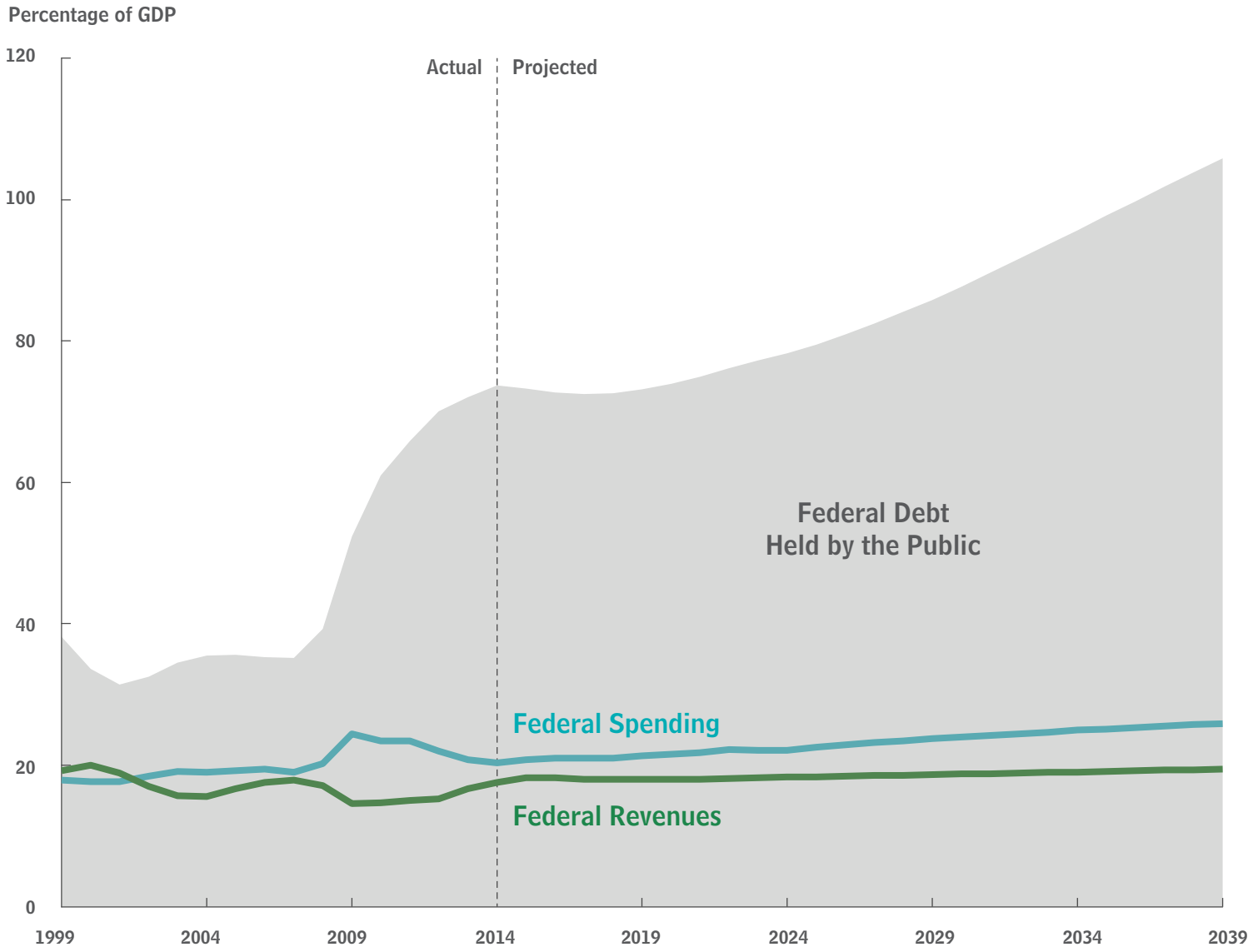
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

CBO

The 2014 Long-Term Budget Outlook



JULY 2014

Notes

CBO's long-term projections extend beyond the usual 10-year budget window to focus on the 25-year period ending in 2039. They generally reflect current law, following the agency's April 2014 baseline budget projections through 2024 and then extending the baseline concept into later years; hence, they constitute the agency's extended baseline. The baseline and the extended baseline are not meant to be predictions of future budgetary outcomes; rather, they represent CBO's best assessment of how the economy and other factors would affect revenues and spending if current law generally remained unchanged. Thus, they serve as benchmarks for measuring the budgetary effects of proposed changes in law regarding federal revenues or spending.

Unless otherwise indicated, the years referred to in most of this report are federal fiscal years (which run from October 1 to September 30). In Chapters 6 and 7, budgetary values, such as the ratio of debt or deficits to gross domestic product (GDP), are presented on a fiscal year basis, whereas economic variables, such as gross national product (GNP) or interest rates, are presented on a calendar year basis.

Numbers in the text, tables, and figures of this report may not add up to totals because of rounding. Also, some values are expressed as fractions to indicate numbers rounded to amounts greater than a tenth of a percentage point.

As referred to in this report, the Affordable Care Act comprises the Patient Protection and Affordable Care Act and the health care provisions of the Health Care and Education Reconciliation Act of 2010, as affected by subsequent judicial decisions, statutory changes, and administrative actions.

The figure on the cover shows federal revenues, spending, and debt held by the public under CBO's extended baseline.

Additional data—including the data underlying the figures in this report, supplemental budget projections, and the demographic and economic variables underlying those projections—are posted along with the report on CBO's website (www.cbo.gov/publication/45471).

Pub. No. 4933

Summary

Between 2009 and 2012, the federal government recorded the largest budget deficits relative to the size of the economy since 1946, causing its debt to soar. The total amount of federal debt held by the public is now equivalent to about 74 percent of the economy's annual output, or gross domestic product (GDP)—a higher percentage than at any point in U.S. history except a brief period around World War II and almost twice the percentage at the end of 2008.

If current laws remained generally unchanged in the future, federal debt held by the public would decline slightly relative to GDP over the next few years, the Congressional Budget Office (CBO) projects. After that, however, growing budget deficits would push debt back to and above its current high level. Twenty-five years from now, in 2039, federal debt held by the public would exceed 100 percent of GDP, CBO projects. Moreover, debt would be on an upward path relative to the size of the economy, a trend that could not be sustained indefinitely.

What Is the Outlook for the Budget in the Next 10 Years?

The economy's gradual recovery from the 2007–2009 recession, the waning budgetary effects of policies enacted in response to the weak economy, and other changes to tax and spending laws have caused the deficit to shrink this year to its smallest size since 2007: roughly 3 percent of GDP, compared with a peak of almost 10 percent in 2009. If current laws governing taxes and spending stayed generally the same—an assumption that underlies CBO's 10-year baseline budget projections—the anticipated further strengthening of the economy and constraints on federal spending built into law would keep deficits between 2½ percent and 3 percent of GDP from 2015 through 2018, CBO estimates.[1]

In succeeding years, however, deficits would become notably larger under current law. The pressures stemming from an aging population, rising health care costs, and an expansion of federal subsidies for health insurance would cause spending for some of the largest federal programs to increase relative to GDP. Moreover, CBO expects interest rates to rebound in coming years from their current unusually low levels, raising the government's interest payments. That additional spending would contribute to larger budget deficits—equaling close to 4 percent of GDP—toward the end of the 10-year period spanned by the baseline, CBO anticipates. Altogether, deficits during that 2015–2024 period would total about $7.6 trillion.

With deficits expected to remain close to their current percentage of GDP for the next few years, federal debt held by the public is projected to stay between 72 percent and 74 percent of GDP from 2015 through 2020. Thereafter, larger deficits would boost debt to 78 percent of GDP by the end of 2024.

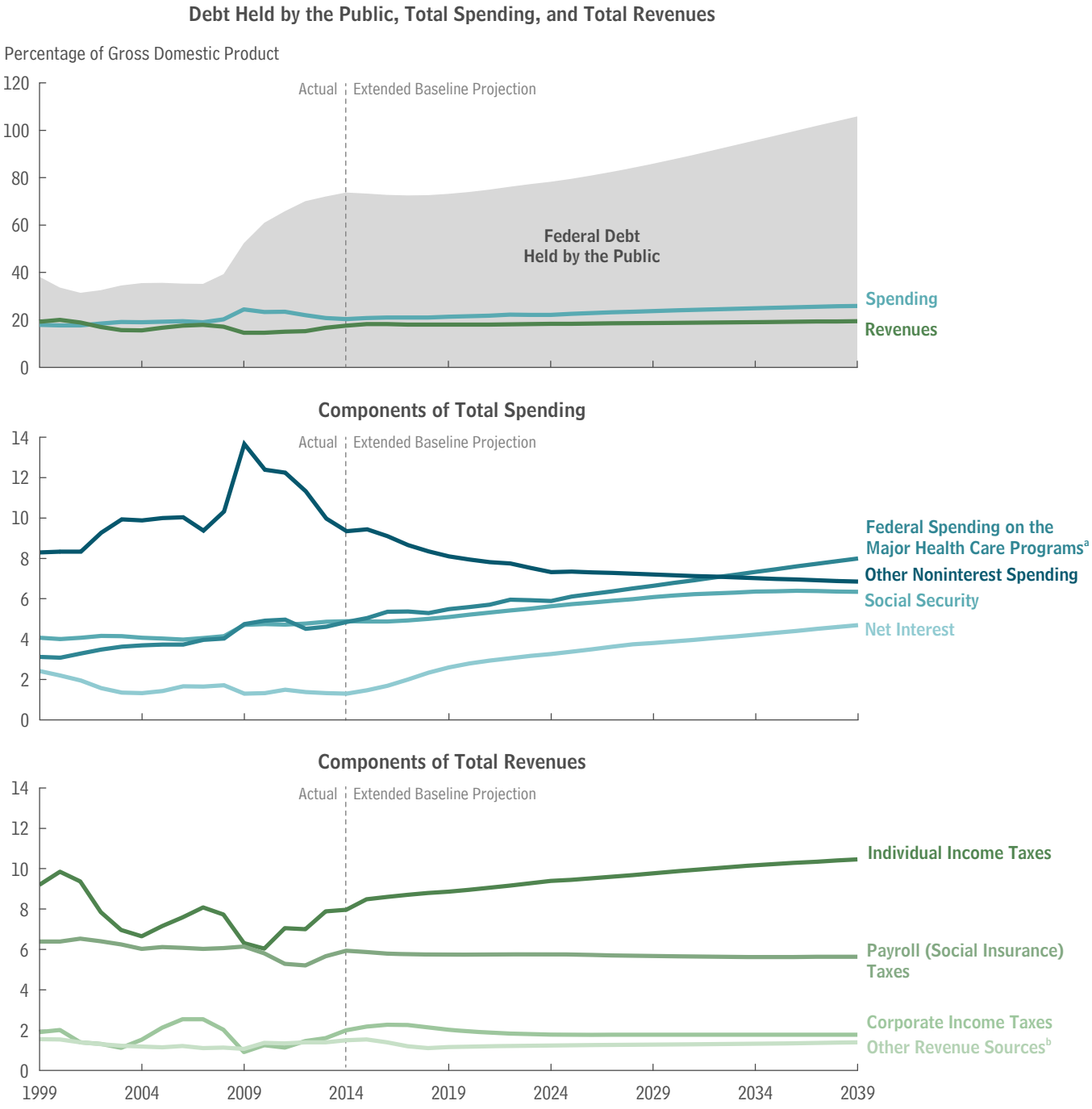
What Is the Outlook for the Budget in the Long Term?

CBO has extrapolated its baseline projections through 2039 (and, with even greater uncertainty, through later decades) by producing an extended baseline that generally reflects current law. The extended baseline projections show a substantial imbalance in the federal budget over the long term, with revenues falling well short of spending (see Summary Figure 1). As a result, budget deficits are projected to rise steadily and, by 2039, to push federal debt held by the public up to a percentage

1. For details about CBO's most recent 10-year baseline, see Congressional Budget Office, *Updated Budget Projections: 2014 to 2024* (April 2014), www.cbo.gov/publication/45229. In this summary, values for spending, revenues, and deficits as a percentage of GDP have been rounded to the nearest one-half percent.

Summary Figure 1.

Federal Debt, Spending, and Revenues



Source: Congressional Budget Office.

Note: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2024 and then extending the baseline concept for the rest of the long-term projection period. These projections do not reflect the economic effects of the policies underlying the extended baseline. (For an analysis of those effects and their impact on debt, see Chapter 6.)

a. Consists of spending on Medicare (net of offsetting receipts), Medicaid, the Children's Health Insurance Program, and subsidies offered through health insurance exchanges.

b. Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

of GDP seen only once before in U.S. history (just after World War II). The harm that such growing debt would cause to the economy is not factored into CBO's detailed long-term projections but is considered in further analysis presented in this report.

Federal spending would increase to 26 percent of GDP by 2039 under the assumptions of the extended baseline, CBO projects, compared with 21 percent in 2013 and an average of 20½ percent over the past 40 years. That increase reflects the following projected paths for various types of federal spending if current laws remained generally unchanged:

- Federal spending for Social Security and the government's major health care programs—Medicare, Medicaid, the Children's Health Insurance Program, and subsidies for health insurance purchased through the exchanges created under the Affordable Care Act—would rise sharply, to a total of 14 percent of GDP by 2039, twice the 7 percent average seen over the past 40 years. That boost in spending is expected to occur because of the aging of the population, growth in per capita spending on health care, and an expansion of federal health care programs.

- The government's net interest payments would grow to 4½ percent of GDP by 2039, compared with an average of 2 percent over the past four decades. Net interest payments would be larger than that average mainly because federal debt would be much larger.

- In contrast, total spending on everything other than Social Security, the major health care programs, and net interest payments would decline to 7 percent of GDP by 2039—well below the 11 percent average of the past 40 years and a smaller share of the economy than at any time since the late 1930s.

Federal revenues would also increase relative to GDP under current law, but much more slowly than federal spending. Revenues would equal 19½ percent of GDP by 2039, CBO projects, compared with an average of 17½ percent over the past four decades. In the next 10 years, revenues are projected to rise to 18½ percent of GDP, from 16½ percent last year, reflecting structural features of the tax system and the ongoing economic recovery. After 2024, revenues would increase gradually relative to GDP under the assumptions of the extended baseline, mainly because people's income is expected to grow faster than the rate of inflation, pushing more income into higher tax brackets over time.

The gap between federal spending and revenues would widen after 2015 under the assumptions of the extended baseline, CBO projects. By 2039, the deficit would equal 6½ percent of GDP, larger than in any year between 1947 and 2008, and federal debt held by the public would reach 106 percent of GDP, more than in any year except 1946—even without factoring in the economic effects of growing debt.

Moreover, the harmful effects that such large debt would have on the economy would worsen the budget outlook. Under current law, the increase in debt relative to the size of the economy, combined with a gradual increase in marginal tax rates (the rates that would apply to an additional dollar of income), would reduce economic output and raise interest rates, compared with the benchmark economic projections that CBO used in producing the extended baseline. Those economic effects in turn would lead to lower federal revenues and higher interest payments on the debt. With those effects included, federal debt held by the public under the extended baseline would rise to 111 percent of GDP in 2039.

Beyond the next 25 years, the pressures caused by rising budget deficits and debt would become even greater unless laws governing taxes and spending were changed. With deficits as big as the ones that CBO projects, federal debt would be growing faster than GDP, a path that would ultimately be unsustainable.

What Consequences Would a Large and Growing Federal Debt Have?

How long the nation could sustain such growth in federal debt is impossible to predict with any confidence. At some point, investors would begin to doubt the government's willingness or ability to pay its debt obligations, which would require the government to pay much higher interest costs to borrow money. Such a fiscal crisis would present policymakers with extremely difficult choices and would probably have a substantial negative impact on the country.

Even before that point was reached, the high and rising amount of federal debt that CBO projects under the extended baseline would have significant negative consequences for both the economy and the federal budget:

- The large amount of federal borrowing would draw money away from private investment in productive capital in the long term, because the portion of people's savings used to buy government securities would not be available to finance private investment. The result would be a smaller stock of capital and lower output and income than would otherwise be the case, all else being equal. (Despite those reductions, the continued growth of productivity would make output and income per person, adjusted for inflation, higher in the future than they are now.)

- Federal spending on interest payments would rise, thus requiring higher taxes, lower spending for benefits and services, or both to achieve any chosen targets for budget deficits and debt.

- The large amount of debt would restrict policymakers' ability to use tax and spending policies to respond to unexpected challenges, such as economic downturns or financial crises. As a result, those challenges would tend to have larger negative effects on the economy and on people's well-being than they would otherwise. The large amount of debt could also compromise national security by constraining defense spending in times of international crisis or by limiting the country's ability to prepare for such a crisis.

What Effects Would Alternative Fiscal Policies Have?

Most of the projections in this report are based on the assumption that laws governing federal taxes and spending will remain generally the same over time—not because CBO expects that to occur but because the budgetary and economic implications of current law are a useful benchmark for policymakers when they consider changing laws. If tax and spending policies differed significantly from those specified in current law, budgetary and economic outcomes could differ substantially as well. To illustrate some possible differences, CBO analyzed the effects of three additional sets of fiscal policies.

Under one set of alternative policies—referred to as the extended alternative fiscal scenario—certain policies that are now in place but are scheduled to change under current law would be continued, and some provisions of law that might be difficult to sustain for a long period would be modified. With those changes to current law, deficits excluding interest payments would be about $2 trillion higher over the next decade than in CBO's baseline; in subsequent years, such deficits would exceed those projected in the extended baseline by rapidly growing amounts. The harmful effects on the economy from the resulting increase in federal debt would be partly offset by the lower marginal tax rates that would be in place under that scenario. Nevertheless, in the long term, economic output would be lower and interest rates would be higher under that set of policies than under the extended baseline. With those economic changes incorporated, federal debt held by the public would exceed 180 percent of GDP in 2039, CBO projects.

Under a different scenario, budget deficits would be smaller than those projected under current law: Deficit reduction would be phased in such that deficits excluding interest payments would be a total of $2 trillion lower through 2024 than in CBO's baseline, and the amount of deficit reduction as a percentage of GDP in 2024 would be continued in later years. In that case, output would be higher and interest rates would be lower in the long term than under the extended baseline. Factoring in the effects of those economic changes on the budget, CBO projects that federal debt held by the public would equal about 75 percent of GDP in 2039, close to its percentage in 2013.

Under yet another scenario, with twice as much deficit reduction—a total decrease of $4 trillion in deficits excluding interest payments through 2024—CBO projects that federal debt held by the public would fall to 42 percent of GDP in 2039. That percentage would be slightly above the ratio of debt to GDP in 2008 and the average ratio over the past 40 years (both 39 percent). As in the preceding scenario, output would be higher and interest rates would be lower in the long term than under the extended baseline.

Such alternative fiscal policies would have differing effects on the economy in the short term as well as in the long term, reflecting the short-term impact of tax and spending policies on the demand for goods and services. The spending increases and tax reductions in the alternative fiscal scenario (relative to what would happen under current law) would increase the demand for goods and services and thereby raise output and employment in the next few years. The deficit reduction under the other scenarios, by contrast, would decrease the demand for goods and services and thus reduce output and employment in the next few years.

How Uncertain Are the Long-Term Budget Projections?

Even if future tax and spending policies match what is specified in current law, budgetary outcomes will undoubtedly differ from CBO's projections because of unexpected changes in the economy, demographics, and other factors. To illustrate the uncertainty of its projections, CBO examined how altering its estimates of future mortality rates, productivity, interest rates on federal debt, and federal spending on health care would affect the projections in the extended baseline. For that purpose, CBO projected budgetary outcomes with those factors varying by amounts that are based on their past variation as well as on CBO's consideration of possible future developments. Those estimates show the following:

- In cases in which only one of those factors varies from the values used for the extended baseline, CBO's projections of federal debt held by the public in 2039 range from about 90 percent of GDP to 135 percent, compared with 111 percent under the extended baseline including the economic effects of future fiscal policies.

- In a case in which all four factors vary simultaneously in a way that raises projected deficits, but they vary only half as much as in the individual cases, federal debt is projected to reach about 160 percent of GDP in 2039. Conversely, in a case in which all four factors vary in a way that lowers deficits but, again, vary by only half as much as in the individual cases, debt in 2039 is projected to equal 75 percent of GDP, about what it is now.

Those calculations do not cover the full range of possible outcomes, nor do they address other sources of uncertainty in the budget projections, such as the risk of an economic depression or major war or the possibility of unexpected changes in birth rates, immigration, or labor force participation. Nonetheless, CBO's analysis shows that the main implication of the central estimates in this report applies under a wide range of possible values for some key factors that influence federal spending and revenues. That implication is that if current laws remained generally unchanged, federal debt, which is already high by historical standards, would be at least as high and probably much higher 25 years from now.

What Choices Do Policymakers Have?

The unsustainable nature of the federal tax and spending policies specified in current law presents lawmakers and the public with difficult choices. Unless substantial changes are made to the major health care programs and Social Security, spending for those programs will equal a much larger percentage of GDP in the future than it has in the past. At the same time, under current law, spending for all other federal benefits and services would be on track to make up a smaller percentage of GDP by 2024 than at any point in more than 70 years. Federal revenues would also represent a larger percentage of GDP in the future than they have, on average, in the past few decades. Even so, spending would soon start to outpace revenues by increasing amounts (relative to GDP), generating rising budget deficits. As a result, federal debt held by the public is projected to grow faster than the economy starting a few years from now, and because debt is already unusually high relative to GDP, further increases could be especially harmful.

To put the federal budget on a sustainable path for the long term, lawmakers would have to make significant changes to tax and spending policies: reducing spending for large benefit programs below the projected levels, letting revenues rise more than they would under current law, or adopting some combination of those approaches.

The size of such changes would depend on the amount of federal debt that lawmakers considered appropriate. For example, lawmakers might set a goal of bringing debt held by the public back down to the average percentage of GDP seen over the past 40 years—39 percent. Meeting that goal by 2039 would require a combination of increases in revenues and cuts in noninterest spending, relative to current law, totaling 2.6 percent of GDP in each year beginning in 2015 (without accounting for the economic effects of the reduction in debt or of the policy changes that might be used to achieve it); in 2015, 2.6 percent of GDP would equal about $465 billion. If those changes came entirely from revenues, they would represent an increase of 14 percent from the revenues projected for the 2015–2039 period under the extended baseline. If the changes came entirely from noninterest spending, they would represent a cut of 13 percent from the amount of noninterest spending projected for that period. A similar level of debt in 2039 would result under the third scenario discussed above (a $4 trillion total reduction in deficits excluding interest payments through

2024, with the amount of deficit reduction in 2024 as a percentage of GDP continuing in later years).

In deciding how quickly to carry out policies to put federal debt on a sustainable path, lawmakers face trade-offs:

- The sooner significant deficit reduction was implemented, the smaller the government's accumulated debt would be, the smaller policy changes would need to be to achieve a particular long-term outcome, and the less uncertainty there would be about what policies would be adopted. However, if lawmakers implemented spending cuts or tax increases quickly, people would have little time to plan and adjust to the policy changes, and those changes would weaken the economic expansion during the next few years.

- Reductions in federal spending or increases in taxes that were implemented several years from now would have a smaller effect on output and employment in the short term. However, waiting for some time before reducing federal spending or increasing taxes would result in a greater accumulation of debt, which would represent a greater drag on output and income in the long term and would increase the size of the policy changes needed to reach any chosen target for debt.

If lawmakers wanted to minimize both the short-term economic costs of reducing deficits quickly and the longer-term costs of running large deficits, they could enact a combination of changes in tax and spending policies that increased the deficit in the next few years relative to what it would be under current law but reduced the deficit thereafter.

Even if policy changes to shrink deficits in the long term were not implemented for several years, making decisions about them sooner rather than later would offer significant advantages. If decisions were reached sooner, people would have more time to alter their behavior to be prepared for the time when the changes would be carried out. In addition, decisions about policy changes that would reduce future debt relative to the amounts projected under current law would tend to increase output and employment in the next few years by holding down longer-term interest rates, reducing uncertainty, and enhancing businesses' and consumers' confidence.

CHAPTER

1

The Long-Term Outlook for the Federal Budget

Again this year, the federal budget deficit is shrinking noticeably, and the Congressional Budget Office (CBO) projects that the deficit will remain roughly stable as a share of the nation's output—its gross domestic product (GDP)—for the next several years if current laws remain generally unchanged. Federal debt held by the public also will be roughly stable relative to the size of the economy for several years, according to CBO's projections.

The long-term budget outlook is much less positive, however. The combination of three factors—the aging of the population, growth in per capita spending on health care, and an expansion of federal subsidies for health insurance—is expected to significantly boost the government's spending for Social Security and major health care programs. Barring changes to current law, that additional spending would contribute to larger budget deficits toward the end of the 10-year period that runs from 2015 to 2024, causing federal debt, which is already quite large relative to the size of the economy, to swell even more. In this report, CBO presents its projections of federal outlays, revenues, deficits, and debt for the next few decades, and it discusses the possible consequences of the projected budgetary outcomes.

The Budget Outlook for the Next 10 Years

The budget deficit is on track to fall in 2014 to its smallest percentage of the economy since 2008: CBO estimates that the deficit will be roughly 3 percent of GDP, which is less than one-third of its peak of nearly 10 percent in 2009. That decline reflects the economy's gradual recovery from the 2007–2009 recession, the waning budgetary effects of policies enacted in response to the weak economy, and other changes to tax and spending policies. However, debt held by the public will edge up relative to GDP, reaching about 74 percent by the end of 2014—its highest level since 1950.

In CBO's 10-year baseline budget projections—which are based on the assumption that current laws governing taxes and spending will remain generally unchanged—a combination of the anticipated further strengthening of the economy and constraints on federal spending built into law keeps deficits close to their current percentage of GDP for the next several years. With deficits staying between 2½ percent and 3 percent of GDP from 2015 through 2018, and then rising slowly thereafter, federal debt held by the public is projected to stay between 72 percent and 74 percent of GDP from 2015 through 2020.[1]

Later in the 10-year baseline projection period, under current law, deficits would be notably larger, CBO anticipates. Interest rates are expected to rebound from their current unusually low levels, sharply increasing interest payments on the government's debt. Moreover, the pressures of an aging population, rising health care costs, and an expansion of federal subsidies for health insurance would cause mandatory spending to rise as a percentage of GDP.[2] In addition, CBO projects, revenues would remain roughly stable relative to GDP for the next 10 years as an increase in individual income taxes was offset by a decline in receipts from corporate income taxes and remittances from the Federal Reserve (all relative to

1. For details about CBO's most recent 10-year baseline, see Congressional Budget Office, *Updated Budget Projections: 2014 to 2024* (April 2014), www.cbo.gov/publication/45229. CBO will update those projections later this summer.

2. Lawmakers generally determine spending for mandatory programs by setting eligibility rules, benefit formulas, and other parameters rather than by appropriating specific amounts each year. In that way, mandatory spending differs from discretionary spending, which is controlled by annual appropriation acts.

the size of the economy). By 2024, under current law, the budget deficit would grow to nearly 4 percent of GDP; federal debt would equal 78 percent of GDP and would be on the rise relative to the size of the economy.

The Long-Term Budgetary Imbalance

CBO's long-term projections extend beyond the usual 10-year budget window to focus on the 25-year period ending in 2039. They generally reflect current law, following the agency's April 2014 baseline budget projections through 2024 and then extending the baseline concept into later years; hence, they constitute what is called the *extended baseline*. The detailed long-term budget estimates that CBO presents in this and the following four chapters depend on projections of a host of demographic and economic conditions that the agency bases primarily on historical patterns. The estimates in these five chapters do not incorporate the economic effects of the fiscal policies in the extended baseline; those effects are incorporated, however, in the estimates presented in Chapter 6. The demographic and economic projections that underlie the detailed long-term budget estimates are summarized later in this chapter and discussed in detail in Appendix A. (Appendix B offers a discussion of changes in the projections since the 2013 report; Appendix C briefly reviews changes since earlier reports; and Appendix D provides information on CBO's projections over the next 75 years.)

CBO's 10-year and extended baselines are meant to serve as benchmarks for measuring the budgetary effects of proposed changes in federal revenues or spending. They are not meant to be predictions of future budgetary outcomes; rather, they represent CBO's best assessment of how the economy and other factors would affect revenues and spending if current law generally remained unchanged. In that way, the baselines incorporate the assumption that some policy changes that lawmakers have routinely made in the past—such as preventing the sharp cuts to Medicare's payment rates for physicians that are called for by law—will not be made again.

CBO's extended baseline projections show a substantial imbalance in the federal budget over the long run, with revenues falling well short of spending. Two measures offer complementary perspectives on the size of that imbalance: Projections of federal debt illustrate how the shortfall of revenues relative to spending would accumulate over time under current law, and estimates of how much spending or revenues would need to be changed to achieve a chosen goal for federal debt illustrate the magnitude of the modifications in law that policymakers might consider.

In addition to its extended baseline, CBO has developed an *extended alternative fiscal scenario*, under which certain policies that are now in place but are scheduled to change under current law are assumed to continue, and under which some provisions of current law that might be difficult to sustain for a long period are assumed to be modified (see Chapter 6). Under that scenario, federal debt would grow even faster than it would under the extended baseline, so larger policy changes would be needed to reach any chosen fiscal target.

The Accumulation of Federal Debt

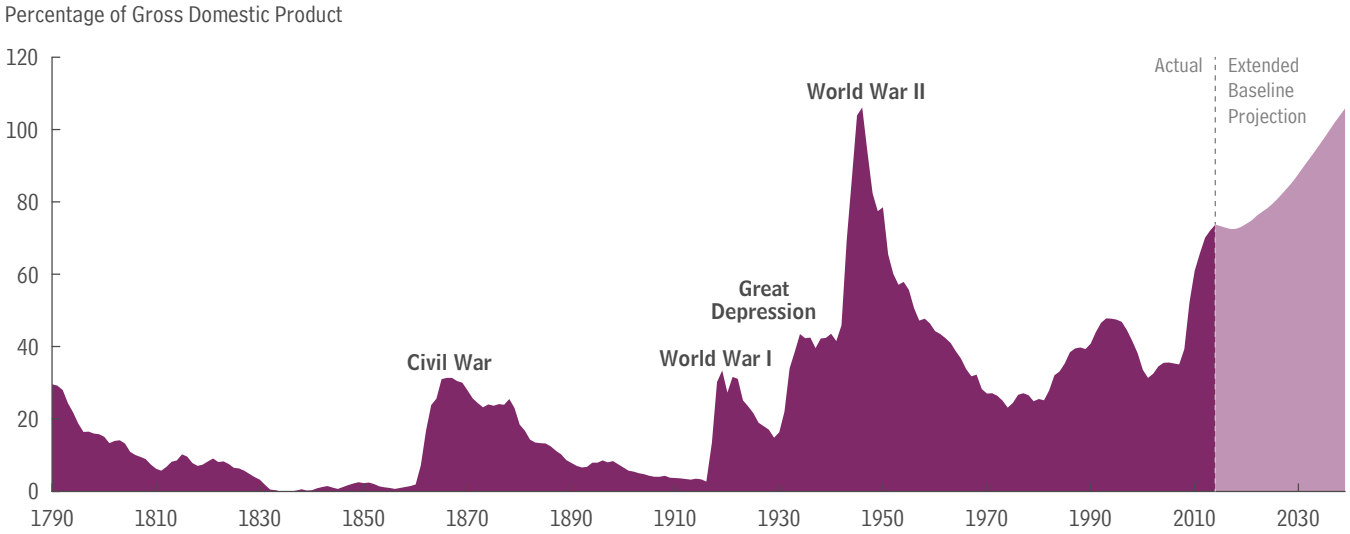
Debt held by the public represents the amount that the federal government has borrowed in financial markets (by issuing Treasury securities) to pay for its operations and activities.[3] If a given combination of federal spending and revenues is to be sustainable over time, debt held by the public eventually must grow no faster than the economy does. If debt continued to rise relative to GDP, at some point investors would begin to doubt the government's willingness or ability to repay its obligations. Such doubts would make it more expensive for the government to borrow money, thus necessitating cuts in spending, increases in taxes, or some combination of those two approaches. For that reason, the amount of federal debt held by the public relative to the nation's annual economic output is an important barometer of the government's financial position.

At the end of 2008, federal debt held by the public stood at 39 percent of GDP, which was close to its average of

3. When the federal government borrows in financial markets, it competes with other participants for financial resources and, in the long run, crowds out private investment, reducing economic output and income. In contrast, federal debt held by trust funds and other government accounts represents internal transactions of the government and has no direct effect on financial markets. (That debt and debt held by the public together make up gross federal debt.) For more discussion, see Congressional Budget Office, *Federal Debt and Interest Costs* (December 2010), www.cbo.gov/publication/21960. Several factors not directly included in the budget totals also affect the government's need to borrow from the public. They include increases or decreases in the government's cash balance as well as the cash flows reflected in the financing accounts used for federal credit programs.

Figure 1-1.

Federal Debt Held by the Public



Source: Congressional Budget Office. For details about the sources of data used for past debt held by the public, see Congressional Budget Office, *Historical Data on Federal Debt Held by the Public* (July 2010), www.cbo.gov/publication/21728.

Note: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2024 and then extending the baseline concept for the rest of the long-term projection period. The long-term projections of debt do not reflect the economic effects of the policies underlying the extended baseline. (For an analysis of those effects and their impact on debt, see Chapter 6.)

the preceding several decades. Since then, large deficits have caused debt held by the public to grow sharply—to a projected 74 percent of GDP by the end of 2014. Debt has exceeded 70 percent of GDP during only one other period in U.S. history: from 1944 through 1950, when it spiked because of a surge in federal spending during World War II to a peak of 106 percent of GDP (see Figure 1-1).

CBO projects that, under current law, debt held by the public will exceed its current percentage of GDP after 2020 and continue rising. By 2039, under the extended baseline, federal debt held by the public would reach 106 percent of GDP (see Table 1-1)—equal to the percentage at the end of 1946 and more than two and a half times the average percentage during the past several decades—and would be on an upward path. That trajectory ultimately would be unsustainable. Moreover, the long-term projections of federal debt presented in this chapter and the next few chapters do not incorporate the negative economic effects of higher debt. Projections that account for those effects show debt reaching 111 percent of GDP in 2039 (see Chapter 6).

Projections so far into the future are highly uncertain, of course. Nevertheless, under a wide range of possible expectations for key factors that affect budgetary outcomes, CBO anticipates that if current law generally stayed the same, federal debt in 2039 would be very high by the nation's historical standards (see Chapter 7).

Policy Changes Needed to Meet Various Goals for Federal Debt

An alternative perspective on the long-term fiscal imbalance comes from assessing the changes in revenues or noninterest spending that would be needed to achieve a chosen goal for federal debt. One possible goal would be to make federal debt the same percentage of GDP in some future year as it is today. Another would be to make federal debt the same percentage of GDP in some future year as it has been, on average, during the past several decades. Other goals are possible as well.

The changes in revenues or noninterest spending that are estimated to be necessary to achieve one of those goals are conceptually similar to the estimated actuarial imbalance (that is, a negative actuarial balance) that is commonly reported for the trust funds for Part A of

Table 1-1.

Projected Spending and Revenues in Selected Years Under CBO's Extended Baseline

Percentage of Gross Domestic Product

	2014	2024	2039
Spending			
Noninterest			
Social Security	4.9	5.6	6.3
Medicare (Net of offsetting receipts)[a]	3.0	3.2	4.6
Medicaid, CHIP, and exchange subsidies	1.9	2.7	3.4
Other mandatory	2.5	2.2	1.7
Discretionary	6.8	5.1	5.2
Subtotal	19.1	18.8	21.2
Net interest	1.3	3.3	4.7
Total Spending	**20.4**	**22.1**	**25.9**
Revenues			
Individual income taxes	8.0	9.4	10.5
Payroll taxes	6.0	5.8	5.7
Corporate income taxes	2.0	1.8	1.8
Excise taxes, estate and gift taxes, and other sources of revenues	1.5	1.3	1.4
Total Revenues	**17.6**	**18.3**	**19.4**
Deficit			
Excluding net interest	-1.5	-0.5	-1.7
Total	**-2.8**	**-3.7**	**-6.4**
Debt Held by the Public at the End of the Year	**74**	**78**	**106**
Memorandum:			
Gross Medicare Spending[a]	3.5	3.9	5.7

Source: Congressional Budget Office.

Notes: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2024 and then extending the baseline concept for the rest of the long-term projection period. These projections do not reflect the economic effects of the policies underlying the extended baseline. (For an analysis of those effects and their impact on debt, see Chapter 6.)

CHIP = Children's Health Insurance Program.

a. Medicare spending net of offsetting receipts reflects premium payments by beneficiaries and certain other receipts used to offset a portion of spending for the Medicare program; gross Medicare spending does not include those offsetting receipts.

Medicare and for Social Security (see Table 2-1 on page 34 and Table 3-1 on page 50). An estimated actuarial imbalance for a trust fund over a given period represents the changes in revenues or spending that would be needed to achieve the target balance for the trust funds if those changes were enacted immediately and maintained throughout the period. A similar calculation for the federal government as a whole is one way to summarize the projected fiscal imbalance over a specified period.

The size of the policy changes that would be needed to achieve a chosen goal for federal debt would depend in part on how quickly that goal was to be reached. Determining the timing of policy changes involves various trade-offs, including the economic effects of those changes and the burdens borne by different generations.

The Size of Policy Changes Needed to Meet Various Goals. The magnitude of the changes in noninterest spending or revenues that would be needed to make federal debt equal its current percentage of GDP at a

specific date in the future is often called the fiscal gap.[4] In CBO's extended baseline, the fiscal gap for the 2015–2039 period amounts to 1.2 percent of GDP (without accounting for the economic effects of the policy changes that might be used to close the gap). That is, relative to projections that generally follow current law, a combination of cuts in noninterest spending and increases in revenues that equaled 1.2 percent of GDP in each year beginning in 2015—about $225 billion in that year—is estimated to result in debt in 2039 that would equal 74 percent of GDP, or the same percentage of GDP in 25 years that it equals now. If those changes came entirely from revenues or entirely from spending, they would amount to roughly a 6½ percent increase in revenues or a 6 percent cut in noninterest spending relative to the amounts projected for the 2015–2039 period.

Increases in revenues or reductions in noninterest spending would need to be larger to reduce debt to the percentages of GDP that are more typical of those in recent decades. To return debt to its average percentage of GDP during the past 40 years (39 percent) by 2039, the government would need to pursue a combination of increases in revenues and cuts in noninterest spending (relative to current-law projections) that totaled 2.6 percent of GDP each year (without accounting for the economic effects of the reduction in debt and the policy changes that might be used to achieve it; in 2015, 2.6 percent of GDP would be about $465 billion).[5] If the changes came entirely from revenues, they would represent an increase of 14 percent relative to the amount projected under the extended baseline for the 2015–2039 period; if they came entirely from noninterest spending, they would represent a cut of 13 percent from the amount projected under the extended baseline for that period.

The Timing of Policy Changes Needed to Meet Various Goals. In deciding how quickly to implement policies to put federal debt on a sustainable path, lawmakers face trade-offs:

- The sooner that significant deficit reduction was implemented, the smaller the government's accumulated debt would be, the smaller the policy changes would need to be to attain a chosen long-run outcome, and the less uncertainty there would be about what policies would be adopted. However, if lawmakers implemented spending cuts or tax increases quickly, people would have little time to plan and adjust to the policy changes. In addition, those policy changes would weaken the economic expansion during the next few years. The negative short-term effects of deficit reduction on output and employment would be especially strong now, because the Federal Reserve is keeping short-term interest rates near zero and could not lower them further to offset the effects of a tightening of fiscal policy.

- By contrast, reductions in federal spending or increases in taxes that were implemented several years from now would have a smaller effect on output and employment during the following few years because short-term interest rates are likely to be well above zero by then and the Federal Reserve could lower those rates in response to a tightening of fiscal policy. However, if lawmakers waited for some time before reducing federal spending or increasing taxes, the result would be a greater accumulation of debt, which would represent a greater drag on output and income in the long run and would increase the size of the policy adjustments needed to reach any chosen target for debt.

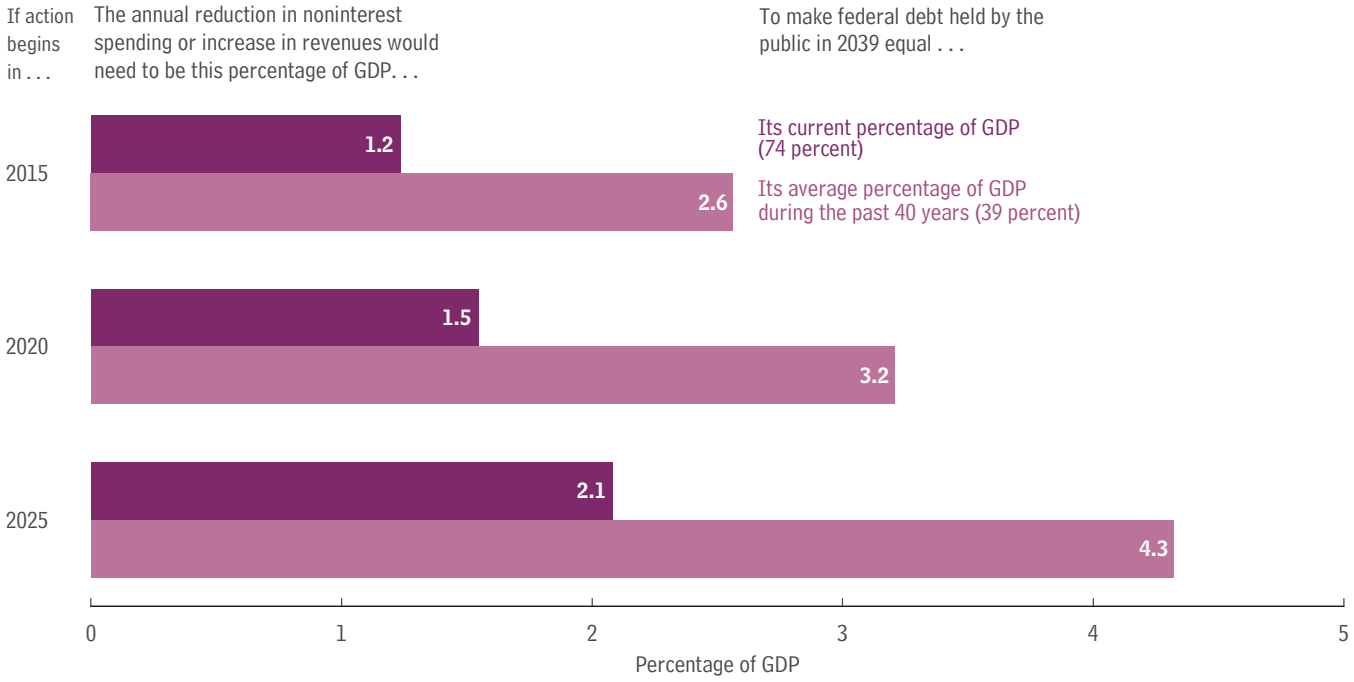
In addition, faster or slower implementation of policies to reduce budget deficits would tend to impose different burdens on different generations: Reducing deficits sooner would probably require more sacrifices by today's older workers and retirees for the benefit of today's younger workers and future generations. Reducing deficits later would require smaller sacrifices by older

4. The fiscal gap equals the present value of noninterest outlays and other means of financing minus the present value of revenues over the projected period with adjustments to make the ratio of federal debt to GDP at the end of the period equal to the current ratio. Specifically, current debt is added to the present value of outlays and other means of financing, and the present value of the target end-of-period debt (which equals GDP in the last year of the period multiplied by the ratio of debt to GDP at the end of 2014) is added to the present value of revenues. A present value is a single number that expresses a flow of current, past, and future revenues or outlays in terms of an equivalent lump sum received or paid today. In calculating present values, CBO uses a discount rate equal to the average interest rate on federal debt held by the public (see Appendix A). Other means of financing include changes in the government's cash balances and the cash flows of federal credit programs (mostly programs that provide loans and loan guarantees).

5. That figure is calculated in the same manner as the fiscal gap except that it uses a different target for end-of-period debt.

Figure 1-2.

The Timing and Size of Policy Changes Needed to Make Federal Debt Meet Two Goals



Source: Congressional Budget Office.

Note: GDP = gross domestic product.

people and greater sacrifices by younger workers and future generations.

CBO has tried to illustrate that collection of trade-offs in three ways. First, the agency has estimated the macroeconomic consequences of several paths for federal debt in both the short term and the longer term. For example, it has analyzed the effects of deficit reduction that is phased in so that deficits excluding interest payments are $2 trillion lower through 2024 than under the baseline, with the reduction in the deficit in 2024 as a percentage of GDP continued in subsequent years. Under that scenario, CBO estimates, economic output would be slightly lower in 2016, but gross national product would be about 2½ percent higher in 2039 than if current laws generally continued. (Unlike the more commonly cited gross domestic product, gross national product includes the income that U.S. residents earn abroad and excludes the income that foreigners earn in this country; it is therefore a better measure of the resources available to U.S. households.) Those results and corresponding results for other scenarios are discussed in Chapter 6.

Second, CBO has estimated the amount by which delaying policy changes to reduce deficits would increase the size of the policy adjustments needed to achieve any chosen goal for debt. If the goal was to have the debt equal 74 percent of GDP in 2039 but to wait to implement new policies until 2020, the combination of increases in revenues and reductions in noninterest spending over the 2020–2039 period would need to be 1.5 percent of GDP, rather than the 1.2 percent of GDP needed to reach that goal if policy changes took effect in 2015 (see Figure 1-2). If lawmakers waited even longer—until 2025—to take action, the policy changes over the 2025–2039 period would need to amount to 2.1 percent of GDP. If, instead of aiming to keep debt from rising relative to GDP, lawmakers wanted to return debt to its historical average percentage of GDP—but policy changes did not take effect until 2020—the policy changes would need to amount to 3.2 percent rather than 2.6 percent of GDP. Waiting an additional five years would require even larger changes, amounting to 4.3 percent of GDP.

Third, CBO has studied how waiting to resolve the long-term fiscal imbalance would affect various generations of

the U.S. population. In 2010, CBO compared economic outcomes under a policy that would stabilize the debt-to-GDP ratio starting in 2015 with outcomes under a policy that would delay stabilizing the ratio until 2025.[6] That analysis suggested that generations born after about 2015 would be worse off if action to stabilize the debt-to-GDP ratio was postponed to 2025. People born before 1990, however, would be better off if action was delayed—largely because they would partly or entirely avoid the policy changes needed to stabilize the debt—and generations born between 1990 and 2015 could either gain or lose from a delay, depending on the details of the policy changes.[7]

If policymakers wanted to minimize both the short-term economic costs of shrinking the deficit very quickly and the longer-term costs of allowing large deficits to persist, they could enact a combination of changes in tax and spending policies that increased the deficit in the next few years relative to what it would be under current law but that reduced the deficit thereafter. That approach, however, would allow a greater amount of federal debt to accumulate and might raise doubts about whether longer-term deficit reduction would actually occur. People would be more likely to believe that the future deficit reduction would truly take effect if the future policy changes were specific and widely supported.

Even if policy changes to reduce deficits in the long term were not implemented for several years, making decisions about them sooner rather than later would offer significant advantages. If decisions were reached sooner, people would have more time to plan and adjust their behavior to be prepared for the time at which changes would be implemented. In addition, decisions about policy changes that would reduce future debt relative to amounts under current law would tend to increase output and employment in the next few years by holding down longer-term interest rates, reducing uncertainty, and enhancing businesses' and consumers' confidence.

6. See Congressional Budget Office, *Economic Impacts of Waiting to Resolve the Long-Term Budget Imbalance* (December 2010), www.cbo.gov/publication/21959. That analysis was based on a projection of slower growth in debt than CBO now projects, so the estimated effects of a similar policy today would be close, but not identical, to the effects estimated in that earlier analysis.

7. Those conclusions do not incorporate the possible negative effects of a fiscal crisis or effects that might arise from the government's reduced flexibility to respond to unexpected challenges.

Budgetary Imbalances Beyond the Next 25 Years

After 2039, the pressures of rising federal budget deficits and debt held by the public would increase further unless laws governing taxes and spending were changed. Although projections for the very long term are highly uncertain, CBO estimates that debt held by the public would be more than twice as large relative to GDP after 75 years as it would be after 25 years (without accounting for the economic effects of such high debt). Moreover, the fiscal gap would be roughly 50 percent larger over a 75-year period than over a 25-year period. (For information on CBO's very long term projections, see Appendix D.)

Consequences of a Large and Growing Federal Debt

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.

Less National Saving and Future Income

Large federal budget deficits over the long term would reduce investment, resulting in lower national income and higher interest rates than would otherwise occur. Increased government borrowing would cause a larger share of the savings potentially available for investment to be used for purchasing government securities, such as Treasury bonds. Those purchases would crowd out investment in capital goods—factories and computers, for example—which makes workers more productive. Because wages are determined mainly by workers' productivity, the reduction in investment would reduce wages as well, lessening people's incentive to work. Both the government and private borrowers would face higher interest rates to compete for savings, and those rates would strengthen people's incentive to save. However, the rise in saving by households and businesses would be a good deal smaller than the increase in federal borrowing represented by the change in the deficit, so national saving (total saving by all sectors of the economy) would

decline, as would private investment. (For a detailed analysis of those economic effects, see Chapter 6.)

In the short term, budget deficits would boost overall demand for goods and services, thus increasing output and employment relative to what they would be with smaller deficits or with no deficits at all. That is especially true under current economic conditions: Large amounts of unused resources and low inflation have led the Federal Reserve to reduce short-term interest rates almost to zero, so the short-term expansionary effects of deficits are not offset by tighter monetary policy. The impact of greater demand is temporary, though, because stabilizing forces in the economy tend to push output back in the direction of its potential (or maximum sustainable) level. Those forces include the response of prices and interest rates to greater demand and (under typical conditions) actions by the Federal Reserve.

Pressure for Larger Tax Increases or Spending Cuts in the Future

When the federal debt is large, the government ordinarily must make substantial interest payments to its lenders, and growth in the debt causes those interest payments to increase. (Net interest payments are currently fairly small relative to the size of the economy because interest rates are exceptionally low, but CBO anticipates that those payments will increase considerably as interest rates return to more typical levels.)

Higher interest payments would consume a larger portion of federal revenues, resulting in a larger gap between the remaining revenues and the amount that would be spent on federal programs under current law. Hence, if lawmakers wanted to maintain the benefits and services that the government has been accustomed to providing, while preventing deficits from increasing as interest payments grew, revenues would need to increase as well. That could be accomplished in different ways, but to the extent that such increases occurred through higher marginal tax rates (the rates that apply to an additional dollar of income), those higher rates would discourage people from working and saving, thus further reducing output and income. Alternatively, lawmakers could choose to offset rising interest costs at least in part by reducing government benefits and services. Those reductions could be made in many ways, but to the extent that they came from cutting federal investments, future output and income also would be reduced. As another option, lawmakers could respond to higher interest payments by allowing deficits to increase for some period, but that approach would require greater deficit reduction later if lawmakers wanted to avoid a long-term increase in the debt-to-GDP ratio.

Reduced Ability to Respond to Domestic and International Problems

When the amount of outstanding debt is relatively small, a government can borrow money to address significant unexpected events—recessions, financial crises, or wars, for example. In contrast, when outstanding debt is large, a government has less flexibility to address financial and economic crises—a very costly circumstance for many countries.[8] A large amount of debt also can compromise a country's national security by constraining military spending in times of international crisis or by limiting the country's ability to prepare for such a crisis.

Several years ago, when federal debt was below 40 percent of GDP, the government had some flexibility to respond to the financial crisis and severe recession by increasing spending and cutting taxes to stimulate economic activity, providing public funding to stabilize the financial sector, and continuing to pay for other programs even as tax revenues dropped sharply because of the decline in output and income. As a result, federal debt almost doubled as a percentage of GDP. If federal debt stayed at its current percentage of GDP or increased further, the government would find it more difficult to undertake similar policies under similar conditions in the future. As a result, future recessions and financial crises could have larger negative effects on the economy and on people's well-being. Moreover, the reduced financial flexibility and increased dependence on foreign investors that accompany high and rising debt could weaken U.S. leadership in the international arena.

Greater Chance of a Fiscal Crisis

A large and continuously growing federal debt would have another significant negative consequence: It would

8. See, for example, Carmen M. Reinhart and Kenneth S. Rogoff, "The Aftermath of Financial Crises," *American Economic Review*, vol. 99, no. 2 (May 2009), pp. 466–472, http://tinyurl.com/ml9kchv; and Carmen M. Reinhart and Vincent R. Reinhart, "After the Fall," *Macroeconomic Challenges: The Decade Ahead* (Federal Reserve Bank of Kansas City, 2011), http://tinyurl.com/lntnp6j (PDF, 1.6 MB). Also see Luc Laeven and Fabian Valencia, *Systemic Banking Crises Database: An Update,* Working Paper 12-163 (International Monetary Fund, June 2012), http://tinyurl.com/p2clvmy.

increase the likelihood of a fiscal crisis in the United States.[9] Specifically, there would be a greater risk that investors would become unwilling to finance the government's borrowing needs unless they were compensated with very high interest rates and, as a result, interest rates on federal debt would rise suddenly and sharply relative to rates of return on other assets. That increase in interest rates would reduce the market value of outstanding government bonds, causing losses for investors and perhaps precipitating a broader financial crisis by creating losses for mutual funds, pension funds, insurance companies, banks, and other holders of government debt—losses that might be large enough to cause some financial institutions to fail.

Unfortunately, there is no way to predict with any confidence whether or when such a fiscal crisis might occur in the United States. In particular, there is no identifiable tipping point in the debt-to-GDP ratio to indicate that a crisis is likely or imminent. All else being equal, however, the larger a government's debt, the greater the risk of a fiscal crisis.

The likelihood of such a crisis also depends on economic conditions. If investors expect continued economic growth, they are generally less concerned about the government's debt burden; conversely, substantial debt can reinforce more generalized concern about an economy. Thus, in many cases around the world, fiscal crises have begun during recessions—and, in turn, have exacerbated them. In some instances, a crisis has been triggered by news that a government would need to borrow an unexpectedly large amount of money. Then, as investors lost confidence and interest rates spiked, borrowing became more expensive for the government. That development forced policymakers to take several actions: cut spending and increase taxes immediately and substantially to reassure investors, renege on the terms of the country's existing debt, or boost inflation to reduce the value of the existing debt. In some cases, a fiscal crisis also made private-sector borrowing more expensive because uncertainty about the government's responses reduced confidence in the viability of private-sector enterprises. Higher private-sector interest rates, when combined with reduced government spending and increased taxes, have tended to worsen economic conditions in the short term.

If a fiscal crisis were to occur in the United States, policymakers would have only limited—and unattractive—options for responding. In particular, the government would need to undertake some combination of three approaches: restructure the debt (that is, seek to modify the contractual terms of existing obligations), pursue an inflationary monetary policy, and adopt an austerity program of spending cuts and tax increases. Thus, such a crisis would confront policymakers with extremely difficult choices and probably have a significantly negative effect on the country.

CBO's Approach to Producing Long-Term Projections

To formulate its extended baseline, CBO projects demographic and economic conditions for the decades ahead and develops assumptions about future policies for the major categories of federal spending and revenues. The set of projected demographic and economic conditions, which CBO refers to as its economic benchmark, is consistent with CBO's baseline projections over the next 10 years and reflects CBO's assessment of long-term trends thereafter; it incorporates an assumption that federal debt as a percentage of GDP and marginal tax rates remain constant at their 2024 levels in subsequent years. (The economic benchmark is described more fully in Appendix A.) CBO's assumptions about federal spending and revenue policies generally reflect current law—they match the assumptions underlying the agency's 10-year baseline through 2024, and they are extended in a similar way to later years. The long-term projections of federal spending, revenues, and debt presented in this and the next few chapters do not incorporate the economic effects of rising debt beyond 2024 or possible changes to fiscal policies; those considerations are addressed in Chapter 6.

Demographic and Economic Projections

Economic growth will be slower in the future than it has been in the past, CBO projects, largely because of a slowdown in the growth of the labor force resulting from the retirement of the baby-boom generation, declining birth rates, and the leveling-off of increases in women's participation in the labor market. The labor force is projected to grow at an average annual rate of 0.5 percent over the next 25 years, compared with the 1.7 percent recorded during the 1970–2007 period. CBO projects that future productivity growth will be close to its historical average. Accounting for those and other economic variables, CBO projects that real (inflation-adjusted) GDP will increase

9. For additional discussion, see Congressional Budget Office, *Federal Debt and the Risk of a Fiscal Crisis* (July 2010), www.cbo.gov/publication/21625.

at an average annual rate of 2.3 percent over the next 25 years, compared with 3.1 percent during the 1970–2007 period.

In the economic benchmark—in which debt as a percentage of GDP is assumed to remain constant at the 2024 level—CBO projects that interest rates will rise from their unusually low levels today but will still be lower in the future than they have been, on average, during the past few decades. The real interest rate (specifically, the interest rate after adjusting for the rate of increase in the consumer price index) on 10-year Treasury notes is projected to rise to 2.6 percent for the 2017–2024 period. After 2024, it is projected to equal 2.5 percent, below its 1970–2007 average of 3.2 percent and its 1990–2007 average of 3.1 percent.

The average interest rate on all federal debt held by the public tends to be a little lower than the rate on 10-year Treasury notes because interest rates are generally lower on shorter-term debt than on longer-term debt, and, since the 1950s, the average maturity of federal debt has been shorter than 10 years. CBO projects that the average real interest rate on all federal debt held by the public will be 2.2 percent after 2024.

For the 2014–2039 period, the real interest rate on 10-year Treasury notes is projected to average 2.5 percent and the rate for all federal debt held by the public is projected to average 1.7 percent. The average interest rate on federal debt is projected to rise more slowly than rates on 10-year Treasury notes because only a portion of federal debt matures each year.

Those figures for real interest rates reflect an adjustment for inflation that is based on the rate of increase in the consumer price index. Adjusting instead for the rate of increase in the price index for GDP (or the price index for personal consumption expenditures) yields an average real interest rate on all federal debt held by the public over the next 25 years of 2.1 percent. Thus, during the next 25 years as a whole, the growth rate of GDP is projected to exceed the average interest rate on federal debt. However, that pattern is driven by a larger difference between growth rates and interest rates during the coming decade. Beyond 2024, the growth rate of GDP is projected to be below the average interest rate on federal debt. When the growth rate of GDP was less than the interest rate, the ratio of debt to GDP would tend to rise over time even if the federal budget excluding interest payments was in balance.

Policy Assumptions

CBO's extended baseline is identical to its baseline projections for 2015 through 2024, and it generally follows the baseline concept in later years (see Table 1-2 for a summary of CBO's policy assumptions).

Social Security. CBO projects spending for Social Security under the assumption that there will generally be no changes to current law. CBO also assumes that Social Security will pay benefits as scheduled under current law regardless of the status of the program's trust funds—an assumption that is consistent with a statutory requirement that CBO, in its 10-year baseline projections, assume that funding for any mandatory program is adequate to make all payments required by law for that program.[10] (For more on Social Security, see Chapter 3.)

The Major Health Care Programs. CBO also projects federal spending for the government's major health care programs—Medicare, Medicaid, the Children's Health Insurance Program, and insurance subsidies provided through the exchanges created under the Affordable Care Act (ACA)—for 2015 through 2024 under the assumption that there will generally be no changes to current law. (Unless otherwise specified, Medicare outlays are presented net of offsetting receipts, such as premiums paid by enrollees, which reduce net outlays for that program.) Thus, the projections incorporate the reduction in Medicare's payments to physicians scheduled for 2015 and the reductions in Medicare spending specified in the Budget Control Act of 2011, as amended, for 2015 through 2024.

Beyond 2024, the considerable uncertainty that exists about the evolution of the health care delivery and financing systems leads CBO to employ a formulaic approach in its projections of federal spending for health care programs. Specifically, CBO combines estimates of the number of people who will be receiving benefits from

10. Section 257(b)(1) of the Balanced Budget and Emergency Deficit Control Act of 1985, 2 U.S.C. §907(b)(1), states that the balances of the trust funds represent the total amount that the government is legally authorized to spend for those purposes. For a discussion of the legal issues related to exhaustion of a trust fund, see Christine Scott, *Social Security: What Would Happen If the Trust Funds Ran Out?* Report for Congress RL33514 (Congressional Research Service, June 15, 2012).

Table 1-2.

Assumptions About Policies for Spending and Revenues Underlying CBO's Extended Baseline

	Assumptions About Policies for Spending
Social Security	As scheduled under current law[a]
Medicare	As scheduled under current law through 2024; thereafter, projected spending depends on the estimated number of beneficiaries and health care costs per beneficiary (for which growth is projected to move smoothly to the underlying path of excess cost growth rates over the succeeding 15 years and then follow that path)[a] *
Medicaid	As scheduled under current law through 2024; thereafter, projected spending depends on the estimated number of beneficiaries and health care costs per beneficiary (for which growth is projected to move smoothly to the underlying path of excess cost growth rates over the succeeding 15 years and then follow that path)*
Children's Health Insurance Program	As projected in CBO's baseline through 2024; remaining constant as a percentage of GDP thereafter
Exchange Subsidies	As scheduled under current law through 2024; thereafter, projected spending depends on the estimated number of beneficiaries, an additional indexing factor for subsidies, and health care costs per beneficiary (for which growth is projected to move smoothly to the underlying path of excess cost growth rates over the succeeding 15 years and then follow that path)*
Other Mandatory Spending	As scheduled under current law through 2024; thereafter, refundable tax credits are estimated as part of revenue projections, and the rest of other mandatory spending is assumed to decline as a percentage of GDP at the same annual rate that it is projected to decline between 2019 and 2024
Discretionary Spending	As projected in CBO's baseline through 2024; remaining constant as a percentage of GDP thereafter
	Assumptions About Policies for Revenues
Individual Income Taxes	As scheduled under current law
Payroll Taxes	As scheduled under current law
Corporate Income Taxes	As scheduled under current law through 2024; remaining constant as a percentage of GDP thereafter
Excise Taxes	As scheduled under current law[b]
Estate and Gift Taxes	As scheduled under current law
Other Sources of Revenues	As scheduled under current law through 2024; remaining constant as a percentage of GDP thereafter

Source: Congressional Budget Office.

Notes: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2024 and then extending the baseline concept for the rest of the long-term projection period.

For CBO's most recent 10-year baseline projections, see Congressional Budget Office, *Updated Budget Projections: 2014 to 2024* (April 2014), www.cbo.gov/publication/45229.

GDP = gross domestic product.

a. Assumes the payment of full benefits as calculated under current law, regardless of the amounts available in the program's trust funds.

b. The sole exception to the current-law assumption applies to expiring excise taxes dedicated to trust funds. The Balanced Budget and Emergency Deficit Control Act of 1985 requires CBO's baseline to reflect the assumption that those taxes would be extended at their current rates. That law does not stipulate that the baseline include the extension of other expiring tax provisions, even if they have been routinely extended in the past.

[*Passage clarified on July 29, 2014]

the government's health care programs with fairly mechanical estimates of the growth in spending per beneficiary. (See Chapter 2 for details about the long-term projections for the major health care programs; CBO assumes that Medicare, like Social Security, will pay benefits as scheduled under current law regardless of the status of the program's trust funds.)

Other Mandatory Programs. For other mandatory programs—such as retirement programs for federal civilian and military employees, certain veterans' programs, the Supplemental Nutrition Assistance Program (SNAP), unemployment compensation, and refundable tax credits—the projections through 2024 are based on the assumption that there will generally be no changes to current law.[11] For years after 2024, CBO projects outlays for refundable tax credits as part of its revenue projections and projects spending for the remaining mandatory programs as a whole by assuming that such spending will decline as a share of GDP after 2024 at the same annual rate that it is projected to fall between 2019 and 2024. That is, CBO does not estimate outlays for each program separately after 2024 (see Chapter 4).

Discretionary Spending. Discretionary spending in the extended baseline matches that in the 10-year baseline through 2024. Under current law, most of the government's discretionary appropriations for the 2015–2021 period are constrained by the caps put in place by the Budget Control Act of 2011, as amended. For 2022 through 2024, those appropriations are assumed to grow from the 2021 amount at the rate of anticipated inflation. Funding for certain purposes, such as war-related activities, is not constrained by the Budget Control Act's caps; CBO assumes that such funding will increase each year through 2024 at the rate of inflation, starting from the amount appropriated for the current year. After 2024, discretionary spending is assumed to remain fixed at its percentage of GDP in 2024, with an adjustment for the timing of certain monthly payments (see Chapter 4).[12]

Revenues. Revenue projections through 2024 follow the 10-year baseline, which generally incorporates the assumption that various tax provisions will expire as scheduled even if they have routinely been extended in the past. After 2024, rules for individual income taxes, payroll taxes, excise taxes, and estate and gift taxes are assumed to evolve as scheduled under current law.[13] Because of the structure of current tax law, total federal revenues from those sources are estimated to grow faster than GDP over the long run. Revenues from corporate income taxes and other sources (such as receipts from the Federal Reserve System) are assumed to remain constant as a percentage of GDP after 2024 (see Chapter 5).

Projected Spending Through 2039

Over the past 40 years, federal outlays other than those for the government's net interest costs have averaged 18 percent of GDP. However, in the past several years, noninterest spending has been well above that average, both because of underlying trends and because of temporary circumstances (namely, the financial crisis, the weak economy, and policies implemented in response to them). Noninterest spending spiked to 23 percent of GDP in 2009 but then declined, falling to about 19 percent this year. If current laws that affect spending were unchanged, noninterest outlays would remain at about 19 percent of GDP throughout the coming decade, CBO projects, as an increase in mandatory spending was offset by a decline in discretionary spending relative to the size of the economy. After the mid-2020s, however, under the assumptions of the extended baseline, noninterest spending would rise relative to the size of the economy, reaching 21 percent of GDP by 2039 and remaining on an upward path.

CBO projects that, under current law, spending for net interest would jump from 1.3 percent of GDP this year to more than 3 percent 10 years from now. By 2039, interest costs would reach nearly 5 percent of GDP, bringing total federal spending to 26 percent of GDP (see Figure 1-3). Federal spending has been larger relative to

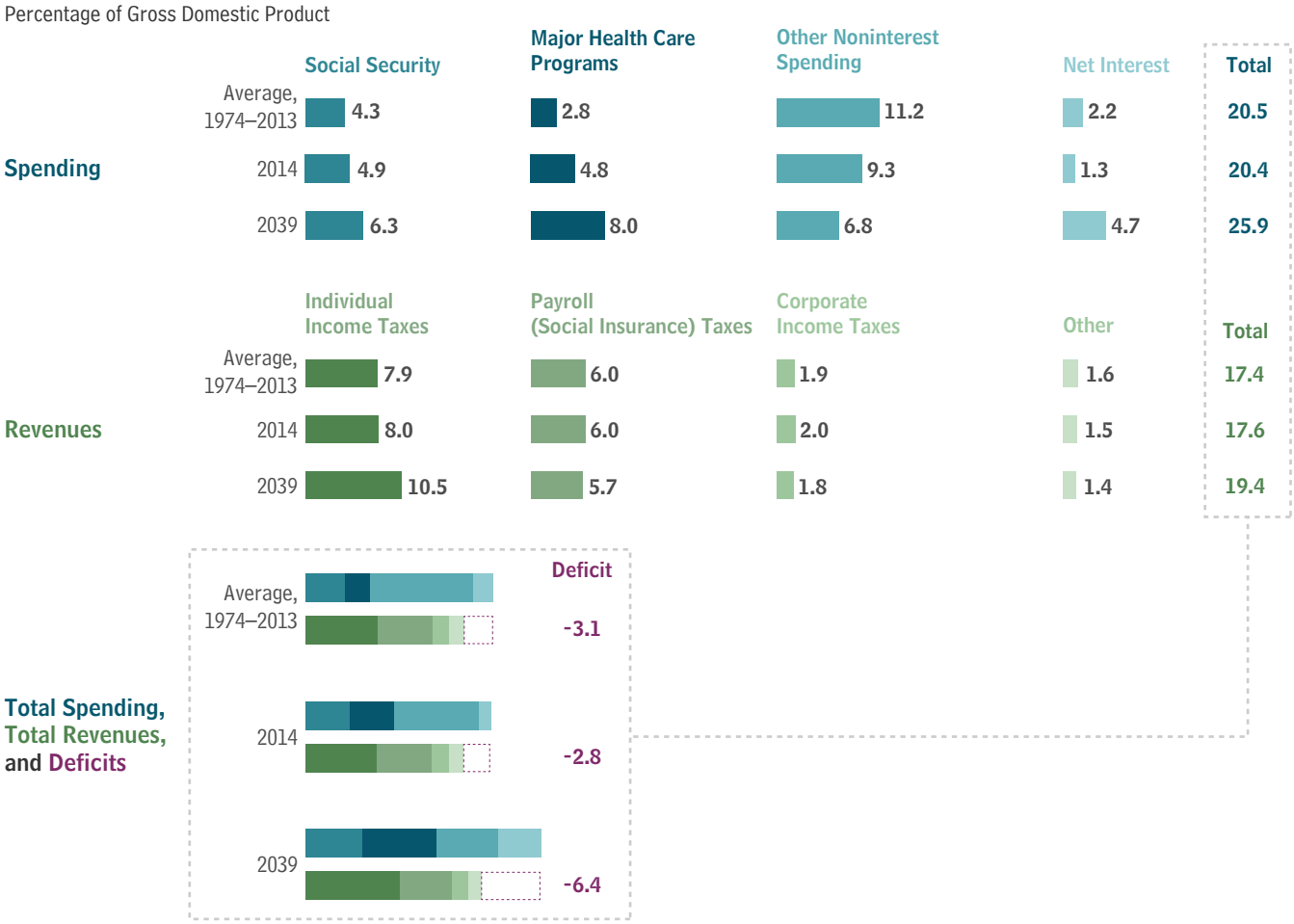
11. The law governing CBO's baseline projections (section 257(b)(2) of the Deficit Control Act) makes exceptions for some programs, such as SNAP, that have expiring authorizations but that are assumed to continue as currently authorized.

12. Because October 1, 2023—the first day of fiscal year 2024—will fall on a weekend, some payments scheduled for that day will instead be made at the end of September, thus shifting the spending into the previous fiscal year.

13. The sole exception to the current-law assumption applies to expiring excise taxes dedicated to trust funds. The Deficit Control Act requires CBO's baseline to reflect the assumption that those taxes would be extended at their current rates. That law does not stipulate that the baseline include the extension of other expiring tax provisions, even if they have been routinely extended in the past.

Figure 1-3.

Spending and Revenues Under CBO's Extended Baseline, Compared With Past Averages



Source: Congressional Budget Office.

Notes: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2024 and then extending the baseline concept for the rest of the long-term projection period.

The major health care programs consist of Medicare, Medicaid, the Children's Health Insurance Program, and subsidies offered through health insurance exchanges. (Medicare spending is net of offsetting receipts.) Other noninterest spending is all federal spending other than that for the major health care programs, Social Security, and net interest.

Other revenues are excise taxes, remittances to the U.S. Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

the size of the economy only during World War II, when it topped 40 percent of GDP for three years.

Spending for the Major Health Care Programs and Social Security

Mandatory programs have accounted for a rising share of the federal government's noninterest spending over the past few decades, averaging 60 percent in recent years. Most of the growth in mandatory spending has involved the three largest programs—Social Security, Medicare, and Medicaid. Federal outlays for those programs together made up more than 40 percent of the government's noninterest spending, on average, during the past 10 years, compared with less than 30 percent four decades ago.

Most of the anticipated growth in noninterest spending as a share of GDP over the long term is expected to come from the government's major health care programs: Medicare, Medicaid, the Children's Health Insurance

Program, and the subsidies for health insurance purchased through the exchanges created under the ACA. CBO projects that, under current law, total outlays for those programs, net of offsetting receipts, would grow much faster than the overall economy, increasing from just below 5 percent of GDP now to 8 percent in 2039 (see Chapter 2). Spending for Social Security also would increase relative to the size of the economy, but by much less—from almost 5 percent of GDP in 2014 to more than 6 percent in 2039 and beyond (see Chapter 3).

Those projected increases in spending for Social Security and the government's major health care programs are attributable primarily to three causes: the aging of the population, rising health care spending per beneficiary, and the ACA's expansion of federal subsidies for health insurance. (For estimates of the extent to which each cause contributes to the projected increases in spending, see Box 1-1 on page 22).

The Aging of the Population. The retirement of the baby-boom generation portends a long-lasting shift in the age profile of the U.S. population—a change that will substantially alter the balance between the working-age and retirement-age groups. During the next decade alone, the number of people age 65 or older is expected to rise by more than one-third, and over the longer term, the share of the population age 65 or older is projected to grow from the current 14 percent to 21 percent in 2039. By contrast, the share of the population between the ages of 20 and 64 is expected to drop from 60 percent to 54 percent. Those trends are expected to continue in later decades, although at a slower pace, as life expectancy increases.

The aging of the population is the main factor driving the projected growth of Social Security spending as a percentage of GDP. Initial Social Security benefits are based on a person's earnings history, but those earnings are indexed to the overall growth of wages in the economy, so average benefits increase at approximately the same rate as average earnings. As a result, economic growth does not significantly alter spending for Social Security as a share of GDP. Rather, that share depends primarily on the ratio of the number of people working in jobs covered by Social Security (covered workers) to the number of Social Security beneficiaries. CBO projects that the ratio of covered workers to beneficiaries will decline significantly over the next quarter century—from almost 3 to 1 now to almost 2 to 1 in 2039—and then continue to drift downward.

Rising Health Care Spending per Beneficiary. Although the growth of health care spending has been slower during the past several years than it had been historically, CBO projects that spending per enrollee in federal health care programs will continue to increase at a faster pace than per capita GDP over the next 25 years. The growth rate of spending per Medicare beneficiary is projected to remain very low over the next few years—reflecting slow growth in the use of medical care, scheduled cuts to payment rate updates, and an influx of younger beneficiaries—but is then projected to increase gradually through 2039 (although remaining below its average growth rate of the past few decades). Compared with Medicare, costs per enrollee in Medicaid and private insurance are expected to grow more rapidly over the coming decade, but CBO projects a gradual slowing in later years. Although costs per beneficiary in federal health care programs are projected to increase faster than per capita GDP over the 25-year projection period, the difference between those two growth rates will be smaller than its average of recent decades, CBO projects (see Chapter 2).

Expansion of Federal Subsidies for Health Insurance. Under provisions of the ACA, many people can purchase subsidized insurance through the health insurance exchanges (or marketplaces) that are operated by the federal or state governments. Those subsidies come in two forms: refundable tax credits that can be applied to premiums, and cost-sharing subsidies that reduce deductibles and copayments. CBO anticipates that 19 million people will receive subsidized health insurance coverage through the exchanges (and that several million others will obtain unsubsidized coverage) in each year between 2019 and 2024.[14]

In addition, as a result of the ACA and a subsequent Supreme Court ruling, each state has the option to expand eligibility for Medicaid to most nonelderly adults whose income is below 138 percent of the federal poverty guidelines (commonly known as the federal poverty level,

14. See Congressional Budget Office, *Updated Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act, April 2014* (April 2014), Table 3, www.cbo.gov/publication/45231.

or FPL).[15] By calendar year 2018, CBO anticipates, about 80 percent of the potential newly eligible population will live in states that will have expanded their programs.[16] Each year between 2018 and 2024, 13 million more people, on net, are projected to have coverage through Medicaid and CHIP than would have had such coverage in the absence of the ACA.

Other Noninterest Spending

In the extended baseline, total federal spending for everything other than the major health care programs, Social Security, and net interest declines to a smaller percentage of GDP than has been the case for more than 70 years. Such spending has been more than 8 percent of GDP each year since the late 1930s, including about 12 percent of GDP in 1974 and about 10 percent in 1994; CBO estimates that it will be about 9 percent of GDP in 2014. Under the assumptions used for this analysis, that spending is projected to fall below 8 percent of GDP in 2020 and then to decline further, dropping to about 7 percent of GDP in 2039 (see Chapter 4).

Spending for discretionary programs is projected to decline significantly over the next 10 years relative to GDP—from roughly 7 percent to roughly 5 percent—because of the constraints on discretionary funding imposed by the Budget Control Act. For its long-term projections, CBO assumed that discretionary outlays would remain at their 2024 share of GDP, with an adjustment for the timing of certain monthly payments, in subsequent years.

Spending for mandatory programs other than the major health care programs and Social Security also is projected to decline relative to the size of the economy during the next 10 years. That spending accounts for about 2½ percent of GDP today and, under current law, is projected to fall to about 2 percent of GDP in 2024. That decline would occur in part because the improving economy would reduce the number of people eligible for some programs in this category and in part because payments per beneficiary under some programs tend to rise with prices (which usually increase more slowly than GDP). Beyond 2024, CBO projects, other mandatory spending, excluding the portion related to refundable tax credits, would decline as a share of GDP at the same annual rate that it is projected to fall between 2019 and 2024. As a result, other mandatory spending would fall to less than 2 percent of GDP by 2039—lower than at any point at least since 1962 (the first year for which comparable data are available).

Interest Payments

CBO expects interest rates to rebound in coming years from their current unusually low levels. As a result, the government's net interest costs are projected to more than double relative to the size of the economy over the next decade—from 1¼ percent of GDP in 2014 to more than 3 percent by 2024—even though, under current law, federal debt would be only slightly larger relative to GDP at the end of that decade than it is today.

Beyond 2024, interest rates are assumed to remain close to their projected levels in 2024, so net interest payments would change roughly in line with changes to the amount of federal debt held by the public. By 2039, interest payments would reach nearly 5 percent of GDP under current law. The growth in net interest payments and debt is mutually reinforcing: Rising interest payments push up deficits and debt, and rising debt pushes up interest payments.

Projected Revenues Through 2039

Over the past 40 years, federal revenues have fluctuated between 14½ percent and 20 percent of GDP, averaging 17½ percent, with no evident trend over time. After amounting to nearly 18 percent of GDP in 2007, federal revenues fell sharply in 2009, to 14½ percent of GDP, primarily because of the recession. With an improving economy and changes in certain tax rules that have

15. The ACA expanded eligibility for Medicaid to include nonelderly residents with income up to 133 percent of the FPL, but the law defines the income used to determine eligibility in a way that effectively increases that threshold to 138 percent of the FPL. The FPL is currently $23,850 for a family of four. See Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation, "2014 Poverty Guidelines" (January 2014), http://aspe.hhs.gov/poverty/14poverty.cfm. As a result of the Supreme Court's decision on June 28, 2012, in *National Federation of Independent Business v. Sebelius,* 132 S. Ct. 2566 (2012), some states may choose not to expand their programs.

16. See Congressional Budget Office, *The Budget and Economic Outlook: 2014 to 2024* (February 2014), p. 58, www.cbo.gov/publication/45010.

Box 1-1.

Causes of Projected Growth in Federal Spending for the Major Health Care Programs and Social Security

Under its extended baseline, the Congressional Budget Office (CBO) projects that the growth of federal noninterest spending as a share of gross domestic product (GDP) results entirely from projected increases in spending for a few large programs: Social Security, Medicare, Medicaid, and the insurance subsidies provided through the health insurance exchanges established under the Affordable Care Act (ACA). The major health care programs, which currently account for about half of total spending for those large programs, are responsible for more than two-thirds of the projected increase in spending for those programs over the next 25 years. (By contrast, under the assumptions that govern the extended baseline, total federal spending on everything other than those programs and net interest is projected to fall significantly as a percentage of GDP over the next 25 years.)

Three factors underlie the projected increase in federal spending for the major health care programs and Social Security relative to the size of the economy:

- The aging of the U.S. population, which will increase the share of the population receiving benefits from those programs and also affect the average age (and thus the average health care costs) of beneficiaries;
- The effects of excess cost growth—that is, the extent to which health care costs per beneficiary, adjusted for demographic changes, grow faster than potential GDP per capita;[1] and
- The continuing expansion of Medicaid under the ACA and the growth in subsidies for health insurance purchased through the exchanges created under that law.

CBO calculated the share of the projected growth in federal spending for the major health care programs and Social Security that could be attributed to each of those factors. (Aging is the only one that affects CBO's projections for Social Security.) The agency compared the outlays projected for those programs under the extended baseline with the outlays that would occur under three alternative paths: one that included aging of the population but no excess cost growth and no expansion of Medicaid or the exchange subsidies, one that included excess cost growth but no aging of the population and no expansion of Medicaid or the exchange subsidies, and one that included both aging and excess cost growth but no expansion of Medicaid or the exchange subsidies.

The ways in which aging of the population and excess cost growth interact accentuate those factors' individual effects. For example, as aging increases the number of Medicare beneficiaries and elderly Medicaid beneficiaries, rising health care spending per person has a greater impact on federal health care spending. Likewise, when per-person health care costs are rising, the increasing number of beneficiaries has greater budgetary consequences. That interaction effect can be identified separately—or, as in CBO's analysis, it can be allocated in proportion to the shares of projected growth that are attributable to the two factors: aging and excess cost growth.

The aging of the population and excess cost growth also affect the budgetary impact of the expansion of Medicaid and the exchange subsidies, but in different directions: Excess cost growth increases the effect of that expansion on federal health care spending, but aging decreases the effect by reducing the share of the population that is under the age of 65 and therefore potentially eligible for the expanded federal benefits.

1. Potential GDP is the economy's maximum sustainable output.

Continued

Box 1-1. **Continued**

Causes of Projected Growth in Federal Spending for the Major Health Care Programs and Social Security

Explaining Projected Growth in Federal Spending for Major Health Care Programs and Social Security

	Percentage of Projected Growth Through	
	2024	2039
	Major Health Care Programs and Social Security	
Aging	43	55
Excess Cost Growth	13	24
Expansion of Medicaid and Exchange Subsidies	44	21
	Major Health Care Programs	
Aging	21	39
Excess Cost Growth	17	33
Expansion of Medicaid and Exchange Subsidies	62	28

Source: Congressional Budget Office.

According to CBO's calculations, the aging of the population accounts for 55 percent of the projected growth in federal spending for the major health care programs and Social Security as a share of GDP through 2039 (see the table). Excess cost growth accounts for 24 percent, and the expansion of Medicaid and exchange subsidies accounts for the remaining 21 percent. (For more information about CBO's projections of demographic changes over that period, see Figure 2-3 on page 41; for more information about excess cost growth and spending on federal health care programs, see Chapter 2.)

For the major health care programs alone, the relative impact of the population's aging is smaller and the significance of factors related to health care is greater. Through 2039, aging accounts for 39 percent of projected growth in federal spending for those programs as a share of GDP, excess cost growth accounts for 33 percent, and the expansion of Medicaid and the exchange subsidies together account for 28 percent. Total federal spending for those programs would increase from 4.8 percent of GDP in 2014 to 8.0 percent in 2039 under current law, CBO projects. Of that rise of 3.1 percentage points, aging would contribute 1.2 percentage points; excess cost growth, 1.0 percentage point; and the expansion of Medicaid and the exchange subsidies, 0.9 percentage points.

Under the assumptions of the extended baseline, the relative importance of those three factors would shift over the longer term. The age profile of the population is expected to change less rapidly after 2039, so aging would account for less of the growth in spending for federal programs. The expansion of Medicaid and the exchange subsidies also would account for less of the growth in spending once it took full effect. Thus, after 2039, excess cost growth in the major health care programs would be the primary driver of the total projected growth in spending for those programs and Social Security as a percentage of GDP.

resulted in higher tax rates, revenues have rebounded to 17½ percent of GDP in 2014, CBO estimates.

Individual income taxes account for the bulk of federal revenues—almost half of all revenues in 2013—payroll taxes (also known as social insurance taxes) account for about one-third of all revenues, and corporate income taxes and excise taxes account for most of the remainder.[17]

CBO projects that, under current law, revenues would grow slightly faster than the economy over the coming decade, reaching a little more than 18 percent of GDP by 2024. Individual income taxes would rise as a percentage

17. Most payroll tax revenues come from taxes designated for Social Security and Medicare; the rest come mainly from taxes for unemployment insurance.

of GDP because of structural features of the individual income tax system and the continued economic recovery. That increase would be partially offset by declines in other taxes relative to GDP, most notably receipts from the Federal Reserve and corporate income taxes.

Over the long run, revenues would keep growing slightly more rapidly than GDP under current law. In particular, with rising real income, a greater proportion of income would be taxed in higher income tax brackets because tax brackets are indexed for inflation but not for growth in real income. By 2039, total revenues would be 19½ percent of GDP, CBO projects. Increases in receipts from individual income taxes account for more than the 2 percentage-point rise in total revenues as a percentage of GDP over the next 25 years; receipts from all other sources, taken together, are projected to decline slightly as a percentage of GDP (see Chapter 5).

Even if no changes in tax law were enacted in the future, the effects of the tax system in 2039 would differ in significant ways from what those effects are today. Average taxpayers at all income levels would pay a greater share of income in taxes than similar taxpayers do now, primarily because a greater share of their income would be taxed in higher tax brackets. Moreover, the effective marginal tax rate on labor income (the percentage of an additional dollar of labor income paid in federal taxes) would be about 34 percent, compared with the current 29 percent, and the effective marginal tax rate on capital income (the percentage of an additional dollar of income from investments paid in federal taxes) would be about 19 percent, compared with about 18 percent today.

Changes From Last Year's Long-Term Budget Outlook

Each time it prepares long-term budget projections, CBO incorporates the effects of new legislation and updates the economic and technical aspects of its projections. The projections of federal revenues and outlays presented in this report are generally similar to those published in 2013, despite certain changes in law, revisions to some of the agency's assumptions and methods, and the availability of more recent data.[18] As a result, the projected path for federal debt is similar to that projected last year. However, a number of small changes (some of them offsetting) have led CBO to estimate a larger fiscal gap and a greater actuarial deficit for Social Security.* (The key revisions to the projections since last year are discussed at greater length in Appendix B.)

Taken together, the legislative, economic, and technical changes had the following effects on CBO's view of the federal budget in the long term:

- Under the extended baseline, CBO now projects that debt would reach 106 percent of GDP in 2039, compared with a projection last year of 102 percent. (Those figures do not incorporate the feedback effects from the economic impact of those paths for federal debt; with such feedback considered, debt in 2039 is now projected to grow to 111 percent of GDP, compared with 108 percent projected last year.)

- The estimated fiscal gap is larger this year than last year. For the 2015–2039 period, CBO now estimates that cuts in noninterest spending or increases in revenues equal to 1.2 percent of GDP in each year through 2039 would be required to have debt in 2039 equal the same percentage of GDP that it constitutes today; last year, CBO estimated that changes equal to 0.9 percent of GDP would be required. That difference is the result of larger gaps between revenues and noninterest spending and the inclusion of other means of financing, offset somewhat by the effect of the lower projected rate of interest.*

- The actuarial shortfall for the Social Security trust funds is estimated to be significantly larger this year than was estimated last year. The estimated actuarial balance for Social Security is the sum of the present value of projected tax revenues and the trust funds' current balance minus the sum of the present value of projected outlays and a target balance at the end of the period; that difference is traditionally presented as a percentage of the present value of taxable payroll. CBO now estimates that the 75-year actuarial deficit for Social Security is 4.0 percent of taxable payroll, compared with the previous projection of 3.4 percent. That change reflects the reduction in projected interest rates, lower payroll tax revenues in CBO's 10-year baseline, updated data, and other factors (see Chapter 3 and Appendix B).

[*Sentence corrected on July 29, 2014]

18. For CBO's long-term projections for the 2013–2038 period, see Congressional Budget Office, *The 2013 Long-Term Budget Outlook* (September 2013), www.cbo.gov/publication/44521.

CHAPTER

4

The Long-Term Outlook for Other Federal Noninterest Spending

In 2014, almost half of the federal government's spending will go toward programs and activities other than major health care programs (Medicare, Medicaid, the Children's Health Insurance Program, and the subsidies for health insurance purchased through exchanges), Social Security, and net interest. That spending—referred to in this report as other federal noninterest spending—includes outlays for discretionary programs, which are funded through the annual appropriation process, and outlays for mandatory programs (other than major health care programs and Social Security), which are usually funded according to underlying statutes that establish eligibility and payment rules.[1] Mandatory spending in this category also includes the refundable portions of the earned income tax credit, the child tax credit, and the American Opportunity Tax Credit, which are recorded in the budget as outlays.

The Congressional Budget Office (CBO) projects that if current laws generally continued without change—an assumption underlying the agency's baseline and extended baseline—other federal noninterest spending would drop from a total of 9.3 percent of gross domestic product (GDP) in 2014 to 7.3 percent in 2024 and then to 6.8 percent in 2039. Discretionary spending, which equaled 6.8 percent of GDP in 2014, would fall to 5.1 percent of GDP by 2024; for its extended baseline, CBO assumed that discretionary spending would remain fixed at its percentage of GDP in 2024, with an adjustment for the timing of certain monthly payments (see Figure 4-1).[2] Mandatory spending other than that for the major health care programs and Social Security would decrease from 2.5 percent of GDP this year to 2.2 percent in 2024. For its extended baseline, CBO assumed that such spending—other than the portion related to refundable tax credits—would continue to fall relative to GDP at the same rate that occurred over the 2019–2024 period. (Refundable tax credits are estimated as part of the revenue projections, which are described in Chapter 5.) Putting those pieces together, other mandatory spending is projected to equal 1.7 percent of GDP in 2039.

Other Federal Noninterest Spending Over the Past Four Decades

During the past 40 years, federal spending for everything other than the major health care programs, Social Security, and net interest has averaged 11 percent of GDP. Such spending equaled 12 percent of GDP in 1974, stayed between 12 percent and 14 percent from 1975 through 1987, and fell to around 8 percent in the late 1990s and early 2000s. Such spending moved up to 10 percent of GDP by 2003 and remained close to that level through most of the first decade of the 2000s. It then spiked to 14 percent of GDP in 2009, before receding to 10 percent in 2013.

Discretionary Spending

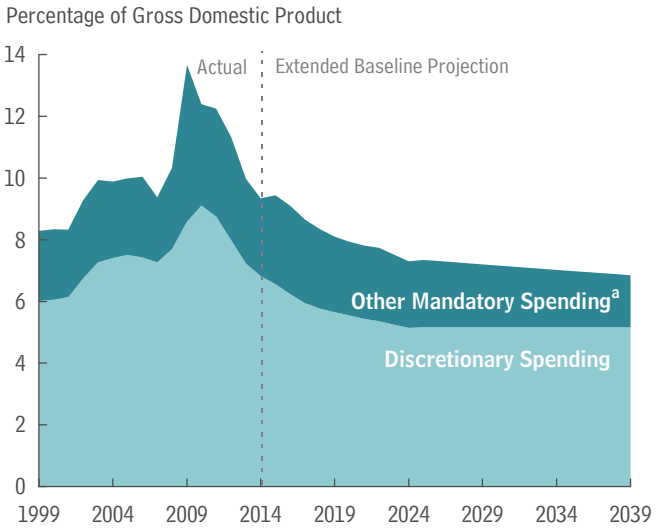
A distinct pattern in the federal budget since the 1970s has been the diminishing share of spending that occurs through the annual appropriation process. Between 1974 and 2013, discretionary spending fell from 51 percent of total federal spending to 35 percent. Relative to the size of the economy, discretionary spending declined from 9.3 percent of GDP to 7.2 percent.

1. For a description of the activities included in various categories of federal spending, see Congressional Budget Office, *The Budget and Economic Outlook: 2014 to 2024* (February 2014), Box 3-1, p. 51, www.cbo.gov/publication/45010.

2. Because October 1, 2023—the first day of fiscal year 2024—will fall on a weekend, certain payments that ordinarily would be made on that day will instead be made at the end of September, thus shifting them into the previous fiscal year.

Figure 4-1.

Other Federal Noninterest Spending



Source: Congressional Budget Office.

Note: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2024 and then extending the baseline concept for the rest of the long-term projection period.

a. Other mandatory spending is all mandatory spending other than that for the major health care programs, Social Security, and net interest. It includes the refundable portions of the earned income and child tax credits and of the American Opportunity Tax Credit.

The portion of discretionary spending devoted to national defense, and administered primarily by the Department of Defense (DoD), falls mostly into three categories:

- Operation and maintenance, which supports the day-to-day activities of the military, the training of military units, the majority of costs for the military's health care program, and compensation for most of DoD's civilian employees;
- Military personnel, which covers compensation for uniformed service members, including pay; housing and food allowances; and related activities, such as moving service members and their families to new duty stations; and
- Procurement, which pays for the purchase of new weapon systems and other major equipment and upgrades to existing weapon systems.

Forty years ago, in 1974, defense discretionary spending equaled 5.4 percent of GDP. It dropped below 5.0 percent of GDP in the late 1970s but averaged 5.9 percent during the defense buildup of 1982 to 1986 (see Figure 4-2). After the end of the Cold War, outlays for defense fell again relative to GDP, reaching a low of 2.9 percent at the turn of the century. Such outlays were higher again in the 2000s, mainly as a result of spending on operations in Iraq and Afghanistan. Defense spending averaged 4.6 percent of GDP from 2009 through 2011, before falling to 3.8 percent in 2013.

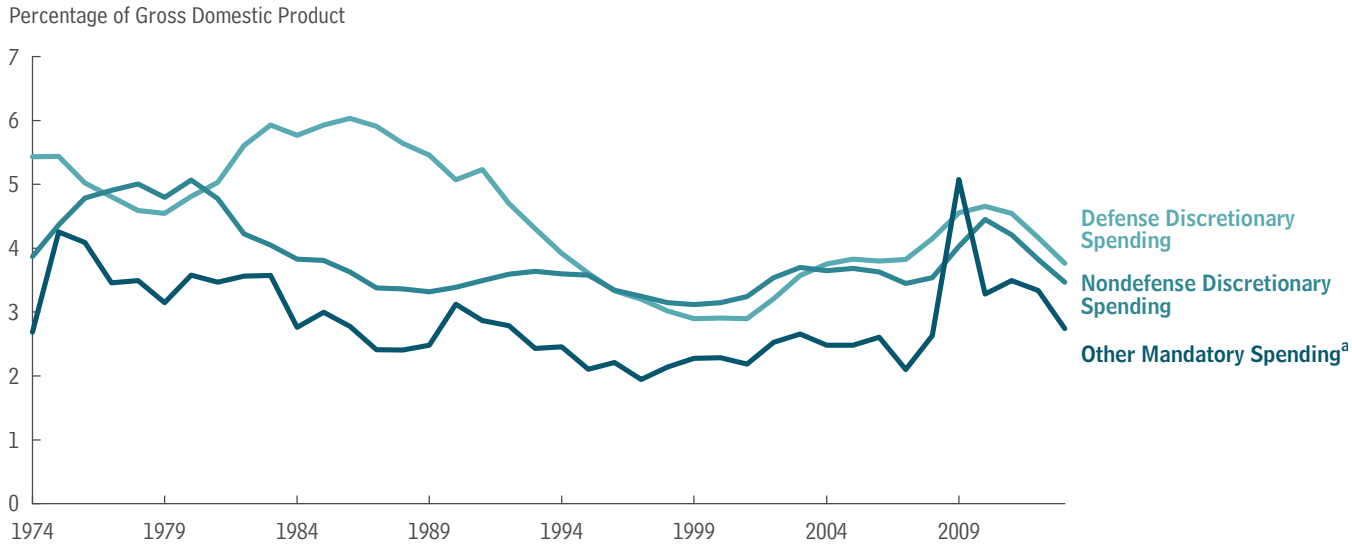
The rest of discretionary spending is for nondefense purposes and covers a wide array of federal investment and other activities, including:

- Education (excluding student loans), training, employment, and social services;
- Transportation, including highway programs, transit programs, and airport security;
- Housing assistance;
- Veterans' health care;
- Health-related research and public health programs;
- Administration of justice, including federal law enforcement, criminal justice, and correctional activities;
- International affairs, including international development, humanitarian assistance, peacekeeping, nuclear nonproliferation, and the operation of U.S. embassies and consulates; and
- Other activities, including natural resources and the environment, science, and community and regional development.

Forty years ago, nondefense discretionary spending amounted to 3.9 percent of GDP. Between 1975 and 1981, such spending averaged almost 5 percent of GDP, but between 1984 and 2008 it stayed between 3 percent and 4 percent of GDP. More recently, funding from the American Recovery and Reinvestment Act of 2009, as well as other funding associated with the federal government's response to the 2007–2009 recession, helped push nondefense discretionary spending above 4 percent of GDP from 2009 through 2011. Such spending dropped back to 3.5 percent of GDP in 2013.

Figure 4-2.

Other Federal Noninterest Spending, by Category, 1974 to 2013



Source: Congressional Budget Office.

a. Other mandatory spending is all mandatory spending other than that for the major health care programs, Social Security, and net interest. It includes the refundable portions of the earned income and child tax credits and of the American Opportunity Tax Credit.

Other Mandatory Spending

Mandatory spending other than that for the major health care programs and Social Security covers the following activities:

- Civilian and military retirement, including benefits paid to retired federal civilian and military employees and to retired railroad workers;
- Earned income, child, and other refundable tax credits, for which payments are made to taxpayers for whom the credit amounts exceed tax liabilities;
- Veterans' benefits, including housing, educational assistance, readjustment benefits, life insurance, disability compensation, pensions, and burial benefits for military veterans;
- Food and nutrition programs, including SNAP (the Supplemental Nutrition Assistance Program, formerly known as the Food Stamp program) and child nutrition programs;
- Unemployment compensation;
- Supplemental Security Income; and
- Family support and foster care, including grants to states that help fund welfare programs, Temporary Assistance for Needy Families, foster care, and child support enforcement.

Other mandatory spending is net of various offsetting receipts, which are payments collected by government agencies from other government accounts or from the public in businesslike or market-oriented transactions and are recorded in the budget as negative outlays (that is, credits against direct spending). A significant share of offsetting receipts goes to the Medicare program and is combined with Medicare outlays in this report (see Chapter 2 for more information). Other offsetting receipts come from the contributions that government agencies make to federal retirement programs, the proceeds from leases to drill for oil and natural gas on the Outer Continental Shelf, payments made by Fannie Mae and Freddie Mac, and other sources.

Other mandatory spending averaged about 3½ percent of GDP from the mid–1970s through the early 1980s. It was generally lower from the mid–1980s to 2008, averaging about 2½ percent of GDP. In 2009, however, other mandatory spending nearly doubled, to 5.1 percent of GDP, because of the financial crisis and recession and the

Table 4-1.

Other Federal Noninterest Spending Projected Under CBO's Baseline

Percentage of Gross Domestic Product

	2014	2024
Discretionary Spending		
Defense	3.4	2.7
Nondefense	3.4	2.5
Total	**6.8**	**5.1**
Other Mandatory Spending		
Civilian and military retirement	0.9	0.8
Nutrition programs	0.6	0.4
Refundable tax credits[a]	0.5	0.3
Veterans' benefits	0.5	0.4
Unemployment compensation	0.3	0.2
Supplemental Security Income	0.3	0.2
Offsetting receipts	-1.1	-0.6
Other	0.6	0.4
Total	**2.5**	**2.2**
Total, Other Federal Spending	**9.3**	**7.3**

Source: Congressional Budget Office.

Note: Other federal spending is all spending other than that for the major health care programs, Social Security, and net interest.

a. The earned income and child tax credits and the American Opportunity Tax Credit.

federal government's response to them. As the economy has improved, and the increases in spending related to the financial crisis and recession have waned, other mandatory spending has declined sharply relative to the size of the economy, falling to 2.7 percent of GDP in 2013.

Long-Term Projections of Other Federal Noninterest Spending

Under CBO's extended baseline, all federal spending apart from the major health care programs, Social Security, and net interest is projected to total 7.3 percent of GDP in 2024 and 6.8 percent in 2039. Those figures represent the lowest amounts relative to the size of the economy since the 1930s.

Discretionary Spending

Projections of discretionary spending for 2014 through 2024 come from CBO's most recent 10-year baseline budget projections, which were published in April.[3]

Through 2021, most discretionary appropriations are constrained by the caps put in place by the Budget Control Act of 2011 (as amended); for 2022 through 2024, CBO assumed that those appropriations would equal the 2021 amount, with increases for projected inflation. Funding for certain purposes, such as war-related activities, is not constrained by the Budget Control Act's caps; through 2024, CBO assumed that such funding would increase each year at the rate of inflation, starting from the current amount. Under those assumptions, outlays from discretionary appropriations are projected to decline from 6.8 percent of GDP this year—already well below the 40-year average of 8.3 percent—to 5.1 percent in 2024 (see Table 4-1). That 2024 amount would be the lowest level of discretionary spending relative to GDP in more than half a century (since at least 1962, the first year for which comparable data are available). Under those projections, in 2024, defense discretionary spending would equal 2.7 percent of GDP and nondefense discretionary spending would equal 2.5 percent of GDP. Each of those amounts would also be the smallest share of the economy in at least five decades.

After 2024, CBO's extended baseline incorporates the assumption that discretionary spending remains at the percentage of GDP projected for 2024—in other words, that such spending grows at the same pace as the economy. CBO's baseline and extended baseline are meant to be benchmarks for measuring the budgetary effects of legislation, so they mostly reflect the assumption that current laws remain unchanged. However, after 2021—when the caps established by the Budget Control Act are due to expire—total discretionary spending will not be limited by current laws and will be determined by lawmakers' future actions. With no basis for predicting those actions, CBO based its long-term projections of discretionary spending on a combination of the baseline projections through 2024 and historical experience.

In CBO's judgment, projecting a continued decline in discretionary spending as a share of GDP beyond 2024 would not provide the most useful benchmark for considering potential changes to discretionary programs, for several related reasons: First, discretionary spending has been a larger share of economic output throughout the past 50 years than it is projected to be in 2024. Second,

3. See Congressional Budget Office, *Updated Budget Projections: 2014 to 2024* (April 2014), www.cbo.gov/publication/45229.

nondefense discretionary spending has been higher than 3.0 percent of GDP throughout the past five decades and has shown no sustained trend relative to GDP. Third, defense spending has equaled at least 2.9 percent of GDP throughout the past five decades and has shown no trend relative to GDP in the past two decades. Conversely, projecting an increase in discretionary spending as a percentage of GDP beyond 2024 would require CBO to select a specific percentage, which the agency does not have a clear basis for doing. As a result of those considerations, CBO assumed for the extended baseline that discretionary spending would remain the same share of GDP after 2024 that the agency projects for 2024 in the 10-year baseline, with an adjustment for the timing of certain monthly payments.

Other Mandatory Spending

In constructing baseline projections, CBO assumes that mandatory programs will operate as they do under current law, which includes the automatic spending cuts put in place by the Budget Control Act.

In CBO's most recent baseline projections, total mandatory spending other than that for the major health care programs and Social Security is estimated to fall from 2.7 percent of GDP in 2013 to 2.5 percent this year. That category of other mandatory spending is projected to move back up to 2.9 percent of GDP in 2015, primarily because of lower offsetting receipts, but then decline in subsequent years, to 2.2 percent by 2024.[4]

A small part of the decline between 2014 and 2024 stems from a projected reduction in spending for the earned income tax credit, the child tax credit, and the American Opportunity Tax Credit. Outlays for the refundable portions of those credits are projected to decrease from 0.5 percent of GDP in 2014 to 0.3 percent in 2024 because the American Opportunity Tax Credit and temporary increases in the earned income and child tax credits are scheduled to expire at the end of calendar year 2017 and because, as income grows, the amounts of various credits that people qualify for decrease.

Much of the remaining projected decline in other mandatory spending relative to GDP between 2014 and 2024 occurs because the structure of many programs in this category leads the number of beneficiaries to decline relative to the size of the population as the economy expands and leads average payments per beneficiary to decline relative to average income. For example, income thresholds for eligibility for some large income support programs, such as Supplemental Security Income and the Supplemental Nutrition Assistance Program, generally rise with prices, while income usually rises more rapidly—especially with the strengthening of the economy that CBO anticipates during the next several years. As a result, CBO expects, the number of beneficiaries of some programs will rise more slowly than the population or even decrease over the next 10 years. Further, average payments under some large programs are often indexed to inflation and therefore tend to grow more slowly than income.

For the years beyond 2024, CBO projected outlays for the refundable portions of the earned income and child tax credits as part of its long-term revenue projections (discussed in Chapter 5). The remainder of other mandatory spending was not projected in detail after 2024 because of the number of programs involved and the variety of factors that influence spending on them. Instead, CBO used an approximate method to project spending for those programs as a group: assuming that such spending would decline as a share of GDP after 2024 at the same rate that it is projected to fall between 2019 and 2024. As benefits from some programs declined further relative to average income in the long run under current law, the effects of the system of federal benefits would become quite different from what they are today.

Under that assumption, mandatory spending other than that for the major health care programs, Social Security, and refundable tax credits would decrease from 1.8 percent of GDP in 2024 to 1.5 percent by 2039. With spending on those tax credits included, other mandatory spending would equal 1.7 percent of GDP in 2039. In later years, under the same assumptions, other mandatory spending would continue to fall.

4. See Congressional Budget Office, *The Budget and Economic Outlook: 2014 to 2024* (February 2014), www.cbo.gov/publication/45010.