

Summary

If current laws governing taxes and spending did not change, the United States would face steadily increasing federal budget deficits and debt over the next 30 years, according to projections by the Congressional Budget Office. Federal debt held by the public, which was equal to 39 percent of gross domestic product (GDP) at the end of fiscal year 2008, has already risen to 75 percent of GDP in the wake of a financial crisis and a recession. In CBO's projections, that debt rises to 86 percent of GDP in 2026 and to 141 percent in 2046—exceeding the historical peak of 106 percent that occurred just after World War II. The prospect of such large debt poses substantial risks for the nation and presents policymakers with significant challenges.

Why Are Projected Deficits Rising?

In CBO's projections, deficits rise during the next three decades because the government's spending grows more quickly than its revenues do (see Summary Figure 1). In particular, spending grows for Social Security, the major health care programs (primarily Medicare), and interest on the government's debt.

Much of the spending growth for Social Security and the major health care programs results from the aging of the population: As members of the baby-boom generation age and as life expectancy continues to increase, the percentage of the population age 65 or older is anticipated to grow sharply, boosting the number of beneficiaries of those programs. By 2046, projected spending for those programs for people 65 or older accounts for about half of all federal noninterest spending.

The remainder of the projected growth in spending for Social Security and the major health care programs is driven by health care costs per beneficiary, which are projected to increase more quickly than GDP per person (after the effects of aging and other demographic changes are removed). CBO projects that those health care costs will rise—though more slowly than in the past—in part because of the effects of new medical technologies and rising personal income.

The federal government's net interest costs are projected to rise sharply as a percentage of GDP for two main reasons. The first and most important is that interest rates are expected to be higher in the future than they are now, making any given level of debt more costly to finance. The second reason is the projected increase in deficits: The larger they are, the more the government will need to borrow.

Mandatory spending other than spending on Social Security and the major health care programs—such as spending for federal employees' pensions and for various income security programs—is projected to decline as a percentage of GDP, as is discretionary spending. (Mandatory spending is generally governed by provisions of permanent law, whereas discretionary spending is controlled by annual appropriation acts.) The projected decline in the latter stems largely from the caps on discretionary funding that are set in law for the next several years.

The modest projected growth in revenues relative to GDP over the next three decades is attributable to increases in individual income tax receipts. Those receipts are projected to grow mainly because CBO anticipates that income will rise more quickly than the price indexes that are used to adjust tax brackets; as a result, more income will be pushed into higher tax brackets over time. Combined receipts from all other sources are projected to decline as a percentage of GDP.

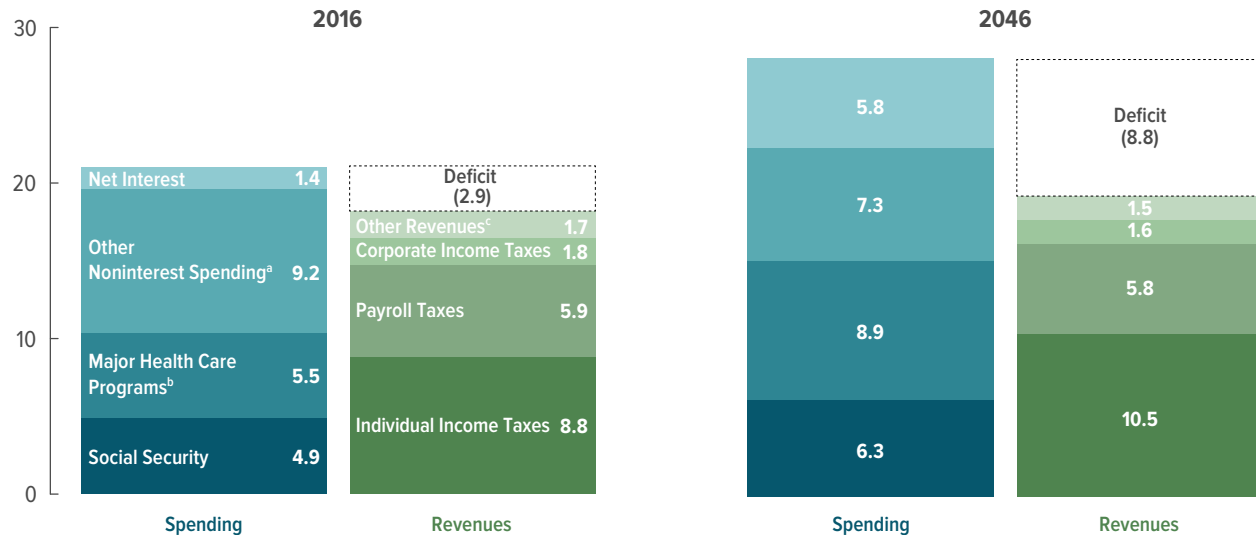
How Does CBO Make Its Long-Term Budget Projections?

CBO's long-term projections start with the agency's 10-year projections of spending and revenues, which combine information about many spending programs and tax provisions with data about broader trends in the population and the economy. The 10-year projections follow the assumptions that current laws governing taxes and spending will generally remain the same in the future, but that some mandatory programs will be extended after their authorizations lapse and that spending for Medicare and Social Security will continue as scheduled even if their trust funds are exhausted. CBO

Summary Figure 1.

The Federal Budget Under the Extended Baseline

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2026 and then extending most of the concepts underlying those baseline projections for the rest of the long-term projection period.

- Consists of all federal spending other than that for Social Security, the major health care programs, and net interest.
- Consists of spending on Medicare (net of offsetting receipts), Medicaid, and the Children's Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.
- Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

makes those assumptions to conform to statutory requirements. Because current laws surely *will* change, CBO's projections are not predictions of what the agency thinks will actually happen. Rather, they give lawmakers a baseline to measure the effects of proposed legislation against. They are therefore called baseline projections.

CBO's detailed long-term projections, produced once each year, follow those assumptions as well. Because they extend the baseline into the following two decades, they are called the extended baseline. Some parts of the extended baseline, such as projections of Social Security spending and individual income taxes, incorporate detailed estimates of how people would be affected by particular elements of programs or the tax code. Other projections reflect past trends and CBO's assessment of how those trends would evolve if current laws generally remained unchanged. Between the annual publications of the detailed analyses, CBO sometimes updates its long-term projections using simplified methods, as it did most recently in January 2016.

CBO's budget projections are built upon its projections of the economy (which incorporate, among many other things, the estimated effects of fiscal policy under current

laws). CBO anticipates that if current laws generally did not change, real GDP—that is, GDP with the effects of inflation excluded—would increase by 2.1 percent per year, on average, over the next 30 years. Over the past 50 years, by contrast, the annual increase in real GDP has averaged 2.9 percent. Projected GDP growth is slower than that largely because of retiring baby boomers, falling birthrates, and declining participation in the labor force. Projected growth is also held down by the effects of fiscal policy under current law—above all, by the reduction in private investment that is projected to result from rising federal debt.

How Have Those Projections Changed Over the Past Year?

The previous edition of this volume, *The 2015 Long-Term Budget Outlook*, was published in June 2015 and showed projections through 2040. CBO now projects debt in 2040 that, measured as a share of GDP, is 15 percentage points higher than it projected last year, mostly because of changes in tax law.

When CBO updated its long-term projections in January 2016, it did so through 2046. The agency's projection of

debt in 2046 is now 14 percentage points lower than it was in January, primarily because CBO now expects interest rates to be lower than previously anticipated.

How Uncertain Are Those Projections?

If current laws governing taxes and spending remained generally the same, CBO estimates, debt would nearly double as a percentage of GDP over the next 30 years. That projection is very uncertain, however, so the agency examined how it would change if four key inputs—labor force participation, productivity in the economy, interest rates on federal debt, and health care costs per person—were different from their levels in the extended baseline. The resulting projections show that debt in 2046, measured as a share of GDP, could be much larger or smaller than it is in the extended baseline, ranging from nearly twice the largest amount recorded in U.S. history to slightly less than that record high. Even at the low end of that range, debt would be higher than it is now.

Other factors, such as an economic depression, a major war, or unexpected changes in fertility, immigration, or mortality rates, could also affect the trajectory of debt. Taking all factors into account, CBO concludes that despite the considerable uncertainty of long-term projections, debt as a percentage of GDP would probably be greater—in all likelihood, much greater—than it is today if current laws remained generally unchanged.

What Might the Consequences Be If Current Laws Remained Unchanged?

Large and growing federal debt over the coming decades would hurt the economy and constrain future budget policy. The amount of debt that is projected in the extended baseline would reduce national saving and income in the long term; increase the government's interest costs, putting more pressure on the rest of the budget; limit lawmakers' ability to respond to unforeseen events; and increase the likelihood of a fiscal crisis, an occurrence in which investors become unwilling to finance a government's borrowing needs unless they are compensated with very high interest rates.

What Would the Effects of Illustrative Changes to Current Laws Be?

To show how changes in law would affect the long-term fiscal imbalance, CBO took two approaches. First, it estimated how large changes in spending or revenues would have to be if lawmakers wished to achieve a chosen goal for federal debt held by the public. Second, the agency approached the issue from the other direction, estimating

how two illustrative deficit-reduction paths would affect debt in 2046.

If lawmakers wanted to reduce debt in 2046 so that it equaled its average percentage of GDP over the past 50 years (39 percent), one way to achieve that result would be to cut noninterest spending, increase revenues, or do both by a total of 2.9 percent of GDP per year, starting in 2017. That would come to about \$560 billion in 2017, or \$6.7 trillion from 2017 through 2026. If instead they wanted debt in 2046 to equal its current percentage of GDP (75 percent), the necessary measures would be smaller, totaling 1.7 percent of GDP per year (about \$330 billion in 2017 and \$4.0 trillion through 2026). The longer lawmakers waited to act, the larger the necessary policy changes would become.

For the two illustrative deficit-reduction paths, CBO assumed that decreases in the deficit would be phased in over time rather than made as equal percentage changes in each year. In one path, cumulative deficits through 2026 would be about \$2 trillion lower than under the extended baseline; in another, they would be about \$4 trillion lower; and in both paths, deficits in subsequent years would be lower than in the baseline by the same percentage of GDP as in 2026. The first path would result in federal debt equal to 96 percent of GDP in 2046, and the second would result in federal debt equal to 55 percent of GDP in 2046.

How Is This Report Arranged?

Chapter 1 of this report offers a broad overview of CBO's extended baseline projections, as well as an examination of the consequences of large and growing federal debt. Though the chapter necessarily touches on CBO's projections of spending and revenues, those subjects are explored at greater length in the next four chapters. Specifically, Chapter 2 discusses spending for Social Security, the single largest program in the federal budget; Chapter 3 addresses spending for the major health care programs, which together represent a still larger fraction of federal spending; Chapter 4 deals with other federal noninterest spending; and Chapter 5 discusses revenues.

The report proceeds in Chapter 6 to examine the illustrative budgetary paths mentioned above. Chapter 7 discusses the uncertainty of CBO's projections. And at the close of the report are two appendixes: Appendix A about the economic and demographic projections underlying the extended baseline, and Appendix B about the changes in CBO's long-term projections since June 2015.