



# The Committee for a Responsible Federal Budget

## CBO's January 2015 Budget and Economic Outlook January 26, 2015

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The Congressional Budget Office (CBO) released its Budget and Economic Outlook today, showing their budget and economic forecasts through 2025. After falling to post-recession lows below \$470 billion this year and next, CBO projects deficits will again start to rise, exceeding *\$1 trillion* by 2025.

Over the next decade, CBO projects deficits of \$7.6 trillion (3.3 percent of GDP), with deficits growing from a low of \$467 billion (2.5 percent of GDP) in 2016 to *\$1.09 trillion* (4.0 percent of GDP) by 2025.

As a result, debt will rise over the next decade, from \$13 trillion today to \$16.6 trillion at the end of 2020 and \$21.6 trillion by the end of 2025. As a share of GDP, debt will remain stable at current post-war highs of about 74 percent of GDP through 2020, but then rise continuously to almost *79 percent of GDP* by 2025 and continue to grow unsustainably over the long run.

The gloomy debt and deficit outlook is the result of rising spending and relatively flat revenue collection. Despite discretionary spending falling as a share of GDP, Social Security, health care, and interest spending will grow substantially, pushing spending from 20.3 percent of GDP in 2015 to 22.3 percent by 2025. At the same time, revenue will remain roughly flat at near 18 percent of GDP through most of the next ten years, reaching 18.3 in 2025.

Compared to their prior projections, released last August, deficits are about \$175 billion lower through 2024 – almost entirely due to changes in 2016 through 2018. However, long-term economic projections have also worsened – with nominal GDP about 1 percent lower in 2024 – resulting in a slightly higher debt-to-GDP ratio by 2024.

Even these projections assume that lawmakers do not enact new deficit-increasing policies. If they act irresponsibly and extend temporary policies and repeal scheduled cuts, debt would be much worse and could reach 88 percent of GDP by 2025.

Overall, CBO's baseline shows a fiscal outlook which is clearly unsustainable. Correcting this course will require reducing the gap between spending and revenue by enacting serious tax and entitlement reforms. The longer policymakers wait, the more difficult they will find it to put our fiscal house in order.



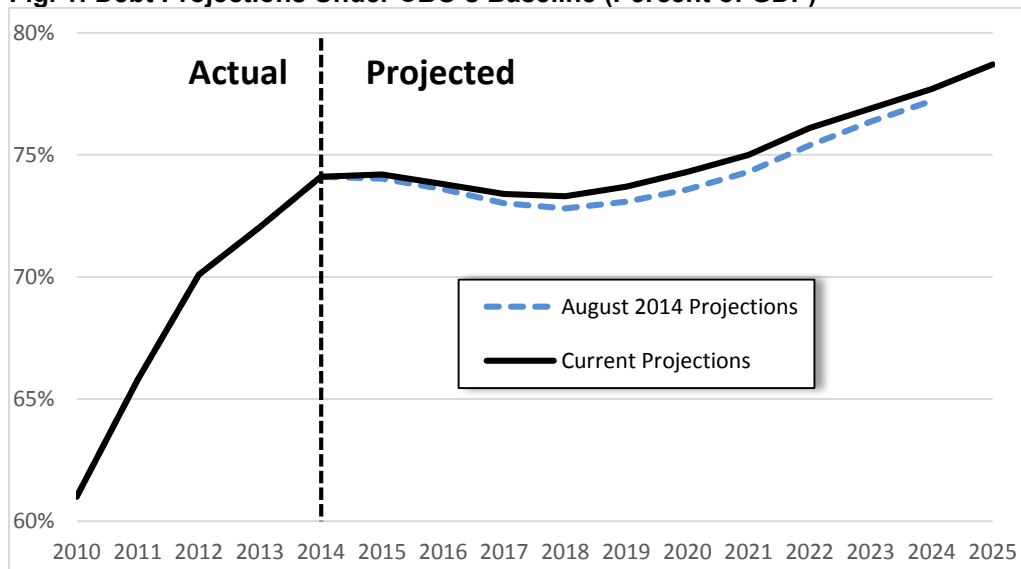
## Spending, Revenue, Deficits, and Debt

Although deficits have fallen significantly in recent years – as the stimulus and financial rescue spending have faded away, the economy has recovered, wars have drawn down, and legislation has reduced deficits – that trend is soon projected to reverse.

CBO projects deficits will fall very slightly over the next two years, but then begin to rise with *trillion-dollar deficits* returning in only a decade. Specifically, deficits will decline from \$483 billion (2.8 percent of GDP) in 2014 to \$468 billion (2.6 percent of GDP) in 2015 and \$467 billion (2.5 percent of GDP) in 2016 before rising to \$739 billion by 2020 (3.3 percent of GDP) and to \$1.09 trillion (4.0 percent of GDP) by 2025.

CBO projects debt as a share of GDP will remain at about its current level of 74 percent through 2020 – higher than at any time in history other than around World War II – before rapidly rising to 79 percent of GDP by 2025 and higher over the long run. In nominal dollars, debt will grow tremendously from \$13 trillion today to \$21.6 trillion by 2025.

**Fig. 1: Debt Projections Under CBO's Baseline (Percent of GDP)**



Behind these rising debt levels is a rise in spending without a commensurate rise in revenue. Spending will grow from 20.3 percent of GDP in 2014 to 22.3 percent by 2025, well above the 50-year historical average of 20.1 percent of GDP. This rise occurs despite a 1.7 percent of GDP decline in discretionary spending, driven by a 2.2 percent of GDP rise in health and retirement spending and a 1.7 percent of GDP rise in interest payments.

Meanwhile, revenue will remain relatively flat at just above 18 percent of GDP over the next ten years, reaching 18.3 percent by 2025, which is somewhat above the 50-year historical average of 17.4 percent. Flat revenue levels are driven by two competing factors. On the one hand, individual income tax revenue collection will rise by about three-



quarters of a percentage point of GDP between 2016 and 2025. On the other hand, corporate income tax revenue will fall by about half a point, and revenue from Federal Reserve remittances and payroll taxes will also decline modestly.

Compared to the previous baseline from August, the budget outlook looks slightly better in nominal dollars and slightly worse as a percentage of GDP. Deficits through 2024 are \$175 billion lower, but debt as a share of GDP is about half a point higher by 2024.

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

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Ten-Year*
<b>REVENUES (Percent of GDP)</b>												
Jan. 2015 Baseline	17.7%	18.4%	18.2%	18.1%	18.1%	18.0%	18.1%	18.1%	18.2%	18.2%	18.3%	18.2%
Aug. 2014 Baseline	18.3%	18.1%	18.1%	18.0%	18.0%	18.1%	18.1%	18.2%	18.2%	N/A	18.1%	
<b>OUTLAYS (Percent of GDP)</b>												
Jan. 2015 Baseline	20.3%	20.8%	20.7%	20.7%	21.1%	21.4%	21.6%	22.0%	21.9%	21.8%	22.3%	21.5%
Aug. 2014 Baseline	20.9%	21.0%	20.8%	20.7%	21.1%	21.3%	21.5%	21.9%	21.9%	21.8%	N/A	21.3%
<b>DEFICITS (Percent of GDP)</b>												
Jan. 2015 Baseline	2.6%	2.5%	2.5%	2.6%	3.0%	3.3%	3.5%	3.9%	3.8%	3.6%	4.0%	3.3%
Aug. 2014 Baseline	2.6%	2.9%	2.7%	2.7%	3.0%	3.3%	3.5%	3.8%	3.7%	3.6%	N/A	3.2%
<b>DEBT (Percent of GDP)</b>												
Jan. 2015 Baseline	74.2%	73.8%	73.4%	73.3%	73.7%	74.3%	75.0%	76.1%	76.9%	77.7%	78.7%	N/A
Aug. 2014 Baseline	74.0%	73.6%	73.0%	72.8%	73.1%	73.6%	74.3%	75.4%	76.4%	77.2%	N/A	N/A
<b>DEFICITS (in Billions of Dollars)</b>												
Jan. 2015 Baseline	\$468	\$467	\$489	\$540	\$652	\$739	\$814	\$948	\$953	\$951	\$1,088	\$7,641
Aug. 2014 Baseline	\$469	\$556	\$530	\$560	\$661	\$737	\$820	\$946	\$957	\$960	N/A	\$7,196
<b>DEBT (in Trillions of Dollars)</b>												
Jan. 2015 Baseline	\$13.4	\$13.9	\$14.5	\$15.1	\$15.8	\$16.6	\$17.5	\$18.5	\$19.5	\$20.5	\$21.6	N/A
Aug. 2014 Baseline	\$13.3	\$13.9	\$14.5	\$15.1	\$15.9	\$16.6	\$17.5	\$18.5	\$19.5	\$20.6	N/A	N/A

\*Ten-year figures reflect 2016-2025 period for January 2015 and 2015-2024 period for August 2014.

These numbers are based on CBO’s current law baseline which assumes lawmakers adhere to legislated deficit reduction, allow temporary provisions to expire as scheduled, and do not enact new deficit-increasing policies. If they deviate from that, debt could be much worse. If lawmakers permanently repeal the sequester and extend temporary tax provisions and doc fixes, the situation would be *\$2.5 trillion worse*. As a result, trillion-dollar deficits would return by 2021, and debt would reach 88 percent of GDP by 2025.

### Changes in the Budget Projections

CBO’s current baseline shows slightly smaller deficits and debt in nominal dollar terms than the previous baseline they released in August. Deficits are \$175 billion lower than previously thought, the net result of \$415 billion of lower revenue and \$590 billion of lower spending.

Legislative changes improve deficits by \$91 billion through 2024, though this total is somewhat misleading. Changes in policy, mainly the one-year extension of the tax extenders and emergency Ebola spending, actually add about \$100 billion to deficits. This is more than offset by a nearly \$200 billion extrapolation of the already-planned war



spending drawdown. Specifically, CBO calculates war-related spending – and other uncapped discretionary spending – by adjusting current numbers for inflation. As a result, spending \$74 billion this year (compared to \$92 billion last year) to reflect existing plans for a troop withdrawal in Afghanistan generates a significant reduction in CBO’s baseline.

The economic outlook reduces deficits by an additional \$38 billion, with \$234 billion of lower revenue more than offset by \$272 billion of lower spending. The lower revenue comes mainly from lower taxable income. On the spending side, lower projected interest rates lead CBO to revise its interest spending calculations by nearly \$150 billion, while lower wages and salaries results in a \$110 billion downward revision of Social Security spending, and lower productivity increases Medicare spending by nearly \$60 billion.

**Fig. 3: CBO’s Legislative, Economic, and Technical Changes from August Projections**

	2015-2019	2015-2024
<b>August 2014 Deficits</b>	<b>\$2,777 billion</b>	<b>\$7,196 billion</b>
<b>Legislative Changes</b>	<b>-\$4 billion</b>	<b>-\$91 billion</b>
Change in War Spending Baseline	-\$75 billion	-\$190 billion
Revenue (Tax Extenders)	\$40 billion	\$44 billion
Emergency Spending	\$30 billion	\$65 billion
Other Spending	\$1 billion	\$1 billion
Debt Service	\$1 billion	-\$9 billion
<b>Economic Changes</b>	<b>-\$83 billion</b>	<b>-\$38 billion</b>
Revenue	\$47 billion	\$234 billion
Interest Spending	-\$45 billion	-\$147 billion
Social Security	-\$49 billion	-\$110 billion
Medicare	\$7 billion	\$57 billion
Unemployment Benefits	-\$11 billion	-\$19 billion
Medicaid	-\$8 billion	-\$16 billion
Other Spending	-\$17 billion	-\$19 billion
Debt Service	-\$8 billion	-\$17 billion
<b>Technical Changes</b>	<b>-\$75 billion</b>	<b>-\$46 billion</b>
Revenue	\$61 billion	\$137 billion
Medicaid and Exchange Subsidies	-\$57 billion	-\$131 billion
Social Security	-\$23 billion	-\$65 billion
Student Loans	\$17 billion	\$39 billion
Spectrum Auctions	-\$31 billion	-\$35 billion
Other	-\$37 billion	\$0 billion
Interest Spending and Debt Service	-\$5 billion	\$9 billion
<b>Total Changes</b>	<b>-\$161 billion</b>	<b>-\$175 billion</b>
<b>January 2015 Deficits</b>	<b>\$2,615 billion</b>	<b>\$7,021 billion</b>

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

Finally, technical changes lead CBO to reduce its ten-year deficit projections by \$46 billion, with \$137 billion of revenue losses being offset by \$184 billion of spending reductions. The revenue loss is more than explained by CBO revising down its estimate of the corporate tax base – costing \$169 billion of revenue – mainly reflecting new information from



corporate tax returns and, to a lesser extent, an uptick in international tax avoidance strategies such as inversions. The bulk of the spending reduction (\$131 billion) comes from the exchange subsidies in the Affordable Care Act and Medicaid. Other notable changes include a \$39 billion increase in student loan costs and a \$35 billion increase in spectrum auction receipts (which count as negative outlays).

This slight improvement is welcome, especially as a counterbalance to many deficit-increasing pieces of legislation passed last year, but the lower economic projections ultimately make the debt picture slightly worse.

## Economic Projections

Economic projections are intrinsically linked to the budget because of their effects on revenue and countercyclical spending programs. Additionally, the rate of economic growth is critical in determining the denominator of the debt-to-GDP ratio. CBO's forecast this time around shows a steady recovery to near full potential over the next few years followed by slowing growth as population aging slows the growth of the labor force.

CBO shows the economy building on the past few quarters of solid growth, increasing in real (inflation-adjusted) terms at annual rates of about 3.0 percent in 2015 and 2016. By the end of 2017, CBO projects the economy will have recovered to near potential levels, after which real growth will slow to about 2.2 percent on average (and 2.1 percent by 2025).

CBO's near-term growth projections are somewhat lower than their August projections; however, they were developed from data available in early December 2014. More recent data suggests third quarter economic growth was stronger than CBO's latest estimate, and falling oil prices have likely provided a further boost.

With the economy recovering and approaching potential, CBO also projects unemployment rates to converge toward the natural rate of unemployment. Specifically, they project unemployment rates to fall from 5.6 percent today to 5.3 percent by mid-2017, and then remain between 5.3 and 5.5 percent for the remainder of the ten-year period.

As unemployment falls and the economy recovers, CBO expects the Federal Reserve will begin to raise the federal funds rates, and interest rates in general will begin to rise from their current very low levels. CBO projects rates on three-month and ten-year Treasuries will rise gradually from 0 and 2.6 percent, respectively, in 2014 to 3.4 and 4.6 percent by 2020 and beyond. As a result, interest paid on the debt will rise substantially.

Finally, growth in the Consumer Price Index (CPI-U) was 1.7 percent in 2014, lower than the previous expectation of 2 percent due to a stronger dollar and to falling oil and gas prices in the last quarter of the year. CBO expects inflation to remain low through 2015 at 1.1 percent but increase to 2.2 percent in 2016 and 2.4 percent annually from 2018 on.



**Fig. 4 CBO's Economic Projections**

Calendar Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Ten-Year
<b>Real GDP Growth</b>												
<b>CBO (January 2015)</b>	2.9%	3.0%	2.7%	2.2%	2.1%	2.2%	2.2%	2.2%	2.1%	2.1%	2.1%	2.3%
<b>CBO (August 2014)</b>	3.2%	3.5%	3.0%	2.4%	2.3%	2.3%	2.2%	2.1%	2.1%	2.0%	N/A	2.5%
<b>OMB (July 2014)</b>	3.5%	3.3%	2.8%	2.5%	2.4%	2.4%	2.3%	2.3%	2.3%	2.3%	N/A	2.6%
<b>Blue Chip</b>	2.9%	2.8%	N/A									
<b>Federal Reserve</b>	2.8%	2.8%	2.4%	N/A								
<b>Inflation (CPI)</b>												
<b>CBO (January 2015)</b>	1.1%	2.2%	2.3%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%
<b>CBO (August 2014)</b>	2.2%	2.0%	2.1%	2.2%	2.3%	2.4%	2.4%	2.4%	2.4%	2.4%	N/A	2.3%
<b>OMB (July 2014)</b>	2.0%	2.1%	2.2%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	N/A	2.2%
<b>Blue Chip</b>	1.4%	2.3%	N/A									
<b>Federal Reserve*</b>	1.3%	1.9%	1.9%	N/A								
<b>Unemployment Rate</b>												
<b>CBO (January 2015)</b>	5.6%	5.4%	5.3%	5.4%	5.5%	5.5%	5.5%	5.5%	5.4%	5.4%	5.4%	5.4%
<b>CBO (August 2014)</b>	5.9%	5.8%	5.7%	5.6%	5.6%	5.6%	5.6%	5.6%	5.6%	5.5%	N/A	5.6%
<b>OMB (July 2014)</b>	5.7%	5.5%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	N/A	5.4%
<b>Blue Chip</b>	5.3%	5.0%	N/A									
<b>Federal Reserve</b>	5.3%	5.1%	5.1%	N/A								
<b>Interest Rates on 10-Year Treasury Notes</b>												
<b>CBO (January 2015)</b>	2.8%	3.4%	3.9%	4.2%	4.5%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.4%
<b>CBO (August 2014)</b>	3.3%	3.8%	4.2%	4.6%	4.7%	4.7%	4.7%	4.7%	4.7%	4.7%	N/A	4.4%
<b>OMB (July 2014)</b>	3.3%	3.7%	4.1%	4.3%	4.5%	4.6%	4.8%	4.8%	4.8%	4.8%	N/A	4.4%
<b>Blue Chip</b>	3.0%	3.7%	N/A									

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

Note: "Ten-year" column reflects 2016-2025 for CBO (January 2015) and 2015-2024 for other rows.

## Conclusion

Although CBO projects very modest declines in the near-term deficit, the report clearly shows an unsustainable long-term trajectory. Even if policymakers abide by current law as CBO's baseline assumes, trillion-dollar deficits will return within a decade. Record-high debt levels will continue to rise, with only a brief respite, over that period.

Unfortunately, CBO's already bleak projections might be too optimistic, since they assume that lawmakers don't further increase the deficit, including by continuing current policies as they often have in recent years.

Under current law, policymakers would need to make significant changes to bring spending and revenues more closely in line in order to prevent debt levels from growing unsustainably. Extending temporary policies and repealing scheduled cuts would make debt rise much more sharply and require even greater corrections later.

Ultimately, it will take a significant package of entitlement and tax reforms to truly put the debt on a sustainable path. It will be difficult work, but it will leave the country on a sounder fiscal footing.