Committee for a Responsible Federal Budget

The 2015 CBO Long-Term Budget Outlook
June 16, 2015

The Congressional Budget Office (CBO) released its 2015 Long-Term Budget Outlook today, outlining the projected budget picture for the next 75 years. The report predicts debt as a share of Gross Domestic Product (GDP) will remain roughly stable at its current post-war record high levels through 2020, before resuming an unsustainable growth rate over the long term.

CBO's Extended Baseline Scenario, which assumes lawmakers abide by current law, shows debt held by the public rising from 74 percent of GDP in 2015 to 103 percent by 2040, 137 percent by 2065, and 181 percent by 2090.

Under the Alternative Fiscal Scenario (AFS) – which assumes policymakers repeal cuts under sequestration, make expired and expiring tax cuts permanent, prevent revenue from rising continuously as a share of GDP, and ultimately restore discretionary and certain other spending to historical levels – CBO projects debt to rise to 156 percent of GDP by 2040. By our calculations, it would further rise to nearly 600 percent of GDP by 2090.

Fig. 1: Projections under CBO's Long-Term Scenarios (% of GDP)

	2000	2015	2025	2040	2065	2090
Extended Baseline Scenario (without economic feedback)						
Spending	17.6%	20.5%	22.2%	25.3%	28.7%	33.2%
Revenue	19.9%	17.7%	18.3%	19.4%	21.6%	23.8%
Deficit	-2.3%	2.7%	3.8%	5.9%	7.1%	9.5%
Debt	**34%**	**74%**	**78%**	**103%**	**137%**	**181%**
Alternative Fiscal Scenario (without economic feedback)*						
Spending	17.6%	20.5%	22.9%	30.4%	40.5%	54.3%
Revenue	19.9%	17.5%	18.1%	18.1%	18.1%	18.1%
Deficit	-2.3%	3.0%	4.9%	12.3%	22.4%	36.2%
Debt	**34%**	**74%**	**86%**	**156%**	**~340%**	**~600%**

*2065 and 2090 numbers for the AFS are rough CRFB extrapolations.

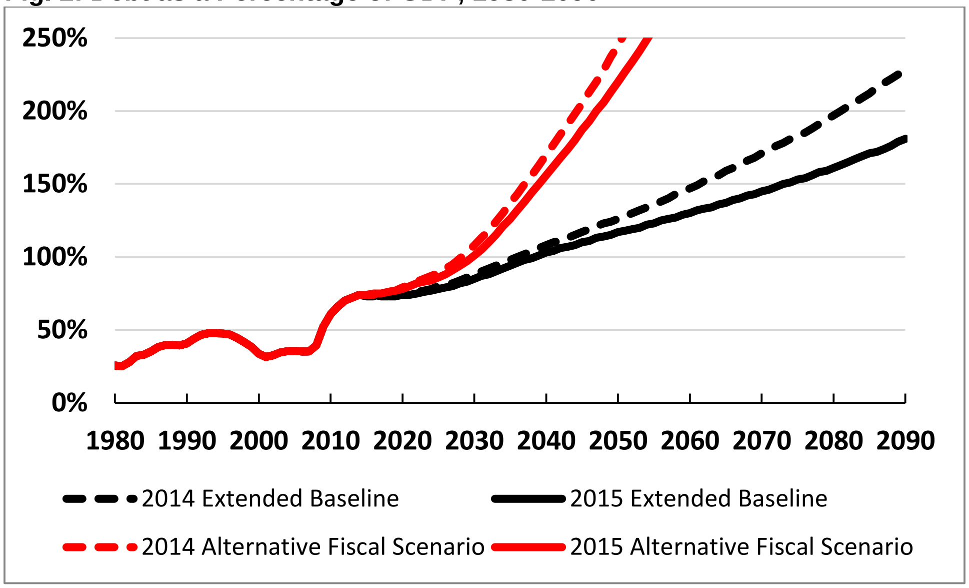
The combination of deficit reduction legislation earlier this decade, low interest rates, and a slowdown in health care cost growth have certainly improved the long-term fiscal outlook, yet debt remains at record-high levels and is set to continue growing unsustainably with no end in sight. If policymakers continue to act irresponsibly – as they did with the "doc fix" legislation earlier this year – the situation will be far worse.

CBO's projections demonstrate why instead of adding to the debt, policymakers should act promptly to put the debt ratio on a downward path.

Long-Term Debt and Deficit Projections

While CBO projects debt to remain around current post-war record high levels of 74 percent of GDP through 2020, the retirement of the baby boom population in concert with rising interest rates and growing health care costs is expected to significantly increase the debt thereafter. Under CBO's Extended Baseline Scenario, debt is projected to reach 78 percent of GDP by 2025, 103 percent by 2040, and 181 percent by 2090.

Fig. 2: Debt as a Percentage of GDP, 1980-2090



This rising debt is the byproduct of growing budget deficits. CBO projects that deficits will temporarily dip down to a low of 2.4 percent of GDP in 2017 before rising to 3.8 percent by 2025, the year that $1 trillion deficits return permanently. Long-term projections show deficits more than doubling from current levels up to 5.9 percent of GDP by 2040 and reaching a massive 9.5 percent by 2090.

Projected deficit and debt levels are clearly on an unsustainable path. As CBO explains,

> "The high and rising amounts of federal debt held by the public that CBO projects for the coming decades under the extended baseline would have significant negative consequences for the economy in the long term and would impose significant constraints on future budget policy. In particular, the projected amounts of debt would reduce the total amounts of national saving and income in the long term; increase the government's interest payments, thereby putting more pressure on the rest of the budget; limit lawmakers' flexibility to respond to unforeseen events; and increase the likelihood of a fiscal crisis."

Compared to last year's long-term outlook, this year's projections represent a slight improvement in the long-term fiscal situation, more so over the very long-run, largely due to lower estimates for long-term interest rates.

However, CBO's Extended Baseline Scenario represents a fairly optimistic view of lawmakers' decisions over the long term. It assumes that Congress maintains the sequester without resorting to gimmicks, allows a host of frequently-extended tax breaks to expire or remain expired, allows revenue to rise continuously as a share of GDP, and allows discretionary spending to continue falling below its historical low as a share of GDP.

CBO's Alternate Fiscal Scenario (AFS) shows a much bleaker picture. The AFS illustrates how debt and deficits will shape up in the long term if lawmakers address a series of issues in a fiscally-irresponsible manner – as they often have in the past. It assumes that lawmakers will fully repeal the sequester, continue extending expiring and expired tax provisions, prevent increases in revenue relative to GDP after 2025, and maintain non-health care, non-Social Security spending at or near their historical averages. Under the AFS, CBO estimates that debt will rise from 74 percent of GDP today to 86 percent of GDP by 2025 and 156 percent by 2040. By our estimates, debt would reach roughly 600 percent of GDP by 2090.

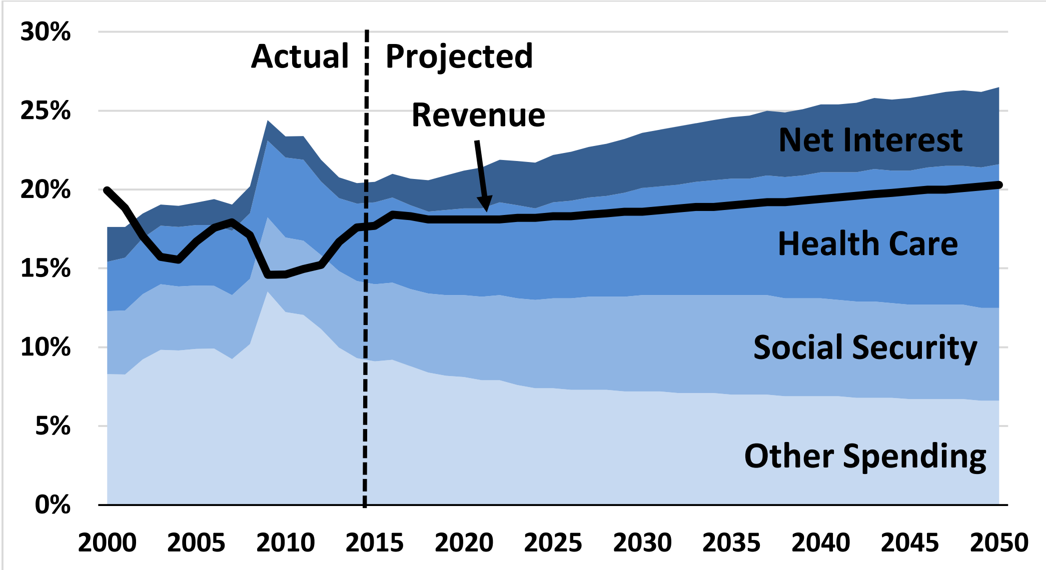
Long-Term Spending and Revenue Projections

Growing long-term deficits and debt result from spending growing faster than revenue, particularly spending on Social Security, health care programs, and interest on the debt.

CBO projects that total spending will grow from 20.5 percent of GDP in 2015 to 22.2 percent in 2025, 25.3 percent in 2040, and 33.2 percent of GDP in 2090, compared to the 50-year historical average of 20.1 percent.

CBO projects revenues to grow as well, but much more slowly and from a lower starting point. Revenues will hover around 18 percent of GDP for the next ten years before slowly growing to 19.4 percent of GDP in 2040, 21.6 percent in 2065, and 23.8 percent in 2090, compared to the historical average of 17.4 percent.

Fig. 3: Composition of Spending and Revenue as a Percent of GDP



Despite the recent slowdown in health care spending growth, federal health costs are projected to rise from 5.2 percent of GDP in 2015 to 6.1 percent in 2025, 8 percent in 2040, and 13.3 percent in 2090. Growth in the next few decades is particularly concentrated in Medicare due to the retirement of the baby boomers and aging of the population.

The same demographic trends are also driving up Social Security spending, which has already grown from 4 percent of GDP in 2000 to 4.9 percent today, and is projected to further grow to 5.7 percent by 2025 and 6.2 percent by 2040.

Rising interest rates, combined with growing debt levels, will also cause interest on the debt to balloon. Under current law, interest spending as a share of GDP will double within six years, and double again by the mid-2050s. Specifically, interest costs will grow from 1.3 percent of GDP today to 3 percent of GDP in 2025 to 4.3 percent by 2040, and 7.5 percent by 2090. In 2090, interest spending will consume nearly one third of revenue, compared to only 7 percent today.

The Outlook for Major Trust Funds

According to CBO, a number of major federal trust funds face exhaustion in the next decade and a half or so. The Highway Trust Fund is on course to be depleted later this summer and the Social Security Disability Insurance Trust Fund within two years. In 2031, the Social Security Old-Age and Survivors' Insurance (OASI) Trust Fund will follow suit, and Medicare's Hospital Insurance Trust Fund is expected to run out of money at a similar time.

On a combined basis, CBO projects the OASDI Trust Fund will be depleted in 2029, at which point benefits would be automatically cut by 28 percent. Avoiding insolvency over the next 75 years will require immediate adjustments equal to 4.4 percent of payroll (1.4 percent of GDP), meaning it would take a 4.4 percentage point increase in the payroll tax rate, an equivalent amount of spending cuts, or some combination thereof to achieve solvency.

The same demographic factors driving up Social Security spending, along with continued growth in health costs, will also drive up Medicare spending significantly over the long term. Because Medicare Part A (Hospital Insurance) is funded in a manner similar to Social Security, growth in its costs will lead to its insolvency a few years after 2025, although CBO does not provide specific figures for the Medicare Trust Fund.

In all cases, note that for the purposes of their overall budget numbers, CBO assumes that spending continues as scheduled regardless of trust fund reserves, in effect assuming transfers to each trust fund as necessary.

The Economic Effects of Growing Debt

Underlying CBO's budget projections are a set of benchmark long-term economic projections that hold steady over time. However, CBO also estimates the economic effects of the high and growing debt it projects, showing that such debt will crowd out productive investment and thus slow economic growth.

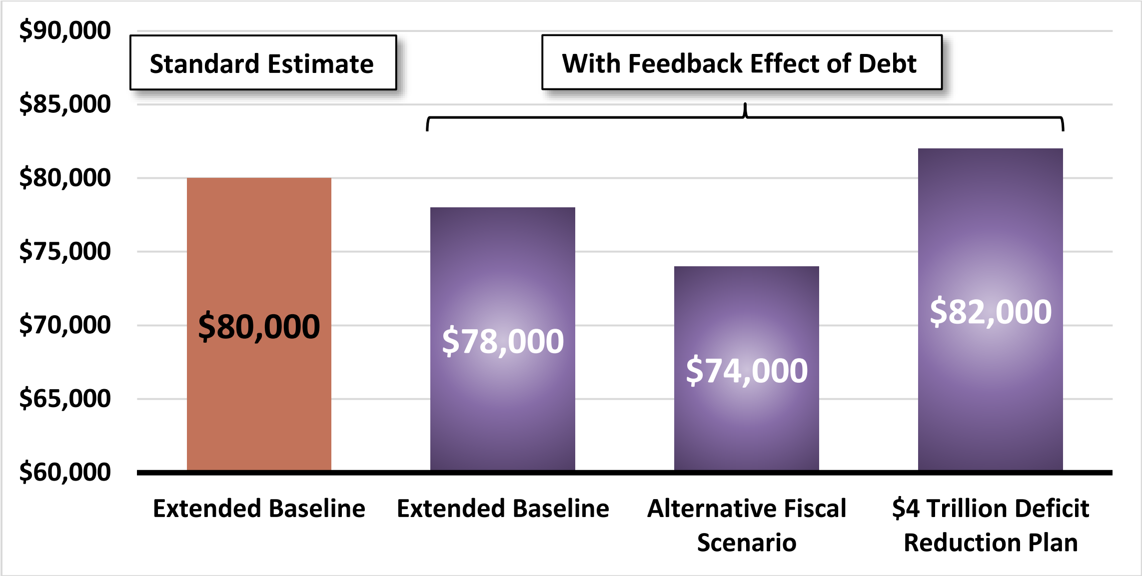
CBO estimates that the accumulation of debt projected under the Extended Baseline would reduce the size of the economy by 2 percent by 2040, result in interest rates that are one-quarter of a percentage point higher, and reduce per-capita Gross National Product (GNP) by $2,000, which is another measure of the size of the economy per person. This reduced economic growth would also have fiscal effects, increasing debt by 4 percentage points of GDP in 2040, from 103 percent to 107 percent of GDP.

The economic effects of debt under the Alternative Fiscal Scenario look even worse, with an *additional* 5 percent (7 percent total) reduction in the size of the economy and another three-quarters percentage point (1 percentage point total) rise in interest rates. Moreover, adding to the debt in this manner would reduce per-capita GNP by an additional $4,000 ($6,000 total) within 25 years. Debt is also projected to be 19 percentage points of GDP higher under the AFS when the economic effects are included, raising projected debt in 2040 from 156 percent to 175 percent of GDP.

Beyond 2040, the negative consequences of high and rising debt would likely continue to grow larger over time.

CBO also shows the flip side: how deficit reduction can benefit economic growth. It estimates that by 2040, a $4 trillion deficit reduction plan would increase the size of the economy by 5 percent relative to current law with economic feedback, lower interest rates by about two-thirds of a percentage point, and raise per-capita GNP by $4,000. As a result of the deficit reduction and, to a lesser extent, the economic benefits, debt under this scenario would fall to 39 percent of GDP by 2040, near average historical levels.

Fig. 4: Effect of Different Fiscal Paths on Per-Capita GNP in 2040 (Percent Change)



Conclusion

CBO's long-term outlook continues to show a clearly unsustainable long-term picture for the federal government's finances. Even under the Extended Baseline Scenario, which assumes that lawmakers stick to the deficit reduction they have enacted and do not continue to extend many policies they have extended in the past or otherwise increase deficits, debt would rise continuously as a share of GDP after 2020. And the rise in debt would be even greater if lawmakers extend temporary policies without offsets and enact deficit-increasing policies as in the Alternative Fiscal Scenario. Adding urgency to the situation is the projected insolvency of the Medicare and Social Security trust funds (on a combined basis) within 15 years.

Lawmakers should start by making sure not to worsen the current debt situation over the next few years, but that is clearly not enough to put debt on a sustainable path. Truly fixing our debt will require significant reforms to entitlement programs and the tax code to bring spending and revenue much more closely in line. The sooner they act, the smaller the changes will need to be and the more time it will give people to adjust to the new policies. Waiting will only make the choices more painful and limit budgetary flexibility as debt continues to grow.

As CBO's long-term outlook shows, this country's debt problems are far from solved.