Congressional **CBO** Budget Office
Summary

The Long-Term Budget Outlook

Recently, the federal government has been recording the largest budget deficits, as a share of the economy, since the end of World War II. As a result of those deficits, the amount of federal debt held by the public has surged. At the end of 2008, that debt equaled 40 percent of the nation's annual economic output (as measured by gross domestic product, or GDP), a little above the 40-year average of 36 percent. Since then, large budget deficits have caused debt held by the public to shoot upward; the Congressional Budget Office (CBO) projects that federal debt will reach 62 percent of GDP by the end of this year—the highest percentage since shortly after World War II. The sharp rise in debt stems partly from lower tax revenues and higher federal spending related to the recent severe recession and turmoil in financial markets. However, the growing debt also reflects an imbalance between spending and revenues that predated those economic developments.

As the economy recovers and the policies adopted to counteract the recession and the financial turmoil phase out, budget deficits will probably decline markedly in the next few years. But over the long term, the budget outlook is daunting. The retirement of the baby-boom generation portends a significant and sustained increase in the share of the population receiving benefits from Social Security, Medicare, and Medicaid. Moreover, per capita spending for health care is likely to continue rising faster than spending per person on other goods and services for many years (although the magnitude of that gap is very uncertain). Without significant changes in government policy, those factors will boost federal outlays sharply relative to GDP in coming decades under any plausible assumptions about future trends in the economy, demographics, and health care costs.

The Outlook for Major Health Care Programs and Social Security

CBO projects that if current laws do not change, federal spending on major mandatory health care programs will grow from roughly 5 percent of GDP today to about 10 percent in 2035 and will continue to increase thereafter.[1] Those projections include all of the effects of the recently enacted health care legislation, which is expected to increase federal spending in the next 10 years and for most of the following decade.[2] By 2030, however, that legislation will slightly reduce federal spending for health care if all of its provisions are fully implemented, CBO projects. That reduction in the level of spending in 2030 yields lower projections of health care spending in the longer term—even though, owing to the great uncertainties involved in projecting such spending many decades in the future, enactment of the legislation did not cause CBO to change its estimates of longer-term growth rates for spending on the government's health care programs.

Under current law, spending on Social Security is also projected to rise over time as a share of GDP, albeit much less dramatically. CBO projects that Social Security spending will increase from less than 5 percent of GDP

1. Mandatory programs are ones that do not require annual appropriations by the Congress; the major mandatory health programs consist of Medicare, Medicaid, the Children's Health Insurance Program, and health insurance subsidies that will be provided through the exchanges established by the recently enacted health care legislation.

2. For details, see Congressional Budget Office, letter to the Honorable Nancy Pelosi about the budgetary effects of H.R. 4872, the Reconciliation Act of 2010 (March 20, 2010). If all of its provisions are carried out, the legislation will also increase federal revenues and reduce budget deficits over the 2010–2019 period and in subsequent years, according to estimates by CBO and the staff of the Joint Committee on Taxation.

today to about 6 percent in 2030 and then stabilize at roughly that level.

All told, CBO projects, the aging of the population and the rising cost of health care will cause spending on the major mandatory health care programs and Social Security to grow from roughly 10 percent of GDP today to about 16 percent of GDP 25 years from now if current laws are not changed. (By comparison, spending on *all* of the federal government's programs and activities, excluding interest payments on debt, has averaged 18.5 percent of GDP over the past 40 years.) To put U.S. fiscal policy on a sustainable path, lawmakers would have to substantially reduce the growth in outlays for those programs relative to the amounts that CBO is projecting—or else match that growth with equivalent declines in other federal spending, corresponding increases in federal revenues, or some combination of the two.

Alternative Long-Term Scenarios

In this report, CBO presents the long-term budget picture under two scenarios that embody different assumptions about future policies governing federal revenues and spending. Budget projections grow increasingly uncertain as they extend farther into the future, so this report focuses largely on the next 25 years. However, because considerable interest exists in the longer-term outlook, figures showing projections through 2080 and associated data are available in Appendix A of the report, and associated data are available on CBO's Web site (www.cbo.gov).

The first long-term budget scenario used in this analysis, the *extended-baseline scenario,* adheres closely to current law. It incorporates CBO's current estimate of the impact of the recently enacted health care legislation on revenues and mandatory spending. (That estimate is unchanged from the one that CBO and the staff of the Joint Committee on Taxation published in March, when the legislation was being considered.) Under this scenario, the expiration of most of the tax cuts enacted in 2001 and 2003, the growing reach of the alternative minimum tax, and the way in which the tax system interacts with economic growth would result in steadily higher average tax rates. Those rising rates, combined with the tax provisions of the recent health care legislation, would push total revenues to 23 percent of GDP by 2035—much higher than has typically been seen in recent decades—and to larger percentages thereafter. At the same time, government spending on everything other than the major mandatory health care programs, Social Security, and interest on federal debt—activities such as national defense and a wide variety of domestic programs—would decline to the lowest percentage of GDP since before World War II.

That significant increase in revenues and decrease in the relative importance of other spending would offset much—though not all—of the rise in spending on health care programs and Social Security. As a result, debt would increase from its already high levels relative to GDP, as would the required interest payments on that debt. Federal debt held by the public would grow from an estimated 62 percent of GDP this year to about 80 percent by 2035. Interest payments, which absorb federal resources that could otherwise be used to pay for government services, currently amount to more than 1 percent of GDP; under this scenario, they would rise to 4 percent of GDP (or one-sixth of federal revenues) by 2035.

The budget outlook is much bleaker under the *alternative fiscal scenario*, which incorporates several changes to current law that are widely expected to occur or that would modify some provisions of law that might be difficult to sustain for a long period. In this scenario, CBO assumed that Medicare's payment rates for physicians would gradually increase (which would not happen under current law) and that several policies enacted in the recent health care legislation that would restrain growth in health care spending would not continue in effect after 2020. In addition, under the alternative scenario, spending on activities other than the major mandatory health care programs, Social Security, and interest would fall below the average level of the past 40 years relative to GDP, though not as low as under the extended-baseline scenario. More important, CBO assumed for this scenario that most of the provisions of the 2001 and 2003 tax cuts would be extended, that the reach of the alternative minimum tax would be kept close to its historical extent, and that over the longer run, tax law would evolve further so that revenues would remain at about 19 percent of GDP, near their historical average.

Under that combination of policy assumptions, federal debt would grow much more rapidly than under the extended-baseline scenario. With significantly lower revenues and higher outlays, debt would reach 87 percent of

GDP by 2020, CBO projects. After that, the growing imbalance between revenues and noninterest spending, combined with spiraling interest payments, would swiftly push debt to unsustainable levels. Debt as a share of GDP would exceed its historical peak of 109 percent by 2025 and would reach 185 percent in 2035.

Neither of those scenarios represents a prediction by CBO of what policies will be in effect during the next several decades. The policies adopted in coming years will surely differ from those assumed for the scenarios. (And even if the assumed policies were adopted, their economic and budgetary consequences would certainly differ from those projected in this report.) Nevertheless, these projections, encompassing two very different sets of policy assumptions, provide a clear indication of the serious nature of the fiscal challenge facing the nation.

The Impact of Growing Deficits and Debt

In fact, CBO's projections understate the severity of the long-term budget problem because they do not incorporate the significant negative effects that accumulating substantial amounts of additional federal debt would have on the economy:

- Large budget deficits would reduce national saving, leading to higher interest rates, more borrowing from abroad, and less domestic investment—which in turn would lower income growth in the United States.

- Growing debt would also reduce lawmakers' ability to respond to economic downturns and other challenges.

- Over time, higher debt would increase the probability of a fiscal crisis in which investors would lose confidence in the government's ability to manage its budget, and the government would be forced to pay much more to borrow money.

Keeping deficits and debt from growing to unsustainable levels would require raising revenues as a percentage of GDP significantly above past levels, reducing outlays sharply relative to CBO's projections, or some combination of those approaches. Making such changes while economic activity and employment remain well below their potential levels would probably slow the economic recovery. However, the sooner that long-term changes to spending and revenues are agreed on, and the sooner they are carried out once the economic weakness ends, the smaller will be the damage to the economy from growing federal debt. Earlier action would require more sacrifices by earlier generations to benefit future generations, but it would also permit smaller or more gradual changes and would give people more time to adjust to them.