3 million. Those effects would result from three partly offsetting forces. First, the increase in federal spending would further boost aggregate demand, as in 2016, CBO estimates. Second, the delayed effects of the slightly tighter monetary policy in 2016, along with additional tightening in 2017, would further dampen the positive effects on output and employment. Third, the increased borrowing by the federal government that the spending increases would bring about would start to gradually reduce—or crowd out—private investment in productive capital because the portion of people's savings used to buy government securities would not be available to finance private investment. On balance, the three forces would result in smaller increases in real GDP and employment in 2017 than in 2016.

Those figures represent CBO's central estimates, which correspond to the assumption that key parameters of economic behavior (in particular, the extent to which higher federal spending boosts aggregate demand in the short term) equal the midpoints of the ranges used by CBO for those parameters. The ranges suggest that if the automatic reductions to the discretionary caps were fully eliminated, real GDP could be 0.1 percent to 0.6 percent higher in calendar year 2016, and 0.1 percent to 0.4 percent higher in calendar year 2017, than projected under current law. The ranges also suggest that full-time-equivalent employment could be 0.2 million to 0.8 million higher in calendar year 2016, and 0.1 million to 0.6 million higher in calendar year 2017, than projected under current law.

Although eliminating the reductions to the spending caps for fiscal years 2016 and 2017 would increase output and employment over the next few years, the resulting increases in federal deficits would, in the longer term, make the nation's output and income lower than they would be otherwise.[4]

I hope that you find this information useful. If you have any questions, please feel free to contact me or CBO's staff. The primary staff contact for this analysis is Devrim Demirel.

Sincerely,

Keith Hall
Director

cc: Honorable Mike Enzi
Chairman

[4] For a recent analysis of the short- and long-term effects of different amounts of deficits and debt, see Congressional Budget Office, *The 2015 Long-Term Budget Outlook* (June 2015), Chapter 6, www.cbo.gov/publication/50250.