CHAPTER

1

The Budget Outlook

The Congressional Budget Office estimates that the federal budget deficit in fiscal year 2015 will be $426 billion, smaller than the $486 billion shortfall the agency estimated in March 2015.[1] That amount would constitute the smallest deficit since 2007, and at 2.4 percent of gross domestic product (GDP), it would be below the average deficit, relative to the size of the economy, over the past 50 years. Moreover, 2015 will mark the sixth consecutive year in which the deficit has declined as a percentage of GDP since it reached a peak at 9.8 percent in 2009 (see Figure 1-1). Nevertheless, debt held by the public will remain near 74 percent of GDP at the end of 2015, CBO estimates—about the same as last year, when it reached the highest ratio since 1950.

As specified in law, CBO constructs its baseline projections of federal revenues and spending under the assumption that current laws will generally remain unchanged. If that assumption was borne out, the period of shrinking deficits would soon come to an end. In CBO's baseline projections, annual budget shortfalls rise substantially over the 2016–2025 projection period—from a low of $414 billion in 2016 to $1.0 trillion in 2025.[2] That increase is projected mainly because growth in revenues would be outpaced by a combination of significant growth in spending on health care and retirement programs—caused by the aging of the population and rising per capita health care costs—and growing interest payments on federal debt. CBO expects that deficits during the decade would total $7.0 trillion if current laws remained unchanged (see Table 1-1).

Deficits are projected to fall to about 2 percent of GDP between 2016 and 2018 and then to begin rising again, reaching almost 4 percent at the end of the 10-year period. By comparison, the deficit averaged 2.7 percent of GDP between 1965 and 2014. Over the next 10 years, revenues and outlays alike are projected to be above their 50-year averages as measured relative to GDP (see Figure 1-2).

In CBO's current baseline projections, federal debt held by the public remains about the same relative to the size of the economy over the next several years but eventually begins to grow slowly, reaching 77 percent of GDP by 2025—roughly twice the 38 percent average of the past five decades. Beyond 2025, if current laws remained in place, the same pressures that contribute to rising deficits during the coming decade would accelerate and push debt up sharply relative to GDP.[3]

Such high and rising debt would have serious negative consequences both for the economy and for the federal budget. When interest rates rise to more typical levels—as CBO expects will be the case in the next few years—federal spending on interest payments will increase considerably. Moreover, federal borrowing boosts the overall demand for funds, and that in turn generally raises the cost of borrowing and reduces the amount of lending in the economy at large. The eventual result would be a smaller stock of capital and lower output and income than would otherwise be the case, all else being equal. In addition, the large amount of debt could restrict policymakers' ability to use tax and spending policies to respond to unexpected challenges, such as economic downturns or financial crises. Finally, continued growth in the debt might lead investors to doubt the government's willingness or ability to pay its obligations, which would require the government to pay much higher interest rates on its borrowing.

1. See Congressional Budget Office, *Updated Budget Projections: 2015 to 2025* (March 2015), www.cbo.gov/publication/49973.

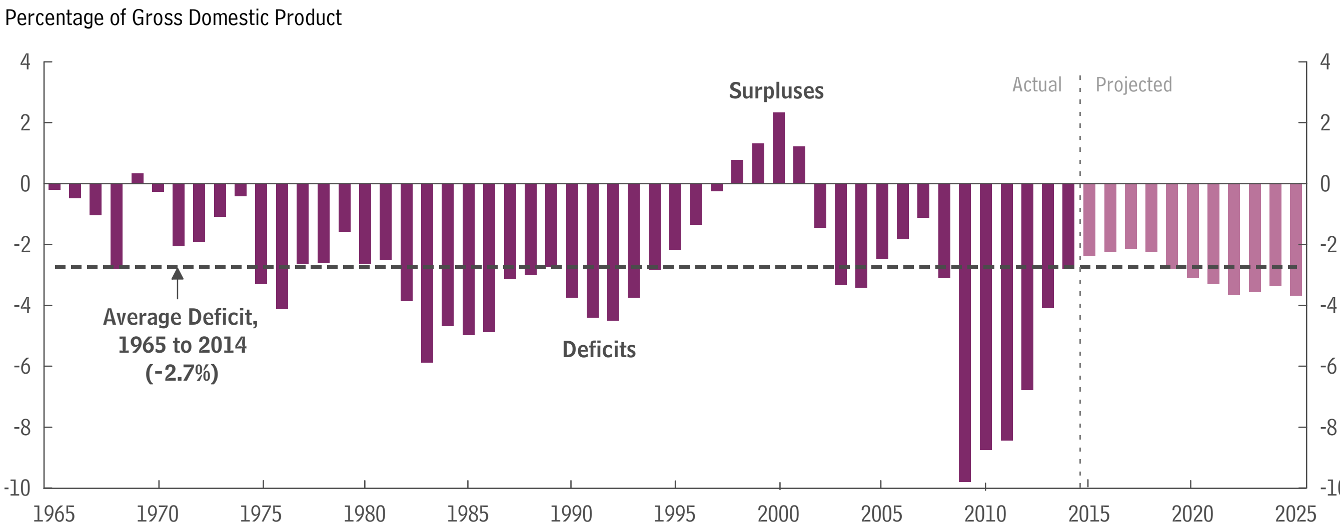
2. CBO's updated baseline projections incorporate the effects of legislation and administrative actions through August 6, 2015.

3. For a more detailed discussion, see Congressional Budget Office, *The 2015 Long-Term Budget Outlook* (June 2015), www.cbo.gov/publication/50250.

Figure 1-1.

Total Deficits or Surpluses

Because outlays are projected to grow faster than revenues after 2018, projected deficits increase to almost 4 percent of gross domestic product from 2022 through 2025.



Source: Congressional Budget Office.

CBO's current baseline projections show a smaller deficit in 2015 and in nearly every year of the 2016–2025 period than the agency estimated in March.[4] The projected deficit for this year is now $60 billion below the earlier estimate; higher revenues account for nearly all of that change. The cumulative deficit from 2016 through 2025 is projected to be about $200 billion less than the March estimate. Although revenues are projected to be lower over the 2016–2025 period than the amounts previously reported, the projections for outlays have declined even more, largely because CBO anticipates lower interest rates and thus smaller interest payments than it did in March.

The Budget Outlook for 2015

In the absence of additional legislation that would affect spending or revenues, the deficit in fiscal year 2015 will be $59 billion less than the $485 billion shortfall recorded in 2014, CBO estimates. The deficit will be smaller because revenues, which are expected to increase by nearly 8 percent, are growing more rapidly than are outlays, which CBO anticipates will increase by 5 percent this year. As a percentage of GDP, in 2015, the deficit is projected to drop to 2.4 percent from last year's 2.8 percent.

In most years, debt held by the public increases by an amount that is greater than the deficit, in part because of federal borrowing to finance student loans and in part because of certain other transactions that the government makes. In 2015, however, debt held by the public is projected to increase by $396 billion, an amount that is less than the deficit, as a result of steps taken by the Treasury to keep debt within its statutory limit. All in all, debt held by the public will equal 73.8 percent of GDP at the end of fiscal year 2015, CBO estimates, slightly below the 74.0 percent recorded at the end of 2014. As recently as 2007, debt held by the public was 35 percent of GDP, less than half its current mark.

Outlays in 2015

Outlays are expected to increase by $171 billion this year—to total $3.7 trillion. By CBO's calculations, federal spending will equal 20.6 percent of GDP, which is above both last year's 20.3 percent and the 20.1 percent average over the past 50 years. CBO's estimates for the three broad categories of federal spending are as follows for 2015:

4. For a discussion of changes in CBO's baseline since March 2015, see Appendix A.

Table 1-1.

CBO's Baseline Budget Projections

	Actual, 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total 2016-2020	Total 2016-2025
							In Billions of Dollars							
Revenues														
Individual income taxes	1,395	1,540	1,665	1,768	1,850	1,927	2,014	2,115	2,226	2,341	2,463	2,593	9,224	20,961
Payroll taxes	1,023	1,066	1,100	1,143	1,188	1,236	1,287	1,342	1,396	1,453	1,511	1,574	5,953	13,229
Corporate income taxes	321	348	445	430	427	419	425	419	435	452	471	491	2,145	4,413
Other	283	297	305	288	265	265	277	289	302	314	327	342	1,400	2,973
Total	**3,021**	**3,251**	**3,514**	**3,628**	**3,730**	**3,847**	**4,004**	**4,164**	**4,359**	**4,560**	**4,772**	**4,999**	**18,723**	**41,577**
On-budget	2,286	2,480	2,719	2,798	2,865	2,948	3,070	3,194	3,351	3,514	3,685	3,871	14,400	32,016
Off-budget[a]	736	771	796	831	865	898	933	970	1,007	1,046	1,086	1,128	4,323	9,561
Outlays														
Mandatory	2,099	2,297	2,491	2,554	2,623	2,783	2,939	3,101	3,328	3,459	3,586	3,852	13,390	30,716
Discretionary	1,179	1,162	1,176	1,186	1,195	1,222	1,249	1,276	1,310	1,336	1,362	1,400	6,028	12,712
Net interest	229	218	261	304	367	437	503	553	606	660	710	755	1,872	5,156
Total	**3,506**	**3,677**	**3,928**	**4,044**	**4,184**	**4,443**	**4,690**	**4,931**	**5,244**	**5,455**	**5,657**	**6,007**	**21,289**	**48,584**
On-budget	2,800	2,936	3,153	3,228	3,313	3,513	3,694	3,866	4,105	4,237	4,356	4,618	16,900	38,083
Off-budget[a]	706	741	775	816	871	930	996	1,065	1,139	1,218	1,301	1,389	4,388	10,501
Deficit (-) or Surplus	**-485**	**-426**	**-414**	**-416**	**-454**	**-596**	**-687**	**-767**	**-885**	**-895**	**-886**	**-1,008**	**-2,566**	**-7,007**
On-budget	-514	-456	-434	-430	-448	-564	-624	-671	-754	-724	-671	-747	-2,500	-6,067
Off-budget[a]	30	30	21	14	-6	-32	-63	-95	-131	-172	-215	-261	-66	-940
Debt Held by the Public	12,780	13,175	13,821	14,338	14,864	15,528	16,277	17,102	18,044	18,993	19,933	21,001	n.a.	n.a.
Memorandum:														
Gross Domestic Product	17,263	17,847	18,587	19,482	20,359	21,234	22,158	23,121	24,115	25,144	26,210	27,317	101,820	227,727
							As a Percentage of Gross Domestic Product							
Revenues														
Individual income taxes	8.1	8.6	9.0	9.1	9.1	9.1	9.1	9.1	9.2	9.3	9.4	9.5	9.1	9.2
Payroll taxes	5.9	6.0	5.9	5.9	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Corporate income taxes	1.9	1.9	2.4	2.2	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.8	2.1	1.9
Other	1.6	1.7	1.6	1.5	1.3	1.3	1.2	1.2	1.3	1.3	1.2	1.3	1.4	1.3
Total	**17.5**	**18.2**	**18.9**	**18.6**	**18.3**	**18.1**	**18.1**	**18.0**	**18.1**	**18.1**	**18.2**	**18.3**	**18.4**	**18.3**
On-budget	13.2	13.9	14.6	14.4	14.1	13.9	13.9	13.8	13.9	14.0	14.1	14.2	14.1	14.1
Off-budget[a]	4.3	4.3	4.3	4.3	4.2	4.2	4.2	4.2	4.2	4.2	4.1	4.1	4.2	4.2
Outlays														
Mandatory	12.2	12.9	13.4	13.1	12.9	13.1	13.3	13.4	13.8	13.8	13.7	14.1	13.2	13.5
Discretionary	6.8	6.5	6.3	6.1	5.9	5.8	5.6	5.5	5.4	5.3	5.2	5.1	5.9	5.6
Net interest	1.3	1.2	1.4	1.6	1.8	2.1	2.3	2.4	2.5	2.6	2.7	2.8	1.8	2.3
Total	**20.3**	**20.6**	**21.1**	**20.8**	**20.6**	**20.9**	**21.2**	**21.3**	**21.7**	**21.7**	**21.6**	**22.0**	**20.9**	**21.3**
On-budget	16.2	16.5	17.0	16.6	16.3	16.5	16.7	16.7	17.0	16.9	16.6	16.9	16.6	16.7
Off-budget[a]	4.1	4.2	4.2	4.2	4.3	4.4	4.5	4.6	4.7	4.8	5.0	5.1	4.3	4.6
Deficit (-) or Surplus	**-2.8**	**-2.4**	**-2.2**	**-2.1**	**-2.2**	**-2.8**	**-3.1**	**-3.3**	**-3.7**	**-3.6**	**-3.4**	**-3.7**	**-2.5**	**-3.1**
On-budget	-3.0	-2.6	-2.3	-2.2	-2.2	-2.7	-2.8	-2.9	-3.1	-2.9	-2.6	-2.7	-2.5	-2.7
Off-budget[a]	0.2	0.2	0.1	0.1	*	-0.1	-0.3	-0.4	-0.5	-0.7	-0.8	-1.0	-0.1	-0.4
Debt Held by the Public	74.0	73.8	74.4	73.6	73.0	73.1	73.5	74.0	74.8	75.5	76.1	76.9	n.a.	n.a.

Source: Congressional Budget Office.

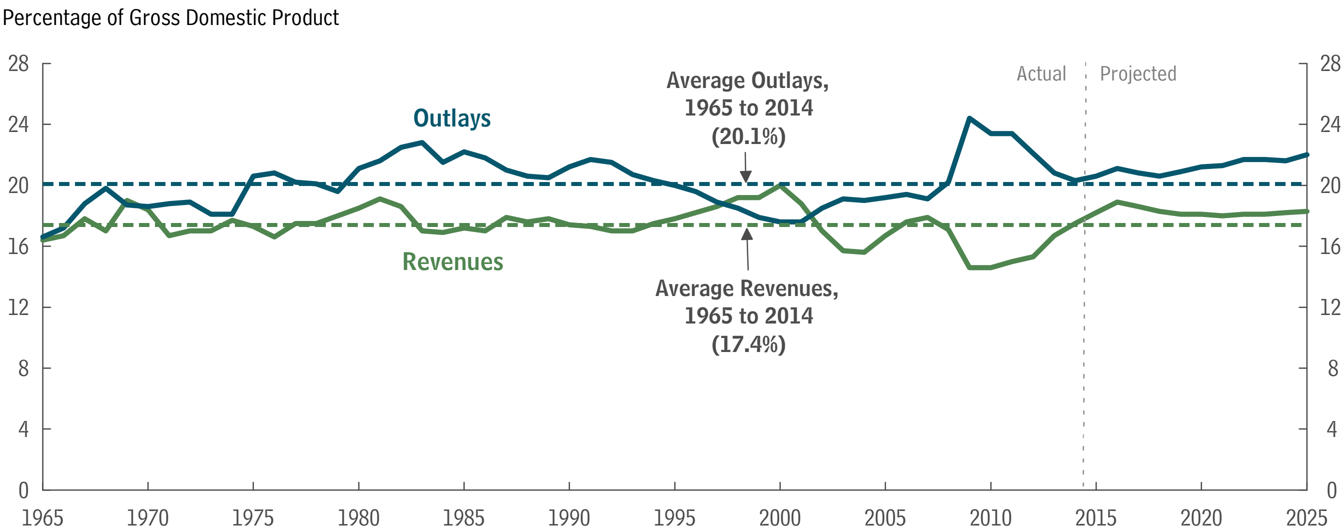
Note: n.a. = not applicable; * = between -0.05 percent and zero.

a. The revenues and outlays of the Social Security trust funds and the net cash flow of the Postal Service are classified as off-budget.

Figure 1-2.

Total Revenues and Outlays

Projected deficits in CBO's baseline remain about the same for the next several years but then increase as mandatory spending and interest payments rise while revenues remain essentially steady relative to gross domestic product.



Source: Congressional Budget Office.

- Mandatory spending is estimated to rise by nearly 10 percent in nominal terms, increasing to 12.9 percent of GDP (compared with 12.2 percent in 2014).[5]

- Discretionary spending is anticipated to decline by about 1 percent in nominal terms, falling to 6.5 percent of GDP (compared with 6.8 percent last year).[6]

- Net interest spending is expected to fall by nearly 5 percent in nominal terms, declining to 1.2 percent of GDP (compared with 1.3 percent in 2014).

Mandatory Spending. Outlays for mandatory programs are projected to rise to $2.3 trillion this year, an increase of $199 billion from 2014 (see Table 1-2). Most mandatory spending is for the federal government's major health care programs and Social Security. Those health care programs consist of Medicare (net of premiums and other offsetting receipts); Medicaid; the Children's Health Insurance Program; and federal subsidies for health insurance purchased through exchanges along with related spending.[7] By CBO's estimate, the largest increases in net outlays, compared with spending in 2014, will be for those programs, for the government's transactions with Fannie Mae and Freddie Mac, and for higher education.[8] That set of increases will be partially offset by increased receipts from auctions of licenses to use the electromagnetic spectrum (the proceeds of those auctions are recorded as offsets to mandatory outlays) and by reduced spending for unemployment compensation.

Major Health Care Programs. Federal spending for the major health care programs will jump by $106 billion (or about 13 percent) in 2015, CBO estimates. The largest increase will be for Medicaid outlays, which are projected

5. Mandatory spending is governed by statutory criteria and is not normally controlled by the annual appropriation process.

6. Discretionary spending is controlled by annual appropriation acts that specify the amounts that are to be provided for a broad array of government activities, including, for example, defense, law enforcement, and transportation.

7. Related spending consists of outlays for certain grants to states, payments for risk adjustment (amounts paid to plans that attract less healthy enrollees), and payments for reinsurance (amounts paid to plans that enroll people who subsequently incur very high health care costs). Outlays for risk adjustment and reinsurance will be offset by associated revenues, resulting in no net budgetary effect.

8. Payments from Fannie Mae and Freddie Mac to the U.S. Treasury are recorded as reductions in outlays. CBO expects that payments from the two entities will be smaller this year than they were last year, thereby boosting outlays.

to increase by $49 billion (or 16 percent) this year, largely because of new enrollees added through the optional expansion of coverage authorized by the Affordable Care Act (ACA). As a result, CBO projects, Medicaid enrollment will rise by between 5 percent and 10 percent in 2015. In addition, the provisions of the ACA that led to the increased enrollment will be in place for all of the current fiscal year; because they took effect in January 2014, they were in place for just nine months of fiscal year 2014.

Similarly, CBO estimates that outlays for subsidies that help eligible people to purchase health insurance through exchanges, as well as related spending, will increase by $22 billion in 2015, to $37 billion. That growth largely reflects a significant increase in the number of people who have purchased coverage through the exchanges as well as the fact that subsidies for that coverage will be available for the entire fiscal year. (Last year the subsidies did not become available until three months into the fiscal year.)

In 2015, spending for Medicare (net of premiums and other offsetting receipts) will rise by $35 billion, or about 7 percent, CBO expects—the fastest rate of growth recorded for the program since 2009 (after adjustments are made for shifts in the timing of certain payments). Part of that increase reflects the fact that certain provisions of the ACA that reduced the rate of growth in Medicare spending have been implemented already. Those provisions will continue to constrain Medicare spending, but to roughly the same extent each year, so they are no longer reducing its growth rate. In addition, the increase in 2015 reflects growth in the number or cost of services furnished to Medicare beneficiaries, although data are not yet available to show how much of that growth is attributable to changes in hospital admissions, physician visits, prescriptions of expensive new drugs, or other health care services.

Social Security. Outlays for Social Security benefits are projected to climb by $37 billion, or 4.4 percent, this year, which is about the same rate of growth as in 2014. That increase includes the effects of the 1.7 percent cost-of-living adjustment that beneficiaries received in January and of an estimated 1.8 percent increase in the number of beneficiaries.

Fannie Mae and Freddie Mac. CBO estimates that payments to the U.S. Treasury from Fannie Mae and Freddie Mac will be $52 billion less than they were in 2014. Such payments, which are recorded as reductions in outlays (rather than as revenues), totaled $74 billion in 2014 but will fall to $23 billion in 2015. That drop is partly attributable to a onetime revaluation of certain tax assets held by Freddie Mac, which boosted its payments to the Treasury by nearly $24 billion in fiscal year 2014. In addition, financial institutions are expected to make fewer payments to Fannie Mae and Freddie Mac in 2015 to settle allegations of fraud in connection with residential mortgages and certain other securities. The result is that the two entities' profits will be smaller this year, as will their remittances to the Treasury.

Higher Education. Mandatory outlays for higher education were –$12 billion in 2014 but are expected to be positive by $21 billion this year. Such outlays include subsidies for federal student loans issued in the current year, revisions to the subsidy costs for loans made in previous years, and mandatory spending for the Federal Pell Grant Program. Outlays for 2014 were negative because the estimated subsidy costs of those loans were negative—that is, over the lifetime of the loans, the amounts the government expects to receive will be greater than the payments the government is expected to make, as measured on a discounted present-value basis.[9] Outlays in 2015 are projected to be positive, mostly because the Department of Education recorded a revision to the subsidy costs for past loans that resulted in an $18 billion increase for 2015 (the 2014 revision totaled $1 billion). In addition, the department is applying subsidy rates in 2015 that are less negative than those used in 2014 to estimate the costs of new loans.

Spectrum Auctions. Under current law, the Federal Communications Commission occasionally auctions licenses for commercial use of the electromagnetic spectrum. The auctions' receipts are recorded as reductions in mandatory outlays rather than as revenues collected by the federal

9. Under the Federal Credit Reform Act, a program's subsidy costs are calculated by subtracting the discounted present value of the government's projected receipts from the discounted present value of its projected payments. The estimated subsidy costs can be increased or decreased in subsequent years to reflect updated assessments of the payments and receipts associated with the program. Present value is a single number that expresses a flow of current and future income (or payments) in terms of an equivalent lump sum received (or paid) today. The present value depends on the rate of interest (the discount rate) that is used to translate future cash flows into current dollars.

Table 1-2.

Mandatory Outlays Projected in CBO's Baseline

Billions of Dollars

	Actual, 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total 2016-2020	Total 2016-2025
Major Health Care Programs														
Medicare[a]	600	639	695	704	715	793	852	915	1,024	1,058	1,086	1,218	3,758	9,057
Medicaid	301	350	376	394	410	427	446	467	491	516	543	571	2,053	4,641
Health insurance subsidies and related spending[b]	15	37	60	76	81	85	87	91	95	98	102	105	389	880
Children's Health Insurance Program	9	9	13	14	11	6	6	6	6	6	6	6	49	78
Subtotal[a]	925	1,035	1,144	1,187	1,216	1,311	1,391	1,478	1,616	1,678	1,736	1,899	6,249	14,656
Social Security														
Old-Age and Survivors Insurance	703	738	766	804	857	915	979	1,043	1,111	1,183	1,258	1,336	4,322	10,254
Disability Insurance	142	144	145	149	155	160	167	175	184	193	203	212	776	1,745
Subtotal	845	882	912	953	1,012	1,076	1,146	1,219	1,296	1,377	1,461	1,548	5,098	11,999
Income Security Programs														
Earned income, child, and other tax credits[c]	86	85	87	85	85	70	71	72	73	74	75	77	397	769
Supplemental Nutrition Assistance Program	76	76	75	74	73	72	72	72	71	72	72	73	367	726
Supplemental Security Income	54	55	59	56	53	59	61	63	70	67	63	71	289	622
Unemployment compensation	44	33	34	36	38	41	44	48	50	53	56	59	193	458
Family support and foster care[d]	31	31	32	32	32	32	33	33	33	34	34	34	161	329
Child nutrition	20	22	22	23	24	25	26	27	28	30	31	32	121	269
Subtotal	311	302	310	306	305	299	307	314	326	329	331	345	1,527	3,173
Federal Civilian and Military Retirement														
Civilian[e]	94	97	98	101	103	106	110	114	117	121	125	129	518	1,125
Military	55	57	62	58	55	61	63	65	72	69	66	73	300	645
Other	8	7	6	7	7	7	8	9	10	10	10	10	35	82
Subtotal	158	160	165	165	165	175	181	188	199	201	201	212	853	1,853
Veterans' Programs[f]														
Income security	71	76	84	80	76	84	86	87	95	89	84	93	409	857
Other	16	16	25	20	16	18	18	19	21	21	21	23	97	202
Subtotal	87	92	108	99	92	102	104	106	116	110	105	116	505	1,059
Other Programs														
Agriculture	19	13	17	17	17	15	14	14	14	15	15	15	81	153
MERHCF	9	10	10	10	11	12	12	13	14	15	16	17	55	129
Deposit insurance	-14	-10	-9	-10	-13	-15	-13	-10	-12	-13	-14	-15	-61	-124
Fannie Mae and Freddie Mac[g]	n.a.	n.a.	3	3	3	2	1	1	2	2	2	2	13	21
Higher education	-12	21	-7	-2	2	2	3	3	3	3	3	3	-3	11
Other	52	60	65	71	70	69	67	66	64	64	64	68	342	668
Subtotal	54	94	79	90	90	84	85	86	84	85	85	89	427	858

Continued

government. In 2014, net receipts totaled $1 billion for a set of licenses that were of value primarily to a single business. By contrast, the 2015 auction awarded licenses for more bandwidth, which also had more desirable characteristics, thus spurring intense competition among several large telecommunications companies. As a result, CBO anticipates, net collections will increase to $36 billion this year.

Unemployment Compensation. Federal expenditures for unemployment compensation are expected to decline for a fifth consecutive year. Such spending totaled $44 billion

Table 1-2. **Continued**

Mandatory Outlays Projected in CBO's Baseline

Billions of Dollars

	Actual, 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total 2016-2020	Total 2016-2025
Offsetting Receipts														
Medicare[h]	-95	-98	-113	-118	-123	-132	-142	-153	-169	-178	-186	-206	-628	-1,520
Federal share of federal employees' retirement														
Social Security	-16	-16	-17	-17	-18	-18	-19	-20	-20	-21	-22	-22	-89	-194
Military retirement	-21	-20	-19	-20	-20	-21	-22	-22	-23	-24	-25	-26	-102	-222
Civil service retirement and other	-29	-32	-32	-34	-35	-36	-37	-38	-39	-40	-41	-42	-174	-373
Subtotal	-65	-68	-68	-71	-73	-75	-78	-80	-82	-85	-87	-90	-365	-789
Receipts related to natural resources	-14	-11	-12	-12	-16	-15	-15	-16	-16	-16	-18	-18	-70	-154
MERHCF	-8	-7	-7	-7	-8	-8	-9	-9	-10	-10	-11	-11	-39	-90
Fannie Mae and Freddie Mac[g]	-74	-23	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other	-25	-61	-27	-38	-38	-34	-31	-31	-32	-32	-32	-33	-168	-328
Subtotal	-281	-268	-227	-246	-258	-264	-274	-290	-309	-320	-334	-358	-1,270	-2,881
Total Mandatory Outlays	**2,099**	**2,297**	**2,491**	**2,554**	**2,623**	**2,783**	**2,939**	**3,101**	**3,328**	**3,459**	**3,586**	**3,852**	**13,390**	**30,716**
Memorandum:														
Mandatory Spending Excluding the Effects of Offsetting Receipts	2,380	2,565	2,718	2,800	2,881	3,047	3,213	3,391	3,637	3,780	3,919	4,210	14,659	33,597
Spending for Medicare Net of Offsetting Receipts	505	541	582	586	591	661	709	761	855	880	900	1,011	3,130	7,537
Spending for Major Health Care Programs Net of Offsetting Receipts[i]	831	937	1,031	1,069	1,093	1,179	1,248	1,325	1,447	1,500	1,550	1,693	5,620	13,136

Source: Congressional Budget Office.

Notes: Data on spending for benefit programs in this table generally exclude administrative costs, which are discretionary.

MERHCF = Department of Defense Medicare-Eligible Retiree Health Care Fund (including TRICARE for Life); n.a. = not applicable.

a. Gross spending, excluding the effects of Medicare premiums and other offsetting receipts. (Net spending for Medicare and for major health care programs is included in the memorandum section of the table.)

b. Subsidies for health insurance purchased through the exchanges established under the Affordable Care Act. Related spending consists of outlays for certain grants to states, payments for risk adjustments (amounts paid to plans that attract less healthy enrollees), and payments for reinsurance (amounts paid to plans that enroll individuals who subsequently incur very high health costs). Outlays for risk adjustment and reinsurance will be offset by associated revenues, resulting in no net budgetary effect.

c. Includes outlays for the American Opportunity Tax Credit and other credits.

d. Includes the Temporary Assistance for Needy Families program, the Child Support Enforcement program, the Child Care Entitlement program, and other programs that benefit children.

e. Includes Civil Service, Foreign Service, Coast Guard, and smaller retirement programs as well as annuitants' health care benefits.

f. "Income security" includes veterans' compensation, pensions, and life insurance programs. "Other" benefits are primarily education subsidies. The costs of veterans' health care are classified as discretionary spending and thus are not shown in this table.

g. The cash payments from Fannie Mae and Freddie Mac to the U.S. Treasury are recorded as offsetting receipts in 2014 and 2015. Beginning in 2016, CBO's estimates reflect the net lifetime costs—that is, the subsidy costs adjusted for market risk—of the guarantees that those entities will issue and of the loans that they will hold. CBO counts those costs as federal outlays in the year of issuance.

h. Includes premium payments, recoveries of overpayments made to providers, and amounts paid by states from savings on Medicaid's prescription drug costs.

i. Consists of outlays for Medicare (net of offsetting receipts), Medicaid, the Children's Health Insurance Program, and subsidies for health insurance purchased through exchanges and related spending.

Table 1-3.

Discretionary Spending Projected in CBO's Baseline

Billions of Dollars

	Actual, 2014	2015[a]	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total 2016-2020	Total 2016-2025
Budget Authority														
Defense	606	586	589	603	617	632	647	663	679	696	713	730	3,087	6,567
Nondefense	527	530	516	527	539	553	567	580	595	610	625	640	2,704	5,754
Total	**1,134**	**1,116**	**1,105**	**1,130**	**1,156**	**1,185**	**1,215**	**1,243**	**1,274**	**1,305**	**1,338**	**1,371**	**5,791**	**12,321**
Outlays														
Defense	596	583	587	592	599	616	631	645	666	677	689	711	3,025	6,413
Nondefense	582	579	590	593	596	606	618	631	644	658	673	689	3,003	6,299
Total	**1,179**	**1,162**	**1,176**	**1,186**	**1,195**	**1,222**	**1,249**	**1,276**	**1,310**	**1,336**	**1,362**	**1,400**	**6,028**	**12,712**
Memorandum:														
Caps in the Budget Control Act (As Amended), Including Automatic Reductions to the Caps														
Defense	520	521	523	536	549	562	576	590	n.a.	n.a.	n.a.	n.a.	2,746	n.a.
Nondefense	492	492	493	504	515	529	543	555	n.a.	n.a.	n.a.	n.a.	2,585	n.a.
Total	1,012	1,014	1,017	1,040	1,064	1,091	1,119	1,145	n.a.	n.a.	n.a.	n.a.	5,331	n.a.
Adjustments to the Caps[b]														
Defense	86	65	65	67	68	69	71	72	n.a.	n.a.	n.a.	n.a.	341	n.a.
Nondefense	13	23	23	23	24	24	25	25	n.a.	n.a.	n.a.	n.a.	119	n.a.
Total	99	87	88	90	92	94	96	98	n.a.	n.a.	n.a.	n.a.	460	n.a.

Source: Congressional Budget Office.

Notes: CBO's baseline projections incorporate the assumption that the caps on discretionary budget authority and the automatic spending reductions specified in the Budget Control Act of 2011 (as amended) remain in effect through 2021.

Nondefense discretionary outlays are usually higher than budget authority because of spending from the Highway Trust Fund and the Airport and Airway Trust Fund that is subject to obligation limitations set in appropriation acts. The budget authority for such programs is provided in authorizing legislation and is not considered discretionary.

n.a. = not applicable.

a. The amount of budget authority for 2015 in CBO's baseline does not match the sum of the spending caps plus adjustments to the caps mostly because changes to mandatory programs included in the Consolidated and Further Continuing Appropriations Act of 2015 were credited against the caps; in CBO's baseline, those changes (which reduced mandatory budget authority) appear in their normal mandatory accounts.

b. Such adjustments include funding for overseas contingency operations, activities designated as emergency requirements, disaster relief (up to certain limits), and certain efforts to reduce overpayments in benefit programs.

in 2014 and will fall to $33 billion in 2015, CBO estimates, in part because a falling unemployment rate has led fewer people to claim regular benefits and partly because the authority to pay emergency benefits expired at the end of December 2013, the end of the first quarter of fiscal year 2014.

Discretionary Spending. CBO anticipates that outlays from annual appropriations will total nearly $1.2 trillion in 2015—$17 billion less than last year (see Table 1-3). Most of that difference is attributable to a drop in defense spending: Defense outlays, which amounted to $596 billion in 2014, will fall by $14 billion (or about 2 percent), to $583 billion, according to CBO's calculations, marking the fourth consecutive year in which such spending has declined. Most of that change will result from a decline of roughly $20 billion this year in spending for overseas contingency operations, primarily in

Afghanistan, by CBO's estimates. All told, defense outlays this year are expected to be 17 percent less (in nominal dollars) than they were at their peak in 2011; roughly 70 percent of that decline will stem from lower spending for military operations in Afghanistan and Iraq.

CBO expects that nondefense discretionary outlays will dip by $3 billion in 2015, to $579 billion. That amount would be about 12 percent less than the peak in 2010, when outlays increased substantially because of spending under the American Recovery and Reinvestment Act of 2009 (Public Law 111-5).

Net Interest. Outlays in this category consist of the government's interest payments on debt held by the public minus interest income that the government receives. In 2015, such outlays will fall to $218 billion, from $229 billion last year, CBO estimates. The reduction stems primarily from downward adjustments to the principal of inflation-protected securities. (Those adjustments are made to account for inflation, and they are based on the consumer price index for all urban consumers, a common measure of inflation in the economy.) The effect of the continued accumulation of debt, however, will offset some of that decrease. Because interest rates remain very low by historical standards, total outlays for net interest are similar to amounts recorded 15 to 20 years ago, when federal debt was much smaller.

Revenues in 2015

On the basis of tax collections through July 2015, CBO expects federal revenues to total $3.3 trillion this fiscal year, $230 billion (or 8 percent) more than in 2014. The largest gain, both in dollar terms and on a percentage basis, is expected to be in the form of receipts from individual income taxes. CBO anticipates that total revenues will rise from 17.5 percent of GDP in 2014 to 18.2 percent in 2015, nearly 1 percentage point above the 17.4 percent average over the past 50 years.

Individual Income Taxes. CBO anticipates that collections of individual income taxes will increase by $146 billion (or about 10 percent) in 2015. Nonwithheld and withheld taxes are expected to contribute similar amounts to that increase. Nonwithheld taxes have risen this year because increases in nonwage income in 2014 and 2015 led to higher final tax payments for 2014 (as reflected in amounts paid with tax returns filed this year) and to higher quarterly estimated payments of taxes for 2015. Receipts from withheld taxes also have risen so far this year, primarily because of increases in wages and salaries.

Payroll Taxes. CBO expects that receipts from payroll taxes—which primarily fund Social Security and Medicare's Hospital Insurance program—will increase by $42 billion (or about 4 percent), largely because of rising wages and salaries.

Corporate Income Taxes. Income tax payments by corporations, net of refunds, are expected to increase by $27 billion (or about 8 percent) in 2015. Receipts in the first 10 months of the fiscal year (that is, through July 2015) were higher by $23 billion (or 9 percent) than receipts for the same period last year—an indication that taxable corporate profits increased in 2014 and have continued to do so in recent months. The specific components of income and deductions contributing to the recent movement in profits will become clearer as information from corporate income tax returns becomes available over the next two years.

Revenues From Other Sources. CBO expects that other revenues will increase, on net, by about $15 billion (or 5 percent) in 2015. Most of that increase stems from miscellaneous fees and fines, which are expected to increase by $11 billion (or about 30 percent), largely because of provisions of the ACA that established new collections from health insurers under the reinsurance and risk adjustment programs. (Those revenues will be offset by associated outlays.) In addition, larger receipts from excise taxes, estate and gift taxes, and customs duties will be partially offset by a small decline in remittances from the Federal Reserve.

Tax Expenditures in 2015

The tax rules that form the basis of CBO's projections include an array of exclusions, deductions, preferential rates, and credits that reduce revenues for any given level of tax rates, in both the individual and the corporate income tax systems. Some of those provisions are called tax expenditures because, like government spending programs, they provide financial assistance to particular activities, entities, or groups of people. The tax expenditures with the largest effects on revenues are as follows:

- The exclusion from workers' taxable income of employers' contributions for health care, health insurance premiums, and long-term-care insurance premiums;

- The exclusion of contributions to and earnings of pension funds (minus pension benefits that are included in taxable income);
- Preferential tax rates on dividends and long-term capital gains; and
- The deductions for state and local taxes (on nonbusiness income, sales, real estate, and personal property).

On the basis of estimates prepared by the staff of the Joint Committee on Taxation (JCT), CBO expects that those and other tax expenditures will total about $1.5 trillion in 2015—an amount equal to 8.1 percent of GDP, or equivalent to nearly half of the revenues projected for the year.[10] That total is similar to the amount CBO estimated for 2014 because the tax rules affecting tax expenditures are largely the same in 2015 as they were in 2014.

CBO's Baseline Budget Projections for 2016 to 2025

CBO's baseline projections are not a forecast of future outcomes. They are constructed in accordance with provisions of the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget and Impoundment Control Act of 1974. As those laws specify, CBO constructs its baseline projections under the assumption that current laws will generally remain unchanged; the projections can therefore serve as a benchmark for measuring potential changes in law.

Under that assumption, CBO projects that the budget deficit would fall to slightly more than 2 percent of GDP in 2016 and remain near that mark through 2018. Beginning in 2019, deficits would be on a general upward trend, nearing 4 percent of GDP by the end of the projection period.[11] In CBO's baseline, debt held by the public increases relative to GDP over the same period.

Even if federal laws did not change over the next decade, however, actual budgetary outcomes almost certainly would differ from CBO's baseline projections, perhaps significantly, because of unanticipated changes in economic conditions and other factors that affect federal spending and revenues. CBO's projections of outlays and revenues depend on the agency's economic projections for the coming decade—including forecasts for such variables as interest rates, inflation, and GDP—as well as myriad technical factors. Relatively small discrepancies between those economic and technical assumptions and actual outcomes can result in significant deviations from baseline projections of revenues and outlays. For example, if the rate of inflation was higher (or lower) by 1 percentage point each year than CBO projects, baseline deficits over the 10-year period would be about $900 billion larger (or smaller).[12]

Federal Debt From 2016 to 2025

With deficits projected to total $7.0 trillion under current law, and accounting for the government's other borrowing needs, CBO estimates that federal debt held by the public would rise from $13.2 trillion at the end of 2015 to $21.0 trillion at the end of 2025 (see Table 1-4). Relative to the size of the economy, federal debt would decline from 73.8 percent of GDP at the end of 2015 to 73.0 percent at the end of 2018, but it would rise steadily thereafter, reaching about 77 percent of GDP at the end of 2025, CBO estimates.

That debt consists mostly of securities issued by the Treasury to raise the cash that funds the federal government's activities and that it uses to pay off maturing liabilities. The net amount that the Treasury borrows by selling those securities (the amounts that are sold minus the amounts that have matured) is determined primarily by the size of the annual budget deficit. In addition, the Treasury borrows to finance student loan and other federal credit programs. CBO projects that such additional borrowing, often called other means of financing, will range between about $50 billion and $100 billion annually in most years between 2016 and 2025.

Another measure of debt that will be the focus of increasing attention in the coming months is the amount that is subject to the statutory limit on federal borrowing. In addition to debt held by the public, that amount also

10. For more information on how that total was determined, see Congressional Budget Office, *The Budget and Economic Outlook: 2015 to 2025* (January 2015), pp. 101–105, www.cbo.gov/publication/49892.

11. Because October 1 falls on a weekend in 2016, 2017, 2022, and 2023, certain payments that are due on those days will instead be made at the end of September, thus shifting them into the previous fiscal year. Without that shift, deficits would reach a low of 2.0 percent of GDP in 2016 and would climb each year thereafter through 2025, CBO estimates.

12. For further discussion, see Congressional Budget Office, *The Budget and Economic Outlook: 2015 to 2025* (January 2015), Appendix C, www.cbo.gov/publication/49892.

Table 1-4.

Federal Debt Projected in CBO's Baseline

Billions of Dollars

	Actual, 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Debt Held by the Public at the Beginning of the Year	11,983	12,780	13,175	13,821	14,338	14,864	15,528	16,277	17,102	18,044	18,993	19,933
Changes in Debt Held by the Public												
Deficit	485	426	414	416	454	596	687	767	885	895	886	1,008
Other means of financing	313	-30	232	101	71	68	63	58	56	54	54	60
Total	797	396	646	517	525	664	749	825	942	950	940	1,068
Debt Held by the Public at the End of the Year	**12,780**	**13,175**	**13,821**	**14,338**	**14,864**	**15,528**	**16,277**	**17,102**	**18,044**	**18,993**	**19,933**	**21,001**
Debt Held by the Public at the End of the Year (As a percentage of GDP)	74.0	73.8	74.4	73.6	73.0	73.1	73.5	74.0	74.8	75.5	76.1	76.9
Memorandum:												
Debt Held by the Public Minus Financial Assets[a]												
In billions of dollars	11,545	11,831	12,343	12,729	13,153	13,721	14,379	15,118	15,973	16,838	17,692	18,671
As a percentage of GDP	66.9	66.3	66.4	65.3	64.6	64.6	64.9	65.4	66.2	67.0	67.5	68.3
Gross Federal Debt[b]	17,794	18,191	19,056	19,742	20,456	21,261	22,123	23,033	24,010	24,971	25,904	26,906
Debt Subject to Limit[c]	17,781	18,179	19,043	19,729	20,442	21,247	22,109	23,018	23,994	24,956	25,888	26,890
Average Interest Rate on Debt Held by the Public (Percent)[d]	1.8	1.7	1.9	2.1	2.5	2.8	3.1	3.2	3.4	3.5	3.6	3.6

Source: Congressional Budget Office.

Note: GDP = gross domestic product.

a. Debt held by the public minus the value of outstanding student loans and other credit transactions, cash balances, and other financial instruments.

b. Federal debt held by the public plus Treasury securities held by federal trust funds and other government accounts.

c. The amount of federal debt that is subject to the overall limit set in law. "Debt Subject to Limit" differs from gross federal debt mainly because most debt issued by agencies other than the U.S. Treasury and the Federal Financing Bank is excluded from the debt limit. That limit, which had previously been set at $17.2 trillion, was suspended from February 15, 2014, through March 15, 2015. On March 16, the debt limit was raised to $18.1 trillion (its previous level plus the amount of federal borrowing that occurred while the limit was suspended). At that point, the Treasury no longer had room to borrow under standard operating procedures. Therefore, to avoid a breach of the ceiling, the Treasury began employing its well-established toolbox of so-called extraordinary measures to allow continued borrowing. If the debt limit remains unchanged, those measures will be exhausted and the Treasury will run out of cash between mid-November and early December, CBO estimates. Over the next few months, however, the amount and timing of the government's outlays and revenue collections could vary from CBO's projections, and the debt limit could be reached earlier or later as a result.

d. The average interest rate is calculated as net interest divided by debt held by the public.

includes debt issued to accounts of various federal agencies, such as the Social Security trust fund. (Debt issued by agencies other than the Treasury and the Federal Financing Bank is excluded from the debt limit.) That limit, which had previously been set at $17.2 trillion, was suspended from February 15, 2014, through March 15, 2015. On March 16, the debt limit was raised to $18.1 trillion (its previous level plus the amount of federal borrowing that occurred while the limit was suspended). At that point, the Treasury could no longer borrow under its standard procedures.

To avoid a breach of the debt ceiling, the Treasury began to use a well-established set of procedures, known as extraordinary measures, to allow continued borrowing. If the debt limit remains unchanged, those measures will be exhausted and the Treasury will run out of cash between mid-November and early December, CBO estimates. Over the next few months, however, the amounts and timing of the government's outlays and revenue collections could vary from CBO's projections, and the debt limit could be reached earlier or later as a result.[13]

Outlays From 2016 Through 2025

Under current law, total outlays are projected to hover around 21 percent of GDP through 2021 and then to rise to 22 percent the following year and to remain at that level through 2025. In nominal terms, outlays would grow, on net, by $2.3 trillion between 2015 and 2025, CBO estimates—an average annual increase of 5.0 percent. Three major components of the budget—the major health care programs, Social Security, and net interest—account for nearly 85 percent of the total increase in outlays.

Mandatory Spending. In keeping with the requirements of the Deficit Control Act, CBO's projections for most mandatory programs incorporate the assumption that current laws will continue unchanged and reflect anticipated developments in the economy and demographics along with other factors. They also incorporate a set of across-the-board reductions (known as sequestration) that are required under current law for spending on certain mandatory programs.

Mandatory spending (net of offsetting receipts, which are recorded as reductions in outlays) is projected to increase from $2.3 trillion in 2015 to $3.9 trillion in 2025, an average yearly increase of 5.3 percent. It is projected to range between 12.9 percent of GDP and 13.4 percent of GDP between 2015 and 2021 and then to generally rise through the end of the projection period, reaching 14.1 percent of GDP in 2025. During the past 50 years, mandatory spending has averaged 9.3 percent of GDP (although it has been above that mark every year since 1989—reflecting the significant growth in spending for Social Security and health care programs over the past 25 years).

CBO estimates that spending on the government's major health care programs, net of offsetting receipts, will exceed Social Security outlays in every year of the projection period (see Figure 1-3). Taken together, in CBO's baseline, spending in those two categories increases from 10.2 percent of GDP in 2015 to 10.6 percent in 2019, and then rises to 11.9 percent in 2025.

The population age 65 or over in the United States will grow by about one-third over the next decade, thereby boosting the rolls for Social Security and the major health care programs—in particular, for Social Security's Old-Age and Survivors Insurance program and for Medicare.[14] Some other factors slow the growth of spending in the early years of the projection period, but that demographic factor becomes more prominent in the latter part of the 10-year horizon.

Specifically, in CBO's current baseline:

- Outlays for Social Security total 4.9 percent of GDP in 2016 and remain nearly unchanged over the first few years of the projection period relative to the size of the economy but then rise steadily thereafter to measure 5.7 percent of GDP by 2025 (see Figure 1-4).
- Outlays for Medicare (adjusted for shifts in the timing of certain payments) remain near 3.0 percent of GDP through 2018 and then increase each year through 2025, when they total 3.7 percent.
- Federal outlays for Medicaid are stable relative to GDP for the next 10 years, totaling about 2 percent in each year.
- Spending on subsidies for health insurance purchased through exchanges, along with related spending, increases from 0.2 percent of GDP in 2015 to 0.4 percent in 2017, where it remains through 2025.
- All other mandatory spending, net of offsetting receipts, declines as a share of GDP, from 2.7 percent in 2015 to 2.2 percent in 2025.

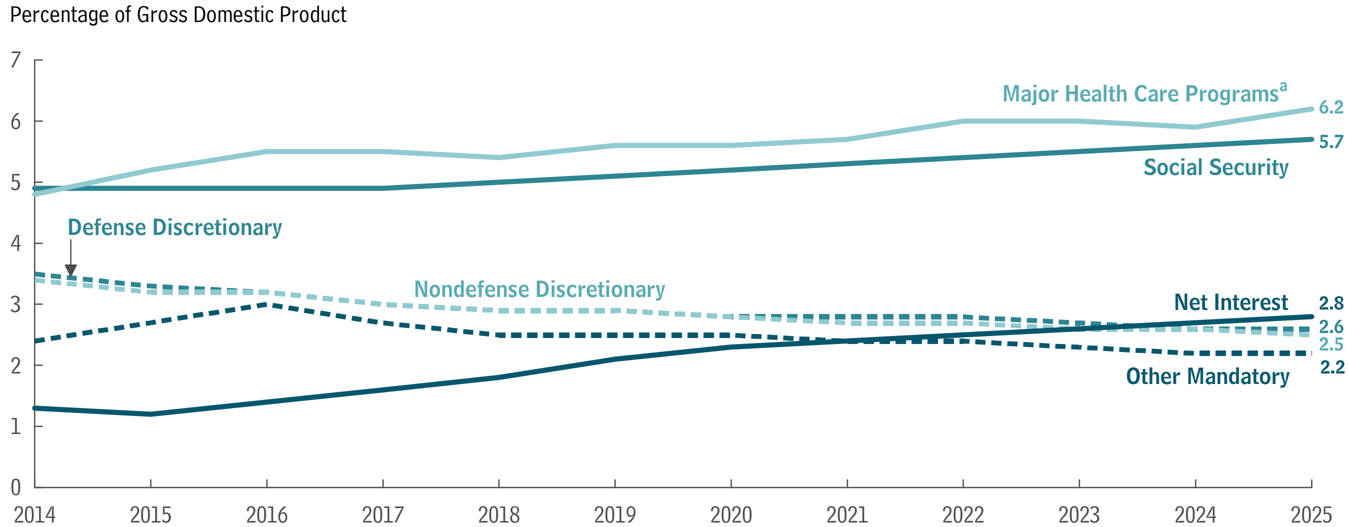
13. For a more detailed discussion of the statutory debt limit, see Congressional Budget Office, *Federal Debt and the Statutory Limit, August 2015* (August 2015), www.cbo.gov/publication/50739.

14. By 2025, about three-fifths of overall spending on the major health care programs will finance care for people ages 65 and older, about one-fifth will provide care for people who are blind or disabled, and about one-fifth will provide care for people in other groups.

Figure 1-3.

Projected Outlays for Major Budget Categories

Spending for the federal government's major health care programs and Social Security is projected to rise from 10.2 percent of gross domestic product in 2015 to 11.9 percent in 2025.



Source: Congressional Budget Office.

a. Medicare, Medicaid, the Children's Health Insurance Program, and subsidies for health insurance purchased through exchanges and related spending. (Medicare spending is net of premiums paid by beneficiaries and other offsetting receipts.) Other mandatory spending is all mandatory spending other than that for major health care programs and Social Security.

That final category includes spending on income support programs (such as unemployment compensation and the Supplemental Nutrition Assistance Program), military and civilian retirement programs, most veterans' benefits, and agriculture programs. The decline in outlays (relative to GDP) is projected because spending for many programs rises roughly with inflation, which is projected to be well below the rate of growth in nominal GDP.

Discretionary Spending. Discretionary spending encompasses an array of federal activities funded or controlled through annual appropriations, including most defense spending and outlays for highway programs, elementary and secondary education, housing assistance, international affairs, and administration of justice. Measured as a share of GDP, discretionary outlays are projected to drop from 6.5 percent in 2015 to 5.1 percent in 2025, the smallest percentage in any year since 1962 (the earliest year for which such data have been reported); by comparison, over the past 50 years, discretionary outlays have averaged 8.8 percent of GDP.

CBO's baseline incorporates the caps on budget authority for discretionary programs that were put in place by the Budget Control Act of 2011 (P.L. 112-25), including the reductions in those caps that are scheduled to occur in fiscal years 2016 through 2021 under the law's automatic enforcement procedures.[15] (After 2021, such funding is assumed to grow at the rate of inflation.) Appropriations for activities that are not constrained by the caps—overseas contingency operations (military operations and related activities in Afghanistan and other countries), activities designated as emergency requirements, disaster relief (up to certain limits), and certain efforts to reduce overpayments in benefit programs—are assumed to grow with inflation from the amounts provided in 2015.[16]

For 2016, the caps on discretionary budget authority for defense and nondefense programs are higher than those for 2015 by $2 billion and $1 billion, respectively.

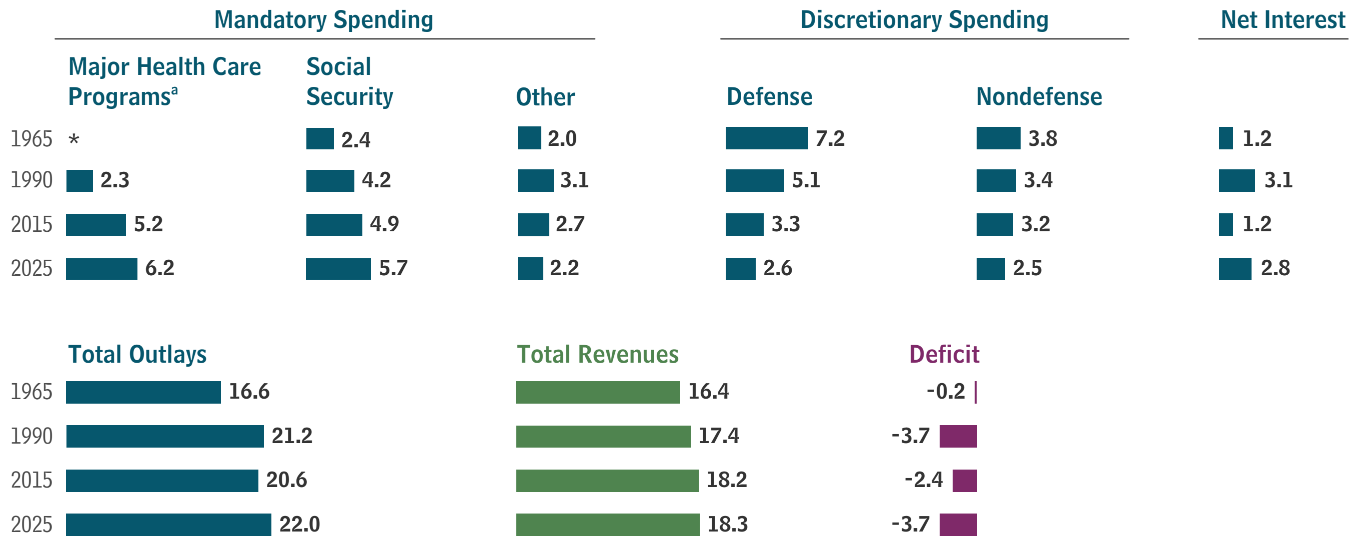
15. Budget authority is the authority provided by law to incur financial obligations that will result in immediate or future outlays of federal government funds.

16. Spending for certain transportation programs is controlled by obligation limitations, which also are not constrained by the caps on discretionary spending.

Figure 1-4.

Spending and Revenues Projected in CBO's Baseline, Compared With Actual Values in 1965 and 1990

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

Note: * = between zero and 0.05 percent.

a. Medicare, Medicaid, the Children's Health Insurance Program, and subsidies for health insurance purchased through exchanges and related spending. (Medicare spending is net of premiums paid by beneficiaries and other offsetting receipts.)

However, the year-to-year changes projected in the baseline are different:

- Discretionary budget authority for nondefense programs declines by $13 billion in 2016 primarily because, in 2015, some reductions in mandatory budget authority were included in appropriation legislation to help keep funding within limits set by the caps. (When such reductions in mandatory programs are included in appropriation acts, the savings are credited against the discretionary funding provided in those acts.) CBO's baseline for discretionary programs for 2016 does not include such changes to mandatory programs (because no such changes have been enacted for 2016), so adhering to the caps would require providing less discretionary budget authority in that year unless similar changes to mandatory programs are legislated again in the appropriation process.

- Budget authority for defense programs is $3 billion greater in 2016 than in 2015 because the cap is slightly higher and because funding for overseas contingency operations is assumed to grow from this year's amount at the rate of inflation.

After 2016, CBO projects, discretionary budget authority would rise by about 2 percent a year, on average, reflecting the rate of increase in the caps prescribed in the Budget Control Act and the assumption that such budget authority grows with inflation after the caps expire in 2021.

Total discretionary outlays in CBO's baseline grow very slowly over the next few years—at an average rate of nearly 1 percent annually between 2016 and 2018—and then keep pace with the projected 2 percent annual increase in budget authority, reaching $1.4 trillion by the end of the projection period.

Net Interest. Although CBO has reduced its projection of interest outlays over the 10-year projection period from its previous baseline (see Appendix A), rising interest rates and growing federal debt are still anticipated to boost those outlays significantly. In the baseline, they more than triple, rising from $218 billion (or 1.2 percent of GDP) in 2015 to $755 billion (or 2.8 percent of GDP) in 2025—the largest ratio since 1997.

In CBO's projections, debt held by the public grows by almost 60 percent from 2015 to 2025, but rising interest rates are projected to have an even greater impact on the government's borrowing costs. During the coming decade, economic conditions are expected to improve and the Federal Reserve is expected to gradually reduce support for economic growth. As a result, CBO anticipates that interest rates on Treasury securities will rise noticeably over the next several years from their current, unusually low levels. CBO expects that the interest rate on 3-month Treasury bills will rise from 0.1 percent to 3.4 percent between calendar years 2015 and 2019 and that it will remain there through 2025. The rate on 10-year Treasury notes, also reflecting those improved economic conditions, is forecast to rise from 2.3 percent in 2015 to 4.3 percent in 2021 and to remain there through 2025. (For further discussion, see "Monetary Policy and Interest Rates" on page 34 in Chapter 2.)

Revenues From 2016 Through 2025

In CBO's baseline, total revenues rise from 18.2 percent of GDP this year to 18.9 percent of GDP in 2016, largely because the end of calendar year 2014 saw the expiration of several provisions of law that had reduced corporate and individual income tax liabilities. Among those provisions was one that allowed businesses to immediately deduct significant portions of their investments in equipment. Although most of the expired tax provisions have routinely been extended in the past, future extensions cannot be assumed because the baseline follows current law. Therefore, in CBO's baseline, those provisions' expiration boosts corporate and individual income tax payments substantially in fiscal year 2016. (Tax payments in 2015 will still reflect many effects of the provisions prior to their expiration.)

After 2016, total revenues as a share of GDP are projected to decline modestly for several years, falling to 18.0 percent in 2021 and then rising slowly to 18.3 percent of GDP by 2025. That pattern stems from several sources of offsetting movements in revenues in CBO's baseline projections:

- Individual income tax receipts continue to increase relative to GDP—largely a result of real bracket creep, with smaller effects from recent changes in tax law and other factors.
- Payroll tax receipts decline relative to GDP, especially over the next several years, reflecting several factors, such as declines to more typical levels in states' deposits to unemployment trust funds.
- Corporate income tax receipts decline relative to the size of the economy after 2016, mostly because of an anticipated drop in domestic economic profits as a percentage of GDP and the waning effect of recently expired tax provisions.
- Remittances to the Treasury from the Federal Reserve—which have been very large since 2010 because of changes in the size and composition of the central bank's portfolio—decline to more typical levels.

All told, CBO estimates, under current law revenues would grow over the projection period by $1.7 trillion—an average annual increase of 4.4 percent, which is slower than the 5.0 percent rate of increase CBO projects for spending.

Individual Income Taxes. If current laws remain generally unchanged, receipts from individual income taxes are expected to rise markedly relative to GDP over the next 10 years—from 8.6 percent in 2015 to 9.5 percent by 2025, which is a greater share of GDP than has been recorded in all but one of the past 50 years (see Figure 1-5). That increase would result from structural features of the tax system (such as real bracket creep), recent changes in tax provisions, and other factors.

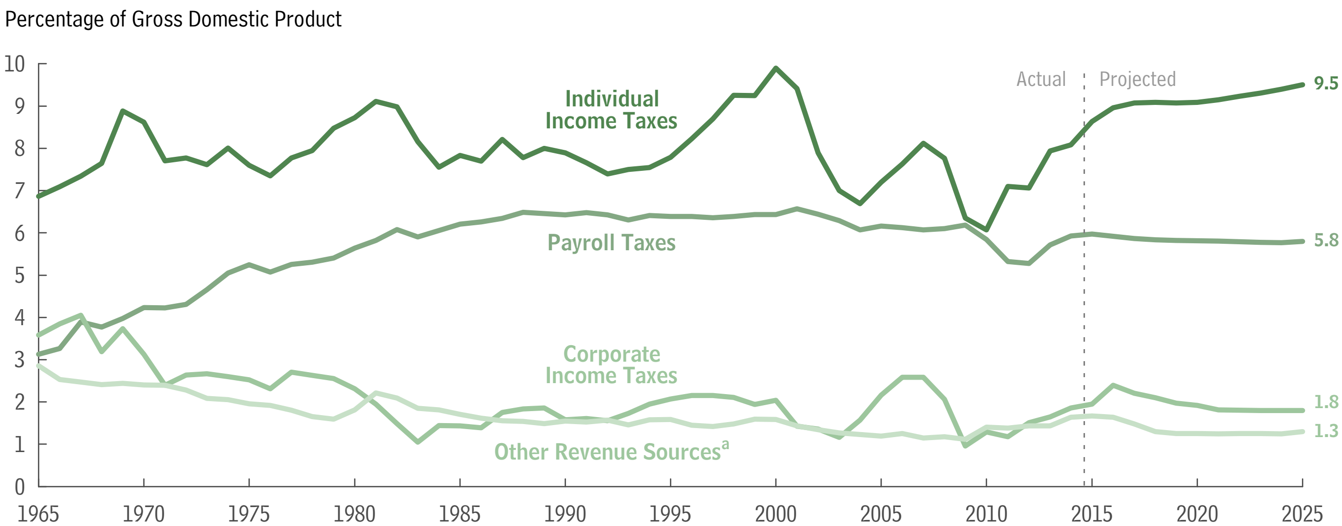
Real Bracket Creep. In CBO's projections, the largest factor pushing up taxes relative to income is the phenomenon known as real bracket creep, which occurs because income tax brackets and exemptions under both the regular income tax and the alternative minimum tax are indexed only to inflation.[17] If income grows faster than the rate of inflation, as generally occurs when the economy is growing, more of it is pushed into higher tax brackets. That in turn causes projected revenues measured as a share of GDP to rise relative to GDP by 0.6 percentage points from 2015 to 2025 in CBO's baseline.

17. The alternative minimum tax is similar to the regular income tax but its calculation includes fewer exemptions, deductions, and rates. People who file individual income tax returns must calculate the tax owed under each system and pay the larger of the two amounts.

Figure 1-5.

Revenues, by Major Source

Over the next decade, individual income taxes will increase at a faster rate than other taxes primarily because of real bracket creep, which occurs when income grows faster than inflation and more income is pushed into higher tax brackets.



Source: Congressional Budget Office.

a. Excise taxes, remittances from the Federal Reserve to the Treasury, customs duties, estate and gift taxes, and miscellaneous fees and fines.

Recent Changes in Tax Provisions. Several revenue-reducing tax provisions expired at the end of December 2014, including one that allowed corporate and noncorporate businesses to immediately deduct a portion of their investments in equipment. (Income of noncorporate business owners is subject to the individual income tax.) Among the other significant tax provisions that expired recently was one that allowed filers to deduct state and local sales taxes rather than income taxes and one that allowed filers to exclude forgiven mortgage debt from their taxable income. If those expired provisions are not extended, starting in calendar year 2015, individual income tax liabilities will increase, and starting mostly in fiscal year 2016, income tax payments will be affected as a result. Those expiring provisions and other changes in tax rules cause a 0.2 percentage-point increase in individual income tax revenues in CBO's baseline between 2015 and 2016. About half of that increase persists through 2025.

Other Factors. Individual income tax receipts are projected to rise by 0.2 percentage points as a share of GDP between this year and 2025 as a result of other factors. Most significant among the causes is a gradual increase in withdrawals from tax-deferred retirement accounts as more members of the baby-boom generation retire. In addition, earnings are expected to increase faster for higher-income people than for others during the next decade—as has been the case for the past several decades—causing a larger share of income to be subject to higher income tax rates.[18]

Payroll Taxes. In CBO's baseline projections, receipts from payroll taxes decline from 6.0 percent of GDP this year to 5.8 percent of GDP by 2018 and continue to decline very gradually relative to GDP thereafter. Much of that decline through 2018 reflects a reduction in receipts from states' deposits to unemployment trust funds.[19] Such receipts increased rapidly from 2010 through 2012 as states boosted their tax rates and tax

18. That increase in individual income tax receipts is partially offset in CBO's baseline by a decrease in payroll tax receipts. Faster growth in earnings for higher-income people would reduce the average payroll tax rate because a greater share of earnings would be above the taxable maximum amount for Social Security ($118,500 in 2015, indexed to growth in average earnings for all workers).

19. Deposits by states to unemployment trust funds are considered federal revenues. Although typically they are funded by taxes that states levy on employers' wage payments, they also can include lump-sum amounts from other sources, including the proceeds of bond sales by states.

bases to replenish unemployment insurance trust funds that had been depleted because of high unemployment. Those receipts have declined each year since 2012, and CBO expects them to continue to fall to more typical amounts in the next few years.

Payroll tax receipts as a percentage of GDP also decline very gradually through 2025 in CBO's baseline because, over the next decade, the faster earnings growth for higher-income people than for others will place a greater share of earnings above the taxable maximum amount for Social Security.

Corporate Income Taxes. Under current law, CBO projects, corporate income tax receipts will rise sharply from 1.9 percent of GDP in 2015 to 2.4 percent of GDP in 2016. That jump reflects the expiration of several tax provisions. CBO projects that receipts will fall relative to GDP starting in 2017—down to 1.8 percent by 2025—largely because profits are projected to decline relative to GDP.

Expiring tax provisions contribute significantly to the increase in 2015 and 2016 in the projections of corporate receipts, but that effect is temporary—it mostly disappears after 2017 in CBO's baseline. In particular, the expiration of the provisions that allowed businesses to expense 50 percent of their investments in equipment is expected to boost receipts substantially in 2016.[20] The more favorable rules for investment deductions were extended at the end of December 2014—retroactively through that calendar year—and reduced corporate tax receipts in fiscal year 2015 because affected businesses received refunds or made smaller final payments when filing their 2014 tax returns. That legislation will not reduce receipts in 2016, and the result will be more growth in receipts between 2015 and 2016.

After 2016, corporate income tax receipts are projected to decline steadily as a share of the economy—and then to remain at 1.8 percent of GDP from 2021 through 2025. The decline through 2021 is mostly attributable to a projected drop in corporations' domestic economic profits as a share of GDP, mainly because of increases in labor compensation and rising interest payments on businesses' debt relative to GDP. The rest of the decline stems largely from the diminishing effects after 2016 of the expiration of the partial-expensing provision described above. That expiration boosts projected receipts substantially in 2016, but the effects wane immediately in CBO's baseline because the provision affected the timing rather than the overall amount of the deductions.

Receipts From Other Sources. The federal government also collects revenue in the form of excise taxes, estate and gift taxes, customs duties, remittances from the Federal Reserve, and miscellaneous fees and fines. CBO projects that, under current law, revenues from all of those sources would decline from 1.7 percent of GDP this year to 1.3 percent of GDP in 2025.

By 2025, CBO projects, remittances of the Federal Reserve will have fallen from 0.5 percent of GDP this year, the sixth consecutive year at roughly that percentage, to 0.2 percent of GDP, about the average over the 2001–2009 period. In recent years, the central bank has significantly expanded and changed the composition of its asset holdings, boosting its earnings and subsequent remittances to the Treasury to far-above-typical amounts. CBO anticipates that the size and composition of the Federal Reserve's portfolio, along with its remittances to the Treasury, will gradually decline to amounts that are more typical.

Receipts from excise taxes also are projected to decrease relative to GDP over the next decade, from 0.6 percent in 2015 to 0.4 percent in 2025, largely because collections from gasoline and tobacco taxes are projected to decline in nominal dollars, implying significant reductions relative to the size of the economy.

Alternative Assumptions About Fiscal Policy

To illustrate the ways in which future deficits would be affected by various decisions of policymakers about federal spending programs and the federal tax system, CBO estimated the budgetary effects of several alternative policies (see Table 1-5). The discussion here focuses on the policies' direct effects on revenues and outlays, but the changes also would affect the costs of paying interest on federal debt (those costs are shown separately in the table).

20. By contrast, since 1982 businesses that invest relatively small amounts in new equipment have been able to fully deduct those costs in the year in which the equipment is placed in service. Although that provision remains in effect today, the maximum amount of those deductions has changed over time.

Table 1-5.

Budgetary Effects of Selected Policy Alternatives Not Included in CBO's Baseline

Billions of Dollars

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total 2016-2020	Total 2016-2025
Policy Alternatives That Affect Discretionary Outlays													
Reduce the Number of Troops Deployed for Overseas Contingency Operations to 30,000 by 2017[a]													
Effect on the deficit[b]	0	12	28	39	46	51	53	55	56	57	58	176	456
Debt service	0	*	1	2	3	6	8	10	13	15	18	12	76
Increase Discretionary Appropriations at the Rate of Inflation After 2015[c]													
Effect on the deficit[b]	0	-22	-33	-39	-44	-49	-54	-58	-62	-66	-70	-188	-498
Debt service	0	*	-1	-2	-4	-6	-8	-11	-13	-16	-20	-13	-82
Freeze Most Discretionary Appropriations at the 2015 Amount[d]													
Effect on the deficit[b]	0	-9	*	20	44	69	95	124	152	181	213	124	890
Debt service	0	*	*	*	1	3	7	11	17	24	32	5	95
Policy Alternative That Affects Both Discretionary and Mandatory Outlays													
Prevent the Automatic Spending Reductions Specified in the Budget Control Act[e]													
Effect on the deficit[b]	n.a.	-61	-88	-97	-100	-103	-103	-105	-110	-113	-99	-449	-979
Debt service	n.a.	-1	-2	-5	-10	-14	-19	-24	-29	-35	-40	-33	-179

Continued

Military and Diplomatic Operations in Afghanistan and Other War-Related Activities

The first alternative path concerns spending for overseas contingency operations. The outlays projected in the baseline come from budget authority provided for those purposes in 2014 and prior years, the $74 billion in budget authority provided for 2015, and the roughly $820 billion that is projected to be appropriated over the 2016–2025 period (under the assumption that annual funding is set at $74 billion, with adjustments for anticipated inflation, in accordance with the rules governing CBO's baseline projections).[21]

In coming years, the funding designated for overseas contingency operations might be less than the amounts projected in the baseline if the number of deployed service personnel and the pace of operations diminished over that time. CBO has thus formulated a budget scenario that reflects a reduction in troops deployed abroad for military action and a concomitant reduction in related diplomatic operations and foreign aid. Many other scenarios—some costing more and some less—are possible.

Over the course of 2014, the number of active-duty, reserve, and National Guard personnel deployed for war-related activities averaged about 110,000. That number has declined to about 90,000 in 2015, CBO estimates. In the agency's alternative scenario, the average number of military personnel deployed for such purposes would decline to 50,000 in 2016 and to 30,000 in 2017 and thereafter. (Those levels could represent various allocations of forces around the world.) Under that scenario, and in keeping with an assumption that extraordinary funding for diplomatic operations and foreign aid would decline at a similar rate, total discretionary outlays over the 2016–2025 period would be $456 billion less than the amount in CBO's current baseline.

Other Discretionary Spending

Policymakers could vary discretionary funding in many ways from CBO's baseline amounts. For example, if caps on discretionary funding were eliminated or modified and appropriations were set to grow each year through 2025 at the same rate as inflation after 2015, discretionary spending would be $498 billion above the baseline

21. Funding for overseas contingency operations in 2015 includes $64 billion for military operations and indigenous security forces and $9 billion for diplomatic operations and foreign aid.

Table 1-5. **Continued**

Budgetary Effects of Selected Policy Alternatives Not Included in CBO's Baseline

Billions of Dollars

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total 2016-2020	Total 2016-2025
	Policy Alternative That Affects the Tax Code												
Extend Expiring Tax Provisions[f]													
Effect on the deficit[b]	0	-152	-81	-76	-95	-91	-92	-93	-96	-100	-103	-495	-979
Debt service	0	-2	-4	-7	-12	-16	-20	-25	-30	-35	-40	-41	-190
Memorandum:													
Outlays for Overseas Contingency Operations in CBO's Baseline	83	78	76	75	76	78	79	81	83	84	86	383	797
Deficit in CBO's Baseline	-426	-414	-416	-454	-596	-687	-767	-885	-895	-886	-1,008	-2,566	-7,007

Sources: Congressional Budget Office; staff of the Joint Committee on Taxation.

Notes: Negative numbers indicate an increase in the deficit; positive numbers indicate a decrease in the deficit.

* = between -$500 million and $500 million; n.a. = not applicable.

a. For this alternative, CBO does not extrapolate the $74 billion in budget authority for military operations, diplomatic activities, and aid in Afghanistan and other countries provided for 2015. Rather, the alternative incorporates the assumption that funding for overseas contingency operations declines from $50 billion in 2016 to a low of $25 billion in 2019. Thereafter, such funding would slowly increase, reaching about $30 billion per year by the end of the projection period—for a total of $300 billion over the 2016–2025 period.

b. Excludes debt service.

c. These estimates reflect the assumption that appropriations will not be constrained by caps set by the Budget Control Act of 2011 as amended and will instead grow at the rate of inflation from their 2015 level. Discretionary funding related to federal personnel is inflated using the employment cost index for wages and salaries; other discretionary funding is inflated using the gross domestic product price index.

d. This option reflects the assumption that appropriations other than those for overseas contingency operations would generally be frozen at the 2015 level through 2025.

e. The Budget Control Act of 2011 specified that if lawmakers did not enact legislation originating from the Joint Select Committee on Deficit Reduction that would reduce projected deficits by at least $1.2 trillion, automatic procedures would go into effect to reduce both discretionary and mandatory spending during the 2013–2021 period. Those procedures are now in effect and take the form of equal cuts (in dollar terms) in funding for defense and nondefense programs. For the 2016–2021 period, the automatic procedures lower the caps on discretionary budget authority specified in the Budget Control Act (caps for 2014 and 2015 were revised by the Bipartisan Budget Act of 2013); for the 2022–2025 period, CBO has extrapolated the reductions estimated for 2021. Nonexempt mandatory programs will be reduced through sequestration; those provisions have been extended through 2024. The budgetary effects of this option cannot be combined with those of any of the other alternatives that affect discretionary spending, except for the one to reduce the number of troops deployed for overseas contingency operations.

f. These estimates are mainly from the staff of the Joint Committee on Taxation and are preliminary. They reflect the impact of extending about 60 tax provisions. Nearly all of those provisions have been extended previously; some, such as the research and experimentation tax credit, have been extended multiple times.

amount for that period. If, by contrast, lawmakers kept appropriations other than those for overseas contingency operations for the 2016–2025 period at the nominal 2015 amount, total discretionary outlays would be $890 billion lower over that period. Under that scenario (sometimes called a freeze in regular appropriations), total discretionary spending would fall from 6.5 percent of GDP in fiscal year 2015 to 4.3 percent in 2025.

Automatic Spending Reductions

The Budget Control Act put in place automatic procedures to reduce discretionary and mandatory spending through 2021. Those procedures require equal reductions (in dollar terms) in defense and nondefense spending. Subsequent legislation extended the required reductions to mandatory spending (by means of a process called sequestration) through 2024. If lawmakers chose to prevent those automatic cuts each year—starting in 2016—without making other changes that reduced spending, total outlays over the 2016–2025 period would be $979 billion (or about 2 percent) higher than the amounts in CBO's baseline. Total discretionary outlays would be $847 billion (or 7 percent) higher, and outlays for mandatory programs—most of which are not subject to sequestration—would be $132 billion (or 0.4 percent) higher.[22]

Revenues

A host of tax provisions, many of them extended repeatedly in recent years, either have expired or are scheduled to do so over the next decade. Most of them, including one that allowed businesses to immediately deduct 50 percent of new investments in equipment, expired at the end of December 2014. If all of those provisions were extended permanently, CBO and JCT estimate, revenues would be lower—and outlays for refundable tax credits would be higher (although by a much smaller amount)—by a total of $979 billion over the 2016–2025 period. Of that total, JCT estimates, about $246 billion in budgetary effects would be attributable to the partial-expensing provision.

Under CBO's alternative assumptions, the largest budgetary cost of extending all of the tax provisions occurs in 2016; in that case, retroactive extension of the provisions would come too late for any budgetary effect in 2015. The effects that would have occurred in 2015 would instead affect tax collections in 2016. The estimated budgetary cost increases in 2019 because certain provisions affecting refundable tax credits are scheduled to expire at the end of December 2017. Extending those provisions would boost outlays for refundable credits and reduce revenues by a combined amount of about $193 billion over the 2019–2025 period. (Payments for refundable credits typically are made a year after the applicable tax year.)

Changes in CBO's Baseline Projections Since March 2015

Since CBO completed its previous set of baseline projections in March 2015, the agency has reduced by $60 billion the estimated deficit in 2015, mostly because receipts from individual income taxes and corporate income taxes have been larger than anticipated (see Appendix A). The agency also has made a $203 billion reduction in its baseline projection of the cumulative deficit for the 2016–2025 period: Revenue projections have been reduced by $170 billion (or by less than one-half of a percent), but outlay projections have declined even more—by $372 billion (or nearly 1 percent) since March.

Revisions to the economic outlook account for the largest changes on the spending side of the budget, reducing projected outlays by $706 billion through 2025. That 10-year change is dominated by a $441 billion reduction in estimated net interest costs, primarily the result of lower projected interest rates throughout the period (see "Interest Rates" on page 58 in Chapter 2). In addition, revisions to the economic forecast—primarily lower measures of inflation through 2016—reduced mandatory outlays in the baseline by $262 billion; Social Security benefits account for about half of that reduction.

Recently enacted legislation, primarily the Medicare Access and CHIP Reauthorization Act of 2015 (P.L. 114-10), which raised the rates Medicare pays to physicians, led CBO to increase its projections of outlays by $159 billion for the 2016–2025 period.

Technical changes—that is, changes other than those that are attributable to economic factors or to legislation—increased CBO's baseline projections of spending by another $175 billion. Upward adjustments for Medicare spending account for roughly three-quarters of that change, primarily because of higher-than-expected spending for Part A (Hospital Insurance) and Part B (Medical Insurance).

Technical adjustments account for the largest changes to CBO's revenue projections, reducing them below the March estimate by $236 billion through 2025. Higher-than-expected tax collections in recent months caused the agency to increase its revenue projections for the next two years, but other factors, including new information from tax returns, caused CBO to reduce its projections for the later years of the 10-year period. The effects of those technical changes were partially offset by the revised economic outlook, including a slightly higher projection for wages and salaries and a slightly lower projection for interest rates, which led to a $63 billion increase in projected revenues; recently enacted legislation added $3 billion over the 2016–2025 period.

22. Because of interactions between the effects of different policy options, the estimated budgetary effects of this option cannot be added to the estimated budgetary effects of any of the alternatives that affect discretionary spending other than the one to reduce the number of troops deployed for overseas contingency operations.