



COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Analysis of CBO's Updated Budget and Economic Outlook August 25, 2015

CHAIRMEN

MITCH DANIELS
LEON PANETTA
TIM PENNY

PRESIDENT

MAYA MACGUINEAS

DIRECTORS

BARRY ANDERSON
ERSKINE BOWLES
CHARLES BOWSHER
KENT CONRAD
DAN CRIPPEN
VIC FAZIO
WILLIS GRADISON
WILLIAM HOAGLAND
JIM JONES
LOU KERR
JIM KOLBE
DAVE MCCURDY
JAMES MCINTYRE, JR.
DAVID MINGE
MARNE OBERNAUER, JR.
JUNE O'NEILL
PAUL O'NEILL
BOB PACKWOOD
RUDOLPH PENNER
PETER PETERSON
ROBERT REISCHAUER
ALICE RIVLIN
CHARLES ROBB
MARTIN SABO
ALAN K. SIMPSON
JOHN SPRATT
CHARLIE STENHOLM
GENE STEUERLE
DAVID STOCKMAN
JOHN TANNER
TOM TAUKE
LAURA TYSON
GEORGE VOINOVICH
PAUL VOLCKER
CAROL COX WAIT
DAVID M. WALKER
JOSEPH WRIGHT, JR.

The Congressional Budget Office (CBO) today released its updated budget and economic projections for the coming decade, showing that while short-term deficits are down, the debt continues to grow unsustainably over the long term. The report focuses on a “current law” baseline, which assumes policymakers generally pay for passing any new or extended tax cuts or spending increases. Under this scenario, CBO shows the following:

- Deficits will fall to \$426 billion (2.4 percent of GDP) in 2015 and \$414 billion (2.2 percent of GDP) in 2016, but will grow from there with *trillion-dollar deficits returning by 2025*, when annual borrowing will total 3.7 percent of GDP.
- Debt held by the public will grow by nearly \$8 trillion between now and 2025, from over \$13 trillion today to \$21 trillion by 2025. As a share of GDP, debt will remain near its post-World War II record high of 74 percent through 2021, before rising to about 77 percent of GDP by 2025.
- Spending will grow from 20.6 percent of GDP in 2015 to 22.0 percent in 2025 while revenues will remain at about 18.3 percent of GDP.
- Interest spending represents the fastest growing major part of the budget, rising from \$218 billion (1.2 percent of GDP) in 2015 to \$755 billion (2.8 percent of GDP) by 2025. Spending on the major health and retirement programs will grow from 10 to 12 percent of GDP.
- CBO's projections are quite similar to those made in March, with lower interest rates improving the forecast but being largely offset by various technical changes and the recent permanent “doc fix” legislation.
- Extrapolating forward, we project debt would likely exceed the size of the economy by around 2040, and continue to grow thereafter.
- We project under the assumptions of CBO's Alternative Fiscal Scenario, where Congress extends various expired and expiring tax provisions and eliminates “sequestration,” debt would exceed 85 percent of GDP by 2025 and exceed the size of the economy by around 2030.

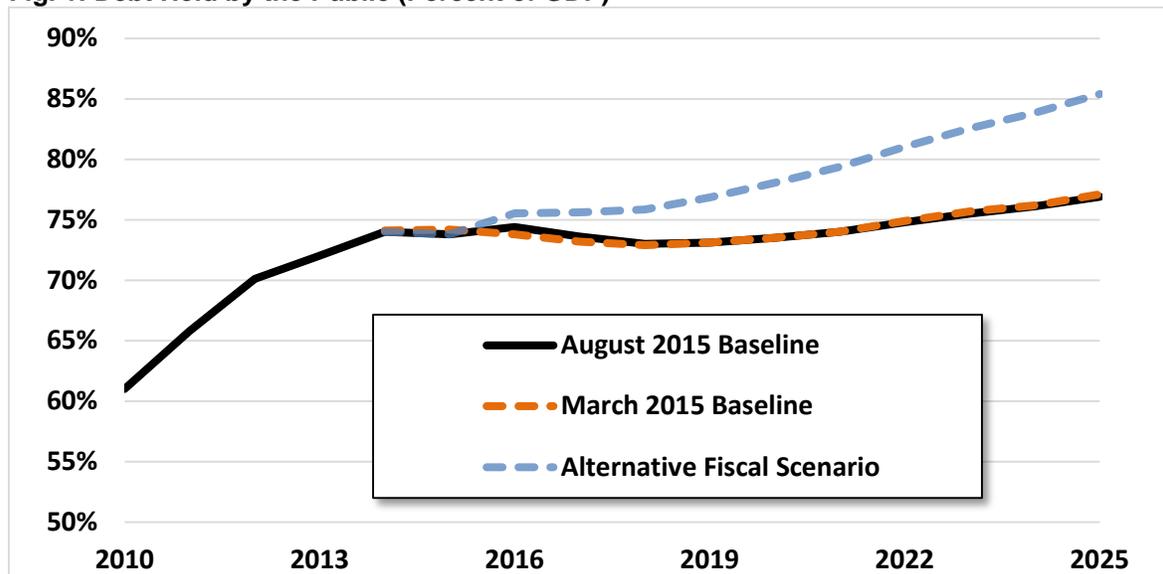
CBO shows an unsustainable fiscal outlook under current law, and an even more dangerous one if policymakers continue to act irresponsibly. Lawmakers will therefore need to strictly abide by pay-as-you-go rules *and* take steps to control the growth of entitlement spending, while enacting other tax and spending reforms to put debt on a downward path over the long run.



Budget Projections

Under current law, CBO expects the debt to remain relatively stable around its post-war record high levels for the next few years, before beginning to rise again late in the budget window. Specifically, CBO projects debt will fall from 73.8 percent of GDP in 2015 to 73.0 percent by 2018, then increase to 76.9 percent by 2025. Similarly, deficits will fall to a low of 2.1 percent of GDP in 2017, and rise thereafter to 3.7 percent by 2025. In dollar terms, deficits and debt will both rise substantially, from \$426 billion and \$13.2 trillion, respectively, in 2015 to \$1.0 trillion and \$21.0 trillion by 2025.

Fig. 1: Debt Held by the Public (Percent of GDP)



Source: CBO and CRFB calculations.

The return of rising deficits are driven by spending increasing faster than revenues. Total outlays will rise from 20.6 percent of GDP in 2015 to 22.0 percent in 2025. Much of this increase is due to the growth in entitlement programs resulting from health care cost growth, the aging population, and the coverage expansion under the Affordable Care Act. Social Security will grow from 4.9 percent of GDP in 2015 to 5.7 percent by 2025. Meanwhile, federal health spending will grow from 5.2 percent of GDP to 6.2 percent by 2025. The fastest growing portion of the budget, however, is interest payments; they will rise precipitously as a result of rising interest rates and growing debt levels. Net interest costs are projected to *double* as a share of the economy between 2015 and 2022 – increasing from 1.2 percent of GDP to 2.5 percent – and grow to 2.8 percent of GDP by 2025.

Revenue, meanwhile, will fail to keep up with spending as it stays largely constant as a percent of GDP over the 10-year window. CBO projects revenues to total 18.2 percent of GDP in 2015, 18.9 percent in 2016, 18.0 percent in 2021, and 18.3 percent in 2025. While individual income taxes will increase as a share of GDP over time – from 8.6 percent of GDP in 2015 to 9.5 percent by 2025 – other sources of revenue will fall or stay flat as a share of GDP to largely offset that gain.



Importantly, the gap between spending and revenue would be much worse if Congress continues to pass costly legislation without annual offsets. For example, if Congress extends expired and expiring tax provisions and enact an unpaid-for repeal of the automatic spending reductions often referred to as “the sequester,” spending would rise to 22.7 percent of GDP (as opposed to 22.0), and revenue would be 18.0 percent of GDP by 2025 (as opposed to 18.3), leaving a deficit of 4.7 percent of GDP and debt in excess of 85 percent of GDP.

Fig. 2: Comparing the August 2015 and Previous CBO Budget Projections

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Ten-Year*
REVENUES (Percent of GDP)												
Aug. 2015 Baseline	18.2%	18.9%	18.6%	18.3%	18.1%	18.1%	18.0%	18.1%	18.1%	18.2%	18.3%	18.3%
Mar. 2015 Baseline	17.7%	18.4%	18.3%	18.1%	18.1%	18.1%	18.1%	18.1%	18.2%	18.2%	18.3%	18.2%
Aug. 2015 AFS	18.2%	18.1%	18.2%	17.9%	17.8%	17.8%	17.7%	17.8%	17.8%	17.9%	18.0%	17.9%
OUTLAYS (Percent of GDP)												
Aug. 2015 Baseline	20.6%	21.1%	20.8%	20.6%	20.9%	21.2%	21.3%	21.7%	21.7%	21.6%	22.0%	21.3%
Mar. 2015 Baseline	20.4%	20.8%	20.6%	20.5%	20.9%	21.2%	21.4%	21.8%	21.8%	21.7%	22.1%	21.3%
Aug. 2015 AFS	20.6%	21.5%	21.2%	21.1%	21.6%	21.9%	22.0%	22.5%	22.5%	22.4%	22.7%	21.9%
DEFICITS (Percent of GDP)												
Aug. 2015 Baseline	2.4%	2.2%	2.1%	2.2%	2.8%	3.1%	3.3%	3.7%	3.6%	3.4%	3.7%	3.1%
Mar. 2015 Baseline	2.7%	2.4%	2.3%	2.4%	2.8%	3.1%	3.3%	3.7%	3.6%	3.4%	3.8%	3.1%
Aug. 2015 AFS	2.4%	3.4%	3.0%	3.1%	3.8%	4.1%	4.3%	4.7%	4.6%	4.5%	4.7%	4.1%
DEBT (Percent of GDP)												
Aug. 2015 Baseline	73.8%	74.4%	73.6%	73.0%	73.1%	73.5%	74.0%	74.8%	75.5%	76.1%	76.9%	N/A
Mar. 2015 Baseline	74.2%	73.8%	73.2%	72.9%	73.1%	73.5%	74.0%	74.9%	75.7%	76.2%	77.1%	N/A
Aug. 2015 AFS	73.8%	75.5%	75.6%	75.8%	76.9%	78.0%	79.4%	81.0%	82.6%	83.9%	85.4%	N/A
DEFICITS (in Billions of Dollars)												
Aug. 2015 Baseline	\$426	\$414	\$416	\$454	\$596	\$687	\$767	\$885	\$895	\$886	\$1,008	\$7,007
Mar. 2015 Baseline	\$486	\$455	\$455	\$489	\$607	\$696	\$763	\$900	\$907	\$899	\$1,038	\$7,209
Aug. 2015 AFS	\$426	\$630	\$590	\$640	\$813	\$911	\$1,001	\$1,133	\$1,160	\$1,168	\$1,290	\$9,335
DEBT (in Trillions of Dollars)												
Aug. 2015 Baseline	\$13.2	\$13.8	\$14.3	\$14.9	\$15.5	\$16.3	\$17.1	\$18.0	\$19.0	\$19.9	\$21.0	N/A
Mar. 2015 Baseline	\$13.4	\$13.9	\$14.4	\$15.0	\$15.7	\$16.4	\$17.2	\$18.2	\$19.1	\$20.1	\$21.2	N/A
Aug. 2015 AFS	\$13.2	\$14.0	\$14.7	\$15.4	\$16.3	\$17.3	\$18.4	\$19.5	\$20.8	\$22.0	\$23.3	N/A

*Ten-year figures reflect 2016-2025 period.

The current 10-year outlook is very similar to the one CBO produced in March, when debt was projected to reach 77.1 percent of GDP (instead of 76.9 percent) by 2025.

Economic Projections

CBO has updated its economic projections for the first time since its January report. Since January, near-term economic growth has slowed, oil prices have dropped, and a variety of other economic changes have taken hold. Importantly, CBO’s newest projections do not take into account the recent stock market downturn nor economic turmoil in China, which might indicate a more fragile economy than CBO expects. CBO also does not account for recent revisions in the National Income and Product Accounts (NIPA).

Based on data released prior to July 1, CBO has revised down their near-term GDP projections – projecting annual growth of 2.3 percent as opposed to the 2.9 percent it previously expected. Beyond this year, CBO expects slightly faster growth to what they



projected in January but from a lower base. On net, GDP in 2025 is projected to be essentially the same as CBO projected in January.

While GDP has grown more slowly than expected, the unemployment rate has continued to fall. CBO now projects the unemployment rate to fall from 5.3 percent today to 5.0 percent by 2017; previously CBO projected an unemployment rate of 5.3 percent in 2017. Beyond 2020, CBO projects an average unemployment rate of 5.3 percent based on its expectation that the economy will, on average, remain modestly below potential over the long run. Previously, they projected an average unemployment rate of 5.4 to 5.5 percent.

Fig. 3 CBO’s Economic Projections

Calendar Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Ten-Year
Real GDP Growth												
CBO (August 2015)	2.3%	3.0%	2.9%	2.3%	2.2%	2.2%	2.2%	2.2%	2.1%	2.1%	2.1%	2.3%
CBO (January 2015)	2.9%	3.0%	2.7%	2.2%	2.1%	2.2%	2.2%	2.2%	2.1%	2.1%	2.1%	2.3%
OMB (July 2015)	2.1%	3.0%	2.8%	2.7%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.5%
Blue Chip	3.1%	2.7%	N/A									
Federal Reserve	1.9%	2.6%	2.3%	N/A								
Inflation (CPI)												
CBO (August 2015)	0.1%	2.1%	2.3%	2.3%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%
CBO (January 2015)	1.1%	2.2%	2.3%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%
OMB (July 2015)	0.2%	1.9%	2.0%	2.1%	2.2%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.2%
Blue Chip	2.3%	2.3%	N/A									
Federal Reserve*	0.7%	1.8%	2.0%	N/A								
Unemployment Rate												
CBO (August 2015)	5.4%	5.1%	5.0%	5.0%	5.1%	5.2%	5.3%	5.3%	5.3%	5.3%	5.3%	5.2%
CBO (January 2015)	5.6%	5.4%	5.3%	5.4%	5.5%	5.5%	5.5%	5.5%	5.4%	5.4%	5.4%	5.4%
OMB (July 2015)	5.3%	4.9%	4.6%	4.6%	4.7%	4.8%	4.9%	4.9%	4.9%	4.9%	4.9%	4.8%
Blue Chip	5.1%	4.8%	N/A									
Federal Reserve	5.3%	5.0%	5.0%	N/A								
Interest Rates on 10-Year Treasury Notes												
CBO (August 2015)	2.3%	3.0%	3.7%	4.0%	4.2%	4.2%	4.3%	4.3%	4.3%	4.3%	4.3%	4.1%
CBO (January 2015)	2.8%	3.4%	3.9%	4.2%	4.5%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.4%
OMB (July 2015)	2.2%	2.9%	3.5%	3.9%	4.1%	4.3%	4.3%	4.4%	4.4%	4.4%	4.4%	4.1%
Blue Chip	3.3%	3.2%	N/A									

*Federal Reserve numbers reflect Personal Consumption Expenditures (PCE) index, which is on average 0.2 to 0.3 percentage points lower than the Consumer Price Index (CPI).

The most significant change in CBO’s economic projections relates to interest rates, which are now predicted to be somewhat lower in both the short term and longer term than CBO projected in January. The 10-year Treasury rate is expected to be 2.3 percent in 2015 instead of 2.8 percent due to lower observed rates so far this year, and is also now expected to stabilize at 4.3 percent rather than 4.6 percent in the longer run. The three-month T-bill rate is expected to ultimately reach 3.4 percent, the same as in previous projections, but to remain lower than previously projected over the next few years.

These lower interest rates translate into lower interest payments by the federal government, and thus reduce CBO’s 10-year deficit projections by about \$400 billion.



Changes in Budget Outlook

Between 2015 and 2025, CBO now expects deficits to be about \$260 billion lower than predicted in March.

The largest change results from lower interest rate projections, which reduce the amount that the federal government must pay to service the federal debt. These lower payments reduce projected deficits directly by over \$330 billion, and by roughly \$400 billion, including debt service and reduced interest payments to the Thrift Savings Plan.

Including these changes in interest payments, CBO estimates economic changes will reduce projected deficits by about \$770 billion through 2025. Over \$130 billion of this comes from Social Security, as CBO projects lower inflation will lead to no Social Security cost-of-living adjustment (COLA) this year. CBO also projects about \$50 billion more in revenue as a result of newer economic data – the net effect of lower projected corporate profits, higher projected wages and salaries, and increased remittances from the Federal Reserve.

Fig. 4: CBO’s Legislative, Economic, and Technical Changes from March 2015 Projections

	2015-2020	2015-2025
CBO March Deficits	\$3,187 billion	\$7,695 billion
Legislative Changes	+\$86 billion	+\$165 billion
Enactment of Permanent Doc Fix and Related Changes	\$82 billion	+\$141 billion
Trade, Highway, and Veterans’ Laws	-\$4 billion	-\$5 billion
Debt Service	+\$8 billion	+\$30 billion
Economic Changes	-\$322 billion	-\$770 billion
Lower Interest Rates	-\$140 billion	-\$332 billion
Changes in Social Security Spending	-\$63 billion	-\$133 billion
Lower Corporate Tax Revenue	+\$117 billion	+\$191 billion
Higher Income Tax, Payroll Tax, and other Revenue	-\$155 billion	-\$245 billion
Changes in Other Spending	-\$57 billion	-\$135 billion
Debt Service	-\$23 billion	-\$118 billion
Technical Changes	+\$41 billion	+\$342 billion
Changes in Revenue Projections	-\$29 billion	+\$166 billion
Changes in Health Care Projections	+\$92 billion	+\$170 billion
Changes in Social Security Projections	-\$14 billion	-\$32 billion
Changes in Other Spending	-\$11 billion	-\$11 billion
Debt Service	+\$3 billion	+\$49 billion
Total Changes	-\$195 billion	-\$262 billion
CBO August Deficits	-\$2,992 billion	-\$7,433 billion

Note: Positives/negatives reflect increases/decreases in deficits. Numbers may not add due to rounding

Offsetting about two-thirds of these economic gains are increased deficit projections due to technical and legislative changes. CBO projected deficits between 2015 and 2025 will be \$342 billion higher because of these technical changes – changes to program-specific data and forecasting methodologies. About half of this adjustment is as a result of higher



expected spending on Medicare and Medicaid, and the other half due to lower revenue. Other factors more or less cancel out.

Finally, legislative changes have added \$165 billion to deficits cumulatively through 2025, with nearly the entire balance due to the permanent doc fix legislation enacted in March. [At the time](#), we estimated the legislation would add about \$170 billion to the debt over 10 years and \$500 billion over 20 years, because only about one-third of its costs were offset. If policymakers fail to offset other pending legislation this fall, as much as [\\$2.5 trillion](#) could be further added to the debt.

Conclusion

CBO's latest baseline continues to show unsustainable federal finances – namely, increasing deficits and debt later this decade and beyond. Although deficits will fall to a post-recession low of \$426 billion this year, trillion-dollar deficits are projected to return by 2025 under CBO's current law projections. Those projections show debt remaining at around post-World War II record high levels for several years and growing rapidly thereafter from 73 percent of GDP in 2018 to almost 77 percent by 2025.

These projections could understate the case because they assume Congress will fully offset (on an annual basis) expired and expiring tax provisions, increases in sequester-level caps, or any other policy changes they pursue. Assuming this does not occur, based on our calculations of the assumptions in CBO's Alternative Fiscal Scenario, trillion-dollar deficits could return as soon as 2021 and debt could reach over 85 percent of GDP by 2025.

These numbers highlight the importance of not only abiding by PAYGO but pursuing sensible spending reductions, identifying new revenues, and slowing the rapid growth of health and retirement programs.

The gathering fiscal storm over the next few months offers policymakers the opportunity to make such changes. Lawmakers should use the exhaustion of the Highway Trust Fund, return of sequester-level caps, expired tax extenders, and need to raise or suspend the debt ceiling as opportunities to determine how to pay for our infrastructure, replace near-term discretionary cuts with long-term entitlement reforms, put in place a better, more pro-growth tax code, and slow the growth of the debt over the long term.

This moment represents one of the last political opportunities to pursue meaningful fiscal improvements before the next President takes office in 2017. For the sake of economic growth and the well-being of future generations, our leaders should pursue this opportunity.