

Changes in Long-Term Budget Projections Since June 2015

The long-term projections of federal revenues and outlays presented in this report differ from the ones that the Congressional Budget Office published in 2015 because of certain changes in law, revisions to some of the agency's assumptions and methods, and the availability of more recent data.¹ (Changes in economic and demographic variables are described in Appendix A.) Additionally, the extended baseline spans 30 years rather than 25—a change consistent with Congressional interest in projections over that period as part of the 2016 budget resolution. Moreover, all of this year's projections beyond 2026 incorporate the effects of fiscal policy under current law. Last year's detailed budget projections did not incorporate those effects.² Because most projections in the 2015 report ended in 2040, CBO is only able to compare projections through that year.

With macroeconomic feedback taken into account, debt is projected to rise from about 75 percent of gross domestic product (GDP) this year to 122 percent in 2040 under the extended baseline; last year, CBO projected that debt would rise to 107 percent of GDP in that year (see Figure B-1). That difference stems both from lower projected revenues and lower projected GDP (see Appendix A for details about projections of GDP). As a percentage of GDP, revenues are lower and spending higher than CBO projected last year, but the increased spending relative to GDP results almost exclusively from a lower projection of GDP rather than from higher projected spending.

CBO published less detailed long-term budget projections in January 2016.³ Those projections were not a full update but rather were based on a simplified approach that the agency has used between full updates.⁴ In January, CBO

projected that federal debt held by the public would reach 155 percent in 2046; it now projects that debt will reach 141 percent of GDP in that year. That change results primarily from lower projected interest rates.

Changes in Spending and Revenues Under the Extended Baseline Since June 2015

In CBO's extended baseline, noninterest spending exceeds revenues throughout the projection period; that difference is greater in each future year than that projected last year (see Figure B-2). Despite higher deficits, interest costs on the debt through 2040 are about the same as last year's projections as a share of GDP because of lower projected interest rates and lower projected GDP.

Noninterest Spending

Through 2040, noninterest spending is projected to be higher relative to GDP than CBO projected in 2015. That spending is projected to equal 22.1 percent of GDP in 2040; last year's projection was 21.3 percent. In the 2015 report, CBO also projected noninterest spending that did not reflect the macroeconomic effects of fiscal policy after 2025. Excluding those effects, noninterest spending was projected to reach 21.1 percent of GDP in 2040 (0.2 percentage points lower than that spending would have been including those effects).

CBO did not publish projections for detailed categories of spending that incorporated the macroeconomic effects of fiscal policy after 2025 in *The 2015 Long-Term Budget Outlook*. Because those projections are not available, the

1. See Congressional Budget Office, *The 2015 Long-Term Budget Outlook* (June 2015), www.cbo.gov/publication/50250.

2. Projections of total revenues, total spending excluding interest payments, deficits, and debt incorporating the effects of fiscal policy under current law were described in Chapter 6 last year.

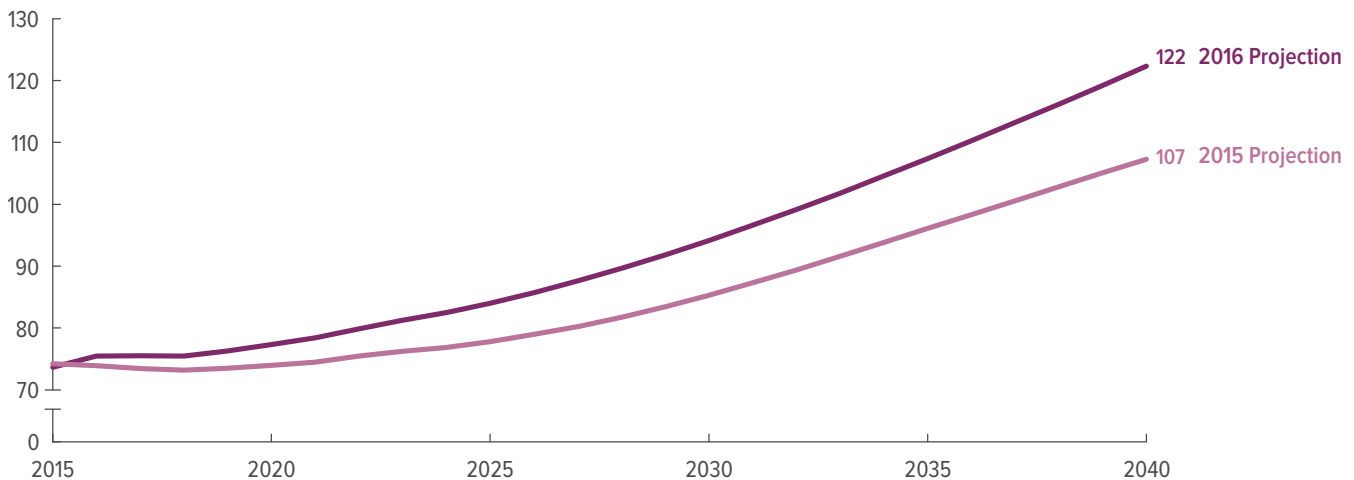
3. See Congressional Budget Office, *The Budget and Economic Outlook: 2016 to 2026* (January 2016), www.cbo.gov/publication/51129.

4. For additional information about that simplified approach, see Congressional Budget Office, *Budgetary and Economic Outcomes Under Paths for Federal Revenues and Noninterest Spending Specified by Chairman Price, March 2016* (March 2016), www.cbo.gov/publication/51260.

Figure B-1.

Comparison of CBO's 2015 and 2016 Projections of Federal Debt Held by the Public Under the Extended Baseline

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2026 and then extending most of the concepts underlying those baseline projections for the rest of the long-term projection period.

comparisons shown below compare this year's projections including the macroeconomic effects of fiscal policy with projections excluding those effects from last year's report. As can be inferred from the 0.2 percentage-point difference between the 2015 projections of overall noninterest spending in 2040 including and excluding the macroeconomic effects of fiscal policy, the change in spending resulting from those effects is generally small in comparison with the amount of spending.

Spending for Social Security is projected to be about the same relative to GDP compared with the amount CBO projected last year, and spending for the major federal health care programs and other noninterest spending are projected to be higher. Those changes result mainly from the decrease in projected GDP.

Social Security Spending. CBO has slightly reduced its projections of outlays for Social Security over the coming decade, compared with the amounts it projected in 2015. Although Social Security spending in CBO's extended baseline has declined in dollar terms, the current projection is about the same as last year's as a percentage of GDP because this year's projections of GDP are lower. Through 2026, changes to Social Security spending mostly reflect lower projections of cost-of-living adjustments. Over the full projection period, they also reflect revised projections of mortality improvements by age group and reductions in projections of participation in Social Security's Disability

Insurance program. The revised mortality improvements result in smaller increases in longevity at older ages and hence fewer Social Security beneficiaries (for details, see Appendix A). On the basis of an analysis of recent trends and recommendations by the Social Security Technical Panel on Assumptions and Methods, CBO has reduced its projection of the rate at which people will qualify for disability benefits beyond the coming decade. Specifically, CBO now projects that for each 1,000 people who have worked long enough to qualify for disability benefits but who are not yet receiving them, an average of 5.4 people will qualify for the program each year after 2026. Last year, that rate was 5.6.

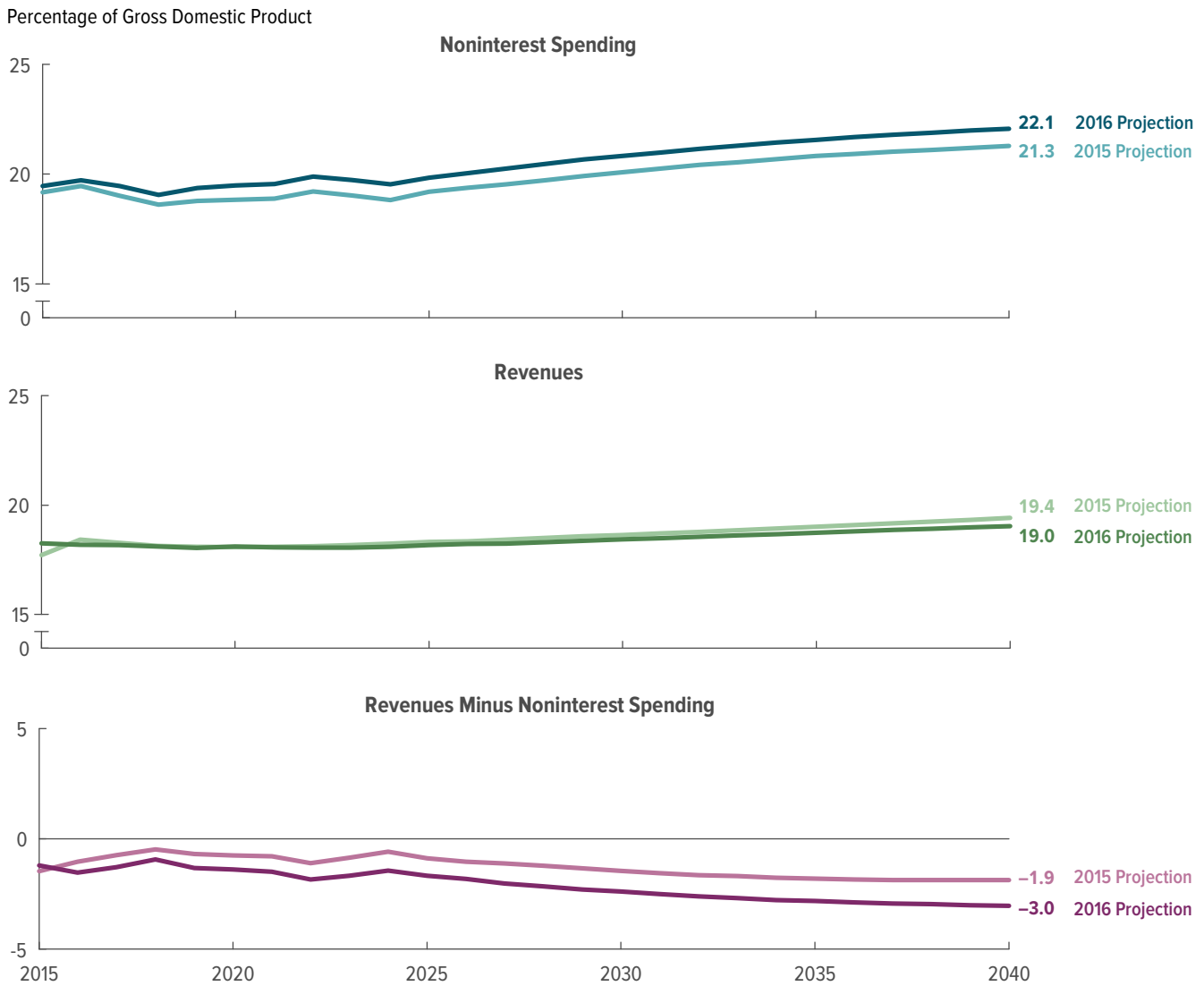
The 75-year actuarial deficit currently projected for Social Security is 4.7* percent of taxable payroll, which exceeds the 4.4 percent estimated last year (see Table 2-1 on page 28). Factors that increased the actuarial deficit include lower projected interest rates and taxable payroll amounts, technical changes to education projections and the claiming methodology for Old-Age Insurance, and the effects of the one-year shift in the projection period. Factors that partially offset the growth in the deficit include revised demographic projections and lower rates of disability incidence.

Major Federal Health Care Spending. CBO's current long-term projection of federal spending for the major health care programs, measured relative to GDP, is

[*Value corrected on July 22, 2016]

Figure B-2.

Comparison of CBO’s 2015 and 2016 Projections of Spending and Revenues Under the Extended Baseline



Source: Congressional Budget Office.

The extended baseline generally reflects current law, following CBO’s 10-year baseline budget projections through 2026 and then extending most of the concepts underlying those baseline projections for the rest of the long-term projection period.

slightly higher than last year’s projection. Spending for Medicare net of offsetting receipts is now estimated to amount to 5.3 percent of GDP in 2040, or about 0.2 percentage points higher than what CBO estimated last year. Outlays for Medicaid and the Children’s Health Insurance Program, combined with spending on subsidies for health insurance purchased through the marketplaces established under the Affordable Care Act (ACA) and related spending, are projected to total 3.0 percent of GDP in 2040, which is about 0.1 percentage point higher than the sum projected last year.

CBO’s projections of spending for the major federal health care programs beyond 2026 are based on projected enrollment and the rates of excess cost growth for each program (see Chapter 3).⁵ Although CBO’s general approach has not changed, the agency has adjusted the specifics of its projections for excess cost growth.

5. Excess cost growth is the extent to which health care costs per beneficiary, as adjusted for demographic changes, grow faster than potential GDP per capita. (Potential GDP is CBO’s estimate of the maximum sustainable output of the economy.)

- Last year, CBO's long-term projection for excess cost growth for Medicare, Medicaid, and private health insurance premiums depended on three factors: CBO's assessment of the underlying rate of excess cost growth, the rate of excess cost growth implied by baseline projections for the next decade, and a blend of those factors for the 11th through 24th years of the projection period. CBO's estimate of the underlying growth rates in 2014 equaled the historical average rate of excess cost growth for total health care spending—1.4 percent per year over the period from 1985 to 2013. The underlying rate was projected to decline gradually over 75 years to a lower rate that varied by program. The rate after 75 years was 1 percent for Medicare, zero for Medicaid, and zero for private health insurance premiums (an input into projections of subsidies for insurance purchased through the marketplaces and related spending).
- This year, the projected rates of excess cost growth for Medicare, Medicaid, and private health insurance premiums slowly converge to the same rate after 30 years. Through 2026, the rate of excess cost growth for each program matches the rate implied by baseline projections, determined using the same approach as last year. After 2026, excess cost growth for all programs moves toward a rate of 1 percent—which is CBO's estimate of the average rate of excess cost growth for the health care sector 30 years from now (see Chapter 3 for discussion). Thus, CBO projects that Medicare, Medicaid, and private health insurance premiums will all have the same rates of excess cost growth in 30 years. Because the health care system is integrated to a significant degree, spending growth in all parts of the system will be affected by common factors (such as the patterns of practice by physicians and the development and diffusion of new medical technologies). CBO does not have a basis for projecting that the rates of excess cost growth for those three categories would differ in the long term.

As a result of that change in methodology, after the first decade the rate of excess cost growth for Medicare is lower than CBO projected a year ago, whereas excess cost growth rates for Medicaid and private health insurance premiums are similar to last year's projections. The method used to project enrollment in each program is the same as that used in 2015. Spending for those programs as a share of GDP is projected to be slightly higher because of lower projected GDP.

Other Noninterest Spending. In this year's projections, total federal spending on everything other than Social Security, the major federal health care programs, and net interest is projected to be higher as a share of GDP than the share CBO projected last year. The difference in projected spending is small in 2016 but will grow in later years. In 2026, CBO's projection of other noninterest spending is 0.3 percent of GDP higher than last year's projection, and the difference between the projections widens to 0.5 percent of GDP by 2040.

Several factors are driving those changes. Primarily, GDP is projected to be smaller than CBO estimated last year, causing any spending as a share of GDP to be higher than it would be otherwise. Secondarily, projected spending has increased. CBO's projected outlays for refundable tax credits over the next decade increased because of enactment of the Consolidated Appropriations Act, 2016, which permanently extended the American Opportunity Tax Credit and expansions of the earned income and child tax credits that were first enacted in 2009 and that had been set to expire at the end of 2017.

Beyond the coming decade, CBO projects, mandatory spending other than that for Social Security, the major health care programs, refundable tax credits, and net interest will decline more slowly than it did in last year's projections (see Chapter 4). CBO bases projections of such spending on the average rate of decline over the final five years of its 10-year baseline projection; this year, that rate of decline is slower than it was last year. In addition, CBO removed spending for the Supplemental Nutrition Assistance Program (SNAP) from this year's calculation of that rate because spending for SNAP over the next decade is not expected to be representative of spending over the longer term. Spending for SNAP is expected to decline significantly relative to GDP through 2026 but decline more slowly thereafter. Excluding SNAP outlays from the calculation further slowed the rate of decline relative to last year's rate. In addition, outlays for discretionary spending in the extended baseline are projected to be slightly higher than in last year's projections, because of an upward adjustment, on net, to the caps on budget authority for discretionary programs (as part of the Bipartisan Budget Act of 2015) and because of changes to actual and projected appropriations.⁶

6. For more information, see Congressional Budget Office, *The Budget and Economic Outlook: 2016 to 2026* (January 2016), Appendix A, www.cbo.gov/publication/51129.

Interest Costs

Because CBO projects a higher cumulative deficit and lower GDP than last year, interest outlays as a percentage of GDP are about the same in this year's analysis despite lower projected interest rates. Interest spending in 2040 is projected to equal 4.8 percent of GDP; last year, that figure was 4.7 percent.

Revenues

Federal revenues are projected to be lower relative to GDP in coming decades than what CBO projected in 2015. By 2026, revenues are projected to be 18.2 percent of GDP, slightly below last year's estimate of 18.3 percent. Legislative changes—in particular, enactment of the Consolidated Appropriations Act, 2016, which permanently extended certain tax provisions—are the most significant factor causing CBO to lower its forecast of revenues as a percentage of GDP over the next decade.⁷

That difference in revenues is estimated to persist and grow modestly in later years. By 2040, revenues are projected to equal 19.0 percent of GDP, 0.4 percentage points lower than last year's estimate.⁸ The lower revenues as a percentage of GDP over later decades also are largely a result of provisions of the Consolidated Appropriations Act, 2016. In addition to the extension of certain tax provisions, that law made two significant changes to a new excise tax on certain employment-based health insurance plans with high premiums, both of which resulted in lower revenues. First, implementation of the tax, originally scheduled for 2018, has been postponed until 2020. And more significantly, the tax will now be an allowable deduction under the corporate income tax. The impact of those changes is relatively small over the next decade but becomes increasingly significant over time. Slower projected economic growth also contributes to lower revenues.

The Size of Policy Changes Needed to Make Federal Debt Equal Today's Level

CBO's estimate of the size of policy changes needed this year to make federal debt at some future date equal its current 75 percent of GDP differs from the fiscal gap presented in last year's report, for three reasons.⁹ First, this

year's calculation covers a longer period—30 years instead of 25 (see Chapter 1). Second, the estimate now accounts for the positive macroeconomic effects of deficit reduction. Third, this year's result reflects higher projected deficits and lower projected interest rates.

Higher deficits in this year's report mean that larger policy changes would be required to make federal debt equal its current percentage of GDP in the future. To ensure that debt in 2041—25 years into the future for ease of comparison with last year's estimates—equaled today's level, lawmakers would have to cut noninterest spending or increase revenues by 1.7 percent of GDP each year from 2017 through 2041 (before taking into account macroeconomic feedback). The projected effects on debt include both the direct effects of such policy changes and the resulting macroeconomic feedback to the budget. That feedback reflects the positive macroeconomic effects of lowering the debt but no assumptions about the specifics of the policy changes. If CBO used the same methodology this year as it used last year (namely, estimating the fiscal gap, which excluded the positive macroeconomic effects of lowering the debt) to calculate the size of policy changes needed to ensure that debt in 25 years equaled today's level, lawmakers would have to cut noninterest spending or increase revenues by 2.0 percent of GDP from 2017 to 2041. Last year, for the 2016–2040 period, CBO estimated that changes equaling 1.1 percent of GDP (excluding all macroeconomic effects) would be required.

Changes in the Sources of Growth for Spending on Social Security and the Major Federal Health Care Programs

CBO changed how it identifies the causes of projected spending growth for Social Security and the major federal health care programs. Last year, CBO estimated the growth in spending attributable to three factors: aging, excess cost growth, and the increased number of recipients of subsidies for health insurance purchased through the marketplaces and of Medicaid benefits attributable to the ACA. This year, CBO has not separately identified the contribution from that third factor, which has less of an

7. Ibid., pp. 107–108.

8. Revenue projections as a percentage of GDP in *The 2015 Long-Term Budget Outlook* were the same including and excluding the effects of fiscal policy.

9. The fiscal gap equals the present value of noninterest outlays and other means of financing minus the present value of revenues over the projected period, with adjustments to make the ratio of federal debt to GDP at the end of the period equal to the current ratio. For more on the fiscal gap, see Congressional Budget Office, *The 2015 Long-Term Budget Outlook* (June 2015), Chapter 1, pp. 12–14, www.cbo.gov/publication/50250.

effect on spending growth beyond 2016. Growth in spending attributable to the ACA's coverage provisions was much more significant between 2013 and 2016 than it is projected to be after 2016. In this year's analysis, the amount of spending in 2016 is higher than it would have been without the ACA's coverage provisions. But the contribution to the growth in spending from those coverage provisions between 2016 and 2046 is small as a share of GDP in CBO's projections, so it was not reported separately.

CBO's change in analytic approach has very little effect on the projected shares of spending growth attributable to the first two factors—aging and excess cost growth—over the next 25 years. Using this year's approach, CBO projects that aging will account for about 60 percent of the spending growth for both Social Security and the major federal health care programs, and about 50 percent of the spending growth for the major federal health care programs alone between 2016 and 2041. Those shares are very similar to the results CBO presented last year.

Changes in Alternative Fiscal Paths

Last year, CBO projected spending and revenues under an alternative fiscal scenario. That scenario incorporated several assumptions: that certain policies in place last summer but scheduled to change under current law at that time would continue, that some provisions of law that might be difficult to sustain for a long period would change, and that federal revenues and certain kinds of federal spending would remain at or near their historical shares of GDP. Under those assumptions, the 10-year cumulative deficit increased last year by about \$2 trillion (excluding interest costs and macroeconomic effects) over amounts in the extended baseline.¹⁰ In the fall of 2015, some policies assumed in that alternative fiscal scenario were permanently enacted in legislation, so using an updated version of that scenario this year would have resulted in deficit increases that were considerably smaller than those projected in last year's report relative to deficits under the extended baseline. Instead, to show the effects of higher deficits relative to those under current law, CBO has chosen a different approach: presenting the budgetary effects of an illustrative path that, with unspecified fiscal policies, increases the cumulative deficit (excluding interest costs and macroeconomic effects) by \$2 trillion over the next 10 years compared with deficits under the extended baseline.

Changes in Analyzing Uncertainty

CBO has changed one of the factors it varies in its analysis of uncertainty. This year, CBO has not analyzed changes in the decline in mortality rates because the effects on the federal budget are small over the 30-year projection period. Instead, CBO analyzed the effects of varying the labor force participation rate, although it turns out to have small effects over that time horizon as well.

In addition, CBO now believes that a wider range is appropriate for its alternative projections of interest rates and the growth rate of spending per beneficiary for Medicare and Medicaid.

- This year, CBO estimated the effects of average interest rates on government debt that are 1.0 percentage point higher or lower than in the extended baseline; in 2015, that difference was 0.75 percentage points. CBO estimated that range last year by looking at the historical spread between government and private-sector borrowing rates and considered the reasons those historical outcomes might not fully reflect uncertainty about future outcomes. This year, CBO undertook an empirical analysis of some of the sources of unexpected movements in government borrowing rates that are not caused by changes in the economy or federal borrowing. That analysis suggested a larger range of uncertainty.
- Also this year, CBO estimated the effects of spending per beneficiary for Medicare and Medicaid that grows 1.0 percentage point per year more slowly or more quickly than under the extended baseline; last year, that difference was 0.75 percentage points. Last year, CBO considered the range of average growth in spending over 25-year periods for the health care system as a whole. This year, in assessing possible values for the average rate of excess cost growth for Medicare and Medicaid, CBO considered that if current laws remained unchanged, that average could continue to decline or could revert toward the higher rates observed in the past. Additionally, CBO drew upon an alternative approach to measuring uncertainty that uses information about trends and cycles in excess cost growth over time; that approach produced a potential range for excess cost growth through 2046 that was larger than the range based on historical variation.¹¹ The combination of those two approaches led CBO to increase the range of growth rates.

11. See Ulrich K. Müller and Mark W. Watson, "Measuring Uncertainty About Long-Run Predictions," *Review of Economic Studies* (March 2016), <http://dx.doi.org/10.1093/restud/rdw003>.

10. Ibid., Chapter 6.

Changes in Long-Term Budget Projections Since January 2016

In January 2016, CBO published updated long-term projections, which were not a full update of CBO's June 2015 results but rather reflected a simplified approach. Those projections followed the January 2016 baseline projections from 2016 to 2026 and then, for years after 2026, used the interest rates and growth rates for spending, revenues, and GDP from the extended baseline in *The 2015 Long-Term Budget Outlook*. The fully updated long-term projections in this report, by contrast, use the March 2016 baseline projections from 2016 to 2026 and then use updated long-term economic and budget projections for years after the first decade. Therefore, differences in the long-term projections between the January

report and this report reflect changes to 10-year baseline projections between January and March 2016 as well as updates to long-term assumptions and projections since June 2015.

Federal debt held by the public is now projected to reach 141 percent of GDP in 2046; in January, CBO projected it would reach 155 percent in that year. That change primarily reflects lower projections of interest rates and thus lower projections of interest costs. Both revenues and spending for the major health care programs are projected to grow more slowly in the long term than CBO projected in January 2016. In total, the effect of lower projected interest rates dominates the effects of the changes in revenue and spending growth.