COVID-19 and Short-Run Federal Deficits

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The COVID-19 outbreak and ensuing economic shock may have major effects on future federal budget deficits (the amounts by which annual outlays exceed annual revenues). The latest federal budget baselines from the Congressional Budget Office (CBO) and Office of Management and Budget (OMB) use economic forecasts produced before the COVID-19 outbreak; baselines with updated forecasts would typically not be expected for several months, though agencies could decide to provide updates sooner. This Insight briefly discusses the effects that recent economic and legislative developments may have on short-term federal budget outcomes.

Recent Projections

Budget baseline forecasts projected federal deficits to be well above their historical average before accounting for the ongoing economic decline. CBO's March 2020 baseline included deficit projections of $1,073 billion or 4.9% of gross domestic product (GDP) in FY2020 and $1,002 billion or 4.3% of GDP in FY2021. Those deficit levels are higher than the average inflation-adjusted value from FY1962 through FY2019 (2.7% of GDP), and are attributable to higher outlays and lower revenues than their respective averages over the same period. CBO projections are similar to those produced by OMB's current policy baseline for FY2020 and FY2021.

Some of the fluctuations in budget outcomes are attributable to what economists call *automatic stabilizers* that work in a countercyclical manner, without congressional action, to temper economic growth when the economy is in danger of overheating and stimulate economic growth during downturns. These automatic stabilizers contribute to lower deficits (or higher surpluses) in periods of high economic growth, as revenues rise from taxes on increased economic activity and spending on programs like unemployment insurance declines. The opposite effect occurs during periods of low economic growth, with higher deficit levels from reduced revenues and increased spending on certain programs.

The economic forecast in CBO's latest baseline projected that the economy would operate *above* potential (i.e., the output *higher than* expected with full employment and productivity) in the near term.

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Specifically, automatic stabilizers were projected to reduce budget deficits in FY2020 by 0.4% of GDP and in FY2021 by 0.3% of GDP relative to deficits expected in an economy operating at potential.

Economic Activity

The short-run economic decline associated with the COVID-19 outbreak is expected to be severe. Before the crisis, the Bureau of Economic Analysis (BEA) measured real GDP (annualized) growth of 2.1% in the first quarter of FY2020. CBO announced an expectation that GDP would decline by more than 7% in the second quarter, which would generate a comparable BEA annualized growth rate of roughly -28%. The duration of the crisis and ensuing economic reaction are highly uncertain, though projections are likely to include effects lasting into FY2021.

Although the precise effect is unknowable, historical data suggest that the current economic decline is likely to have notable short-run budget effects. **Table 1** shows CBO calculations of the automatic stabilizer effect in every year the output gap—the difference between potential GDP and actual GDP—was at least 2%. In most years, relatively small output gaps of between 2% and 4% led to an average deficit increase of roughly 1% of GDP. Output gaps of at least 4% of GDP, however, produced deficit increases that averaged 2% of GDP.

Table 1. Automatic Stabilizer Deficit Effect with High Output Gaps, FY1970-FY2019

(Gaps expressed as percentages of GDP)

Output Gap (% of GDP)	Frequency (Fiscal Years)	Average Deficit Effect (% of GDP)
2.0-2.9	5 (1976, 1984, 2002, 2003, 2014)	0.9
3.0-3.9	6 (1975, 1991, 1992, 1993, 2012, 2013)	1.2
>3.9	5 (1982, 1983, 2009 2010, 2011)	2.0

Source: Congressional Budget Office, *Automatic Stabilizers in the Federal Budget: 2020 to 2030*, February 2020.

Notes: CRS calculations. Positive numbers reflect output underperformance and deficit increases, respectively.

Legislative Activity

Recently enacted legislation will also affect FY2020 and FY2021 budget outcomes. The March CBO baseline projections included effects of all legislation enacted through March 6, 2020, including the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020 (P.L. 116-123). Two subsequently enacted pieces of legislation, the Families First Coronavirus Response Act (P.L. 116-127) and the CARES Act (P.L. 116-136), are expected to increase short-run deficits considerably.

Table 2 displays the publicly available cost estimates for the Families First Coronavirus Response Act and the CARES Act. The Families First Coronavirus Response Act was projected to increase deficits in FY2020 and FY2021 by a combined 0.9% of average annual GDP ($191 billion), split roughly evenly between increases in outlays (0.4% of GDP) and decreases in revenue (0.5% of GDP). Roughly two-thirds of that effect (0.6% of GDP) is projected to occur in FY2020, with a FY2021 deficit increase of 0.3% of GDP.

Table 2. Cost Estimates for Select Laws Enacted After March 6, 2020

(as percentages of annual GDP)

Public Law	Name	FY2020 Outlays	FY2020 Revenues	FY2021 Outlays	FY2021 Revenues	Total Deficit Effect
116-127	Families First Coronavirus Response Act	0.3	-0.4	0.2	-0.1	0.9
116-136	CARES Act	4.9	-2.7	0.9	-1.1	Not yet available

Source: CBO and Joint Committee on Taxation cost estimates and CBO March 2020 baseline.

Notes: Individual components may not sum to total deficit effects due to rounding. GDP estimates taken from CBO March 2020 baseline: all else equal, downward revisions to GDP projections would increase the values provided in this table.

As shown in **Table 2**, CBO and the Joint Committee on Taxation (JCT) estimate that increased outlays and reduced revenues from provisions included in the CARES Act will increase deficits by 7.6% of GDP ($1,608 billion) in FY2020 and 2.0% of GDP ($450 billion) in FY2021. CBO and JCT estimate that the CARES Act will decrease deficits in subsequent years, with combined deficit reduction of 1.0% of annual GDP ($299 billion) in FY2022-FY2030. Consistent with standard cost-estimate convention, the estimates in **Table 2** do not include the effect of changes to debt-servicing costs, which would further increase FY2020 and FY2021 deficit estimates.