

The Budget Outlook

If current laws remain in place, the federal budget deficit will total \$514 billion in fiscal year 2014, the Congressional Budget Office (CBO) estimates. That deficit will be \$166 billion smaller than the figure posted in 2013 and down sharply from the shortfalls recorded between 2009 and 2012, which exceeded \$1 trillion annually. At 3.0 percent of gross domestic product (GDP), this year's deficit would be near the average experienced over the past 40 years and about 7 percentage points lower than the figure recorded in 2009 (see Figure 1-1). Nevertheless, debt held by the public would reach 74 percent of GDP by the end of 2014, the largest ratio since 1950.¹

CBO constructs its baseline projections of federal revenues and spending under the assumption that current laws generally remain unchanged. Under that assumption, revenues are projected to grow by about 1 percentage point of GDP over the next 10 years—from 17.5 percent in 2014 to 18.4 percent in 2024. But outlays are projected to rise twice as much, from 20.5 percent of GDP in 2014 to 22.4 percent in 2024. The increase in outlays reflects substantial growth in the cost of the largest benefit programs—Social Security, Medicare, and Medicaid—and in payments of interest on the government's debt; those increases would more than offset a significant decline in discretionary spending relative to the size of the economy.

The deficit in CBO's baseline projections continues to decline as a percentage of GDP in 2015, to 2.6 percent, and then starts to increase again in 2016, totaling 4.0 percent of GDP in 2024 (see Table 1-1). That figure for the end of the 10-year projection period is roughly 1 percentage point above the average deficit over the past 40 years relative to the size of the economy.

That pattern of lower deficits initially, followed by higher deficits for the remainder of the projection period, would cause debt held by the public to follow a similar trajectory. Relative to the nation's output, debt held by the public is projected to decline slightly between 2014 and 2017, falling to 72 percent of GDP in 2017, but to rise thereafter, to 79 percent of GDP at the end of 2024. (As recently as the end of 2007, debt held by the public was equal to 35 percent of GDP.)

Over the next decade, debt held by the public will be significantly greater relative to GDP than at any time since just after World War II. With debt so large, federal spending on interest payments will increase substantially as interest rates rise to more typical levels (see Chapter 2 for a discussion of the economic outlook). Moreover, because federal borrowing generally reduces national saving, the capital stock and wages will be smaller than if debt was lower. In addition, lawmakers would have less flexibility than they otherwise would to use tax and spending policies to respond to unanticipated challenges. Finally, such a large debt poses a greater risk of precipitating a fiscal crisis, during which investors would lose so much confidence in the government's ability to manage its budget that the government would be unable to borrow at affordable rates.²

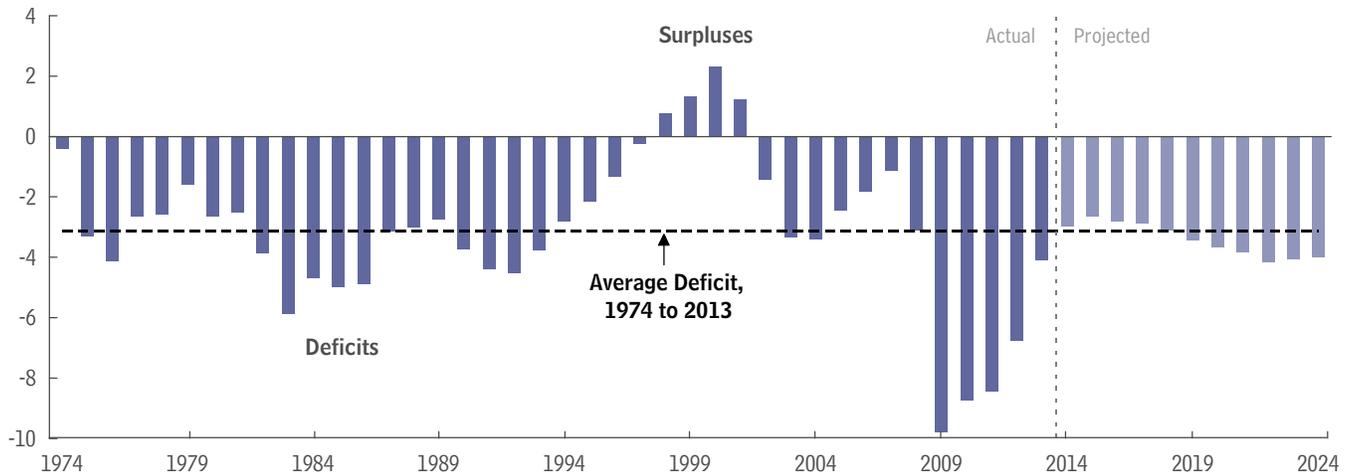
Projected deficits and debt for the coming decade reflect some of the long-term budgetary pressures facing the nation. The aging of the population, the rising costs of health care, and the expansion in federal subsidies for health insurance that is now under way will substantially boost federal spending on Social Security and the government's major health care programs relative to GDP for the next 10 years. But the pressures of aging and the

1. Budget projections in this document incorporate the effects of legislation enacted through January 17, 2014.

2. For a discussion of the consequences of elevated debt, see Congressional Budget Office, *Choices for Deficit Reduction: An Update* (December 2013), pp. 9–10, www.cbo.gov/publication/44967.

Figure 1-1.**Total Deficits or Surpluses**

(Percentage of gross domestic product)



Source: Congressional Budget Office.

rising costs of health care will intensify during the next few decades. Unless the laws governing those programs are changed—or the increased spending is accompanied by corresponding reductions in other spending relative to GDP, by sufficiently higher tax revenues, or by a combination of those changes—debt will rise sharply relative to GDP after 2024.³

Moreover, holding discretionary spending within the limits required under current law—an assumption that underlies these projections—may be quite difficult. The caps on discretionary budget authority established by the Budget Control Act of 2011 (Public Law 112-25) and subsequently amended will reduce such spending to an unusually small amount relative to the size of the economy. With those caps in place, CBO projects, discretionary spending will equal 5.2 percent of GDP in 2024; by comparison, the lowest share for discretionary spending in any year since 1962 (the earliest year for which such data have been reported) was 6.0 percent in 1999. (Nevertheless, total federal spending would be a larger share of GDP than its average during the past 40 years because of higher spending on Social Security, Medicare, Medicaid, other health insurance subsidies for low-income people, and interest payments on the debt.)

3. For a more detailed discussion of the long-term budget situation, see Congressional Budget Office, *The 2013 Long-Term Budget Outlook* (September 2013), www.cbo.gov/publication/44521.

Because the allocation of discretionary spending is determined by annual appropriation acts, lawmakers have not yet decided which specific government services and benefits will be reduced or constrained to meet the specified overall limits.

The baseline budget outlook has worsened slightly since May 2013, when CBO last published its 10-year projections.⁴ At that time, deficits projected under current law totaled \$6.3 trillion for the 2014–2023 period, or about 3 percent of GDP. Deficits are now projected to be about \$1 trillion larger. The bulk of that change occurred in CBO's estimates of revenues: The agency has reduced its projection of total revenues by \$1.6 trillion, largely because of changes in the economic outlook. A decrease of \$0.6 trillion in projected outlays through 2023 partially offset that change.

The projections that make up CBO's baseline are not intended to be a forecast of budgetary outcomes. Rather, they are meant to provide a neutral benchmark that policymakers can use to assess the potential effects of policy decisions. Although CBO's baseline does not incorporate potential changes in law, this chapter shows how some alternative policies would affect the budget

4. For CBO's previous baseline budget projections, see Congressional Budget Office, *Updated Budget Projections: Fiscal Years 2013 to 2023* (May 2013), www.cbo.gov/publication/44172.

Table 1-1.**Deficits Projected in CBO's Baseline**

(Billions of dollars)

	Actual,												Total	
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2015-	2015-
Revenues	2,774	3,029	3,305	3,481	3,631	3,770	3,932	4,104	4,288	4,490	4,702	4,926	18,120	40,630
Outlays	3,454	3,543	3,783	4,020	4,212	4,425	4,684	4,939	5,200	5,522	5,749	6,000	21,124	48,534
Total Deficit	-680	-514	-478	-539	-581	-655	-752	-836	-912	-1,031	-1,047	-1,074	-3,005	-7,904
Net Interest	221	233	268	326	404	493	569	635	694	755	819	880	2,059	5,842
Primary Deficit ^a	-459	-281	-210	-213	-177	-161	-184	-201	-218	-276	-228	-194	-945	-2,061
Memorandum (As a percentage of GDP):														
Total Deficit	-4.1	-3.0	-2.6	-2.8	-2.9	-3.1	-3.4	-3.7	-3.8	-4.2	-4.1	-4.0	-3.0	-3.5
Primary Deficit ^a	-2.8	-1.6	-1.2	-1.1	-0.9	-0.8	-0.8	-0.9	-0.9	-1.1	-0.9	-0.7	-0.9	-0.9
Debt Held by the Public at the End of the Year	72.1	73.6	73.2	72.6	72.3	72.6	73.3	74.2	75.3	76.8	78.0	79.2	n.a.	n.a.

Source: Congressional Budget Office.

Note: GDP = gross domestic product; n.a. = not applicable.

a. Excludes net interest.

over the next 10 years. For example, funding for overseas contingency operations—that is, military operations and related activities in Afghanistan and other countries—has declined in recent years as war-related operations have wound down. Further reductions are very possible, so CBO has constructed a policy alternative under which war funding would continue declining through 2019 and then grow at the rate of inflation through 2024. (In CBO's baseline, such funding grows at the rate of inflation throughout the projection period.) If that occurred, spending for such operations over the 2015–2024 period would be about \$570 billion less than the amount projected in the baseline. Other alternative policies, such as extending certain tax provisions that have already expired or are scheduled to expire, would result in larger deficits than those in the baseline. (For more details, see “Alternative Assumptions About Fiscal Policy” on page 22.)

A Review of 2013

In fiscal year 2013, the budget deficit dropped sharply, reaching \$680 billion. That amount is \$407 billion (or nearly 40 percent) less than the \$1.1 trillion shortfall recorded in 2012. Revenues rose substantially last year—by \$324 billion (or 13 percent), the largest annual

percentage increase since 2005—and outlays declined by \$83 billion (or 2 percent). As a percentage of GDP, the deficit dropped from 6.8 percent in 2012 to 4.1 percent in 2013.

Revenues

Revenues from each of the three major sources—individual income taxes, social insurance taxes, and corporate income taxes—increased by 12 percent or more in 2013. As a share of GDP, revenues rose from 15.2 percent in 2012 to 16.7 percent in 2013, the highest amount since 2008 but still below the average of 17.4 percent for the past 40 years.

Receipts from individual income taxes, the largest revenue source, contributed over half of the total increase in revenues in 2013, rising by \$184 billion (or 16 percent) as a result of growth in wage and nonwage income and (beginning in January 2013) higher tax rates on incomes above certain thresholds. Some of the increase in revenues probably occurred because some businesses and people accelerated the payment of wages, salaries, and dividends, along with capital gains realizations, into calendar year 2012 so that individuals could avoid the higher tax rates

that took effect in 2013; such an acceleration would have shifted final payments of some taxes from April 2014 to April 2013.

Receipts from social insurance taxes, which consist of the payroll taxes that fund social insurance programs (mostly Social Security and Medicare), rose by \$103 billion (or 12 percent), largely because the reduction of 2 percentage points in employees' share of the Social Security tax expired (after having been in effect in calendar years 2011 and 2012). Receipts from corporate income taxes increased by \$31 billion (or 13 percent), stemming from increases in taxable profits.

Outlays

The \$83 billion decline in outlays between 2012 and 2013 resulted primarily from transactions between the Treasury Department and Fannie Mae and Freddie Mac, two entities that guarantee and purchase loans from mortgage lenders.⁵ In 2012, those transactions boosted net outlays slightly because the Treasury's payments to support the operations of Fannie Mae and Freddie Mac were not quite offset by the payments of dividends from those entities to the government. In contrast, Fannie Mae and Freddie Mac received no payments from the Treasury in 2013 because both entities were profitable; instead, they were required to make quarterly payments to the Treasury. In addition, Fannie Mae made a one-time payment to the Treasury totaling about \$50 billion because a revaluation of certain deferred assets significantly increased its net worth. Thus, net outlays related to Fannie Mae and Freddie Mac in 2013 totaled *negative* \$97 billion.

Mandatory Spending. Outlays for mandatory programs (which include spending for benefit programs and certain other payments to people, businesses, nonprofit institutions, and state and local governments) were nearly unchanged in 2013, increasing by just \$0.4 billion (or 0.02 percent). Adjusted for a shift in the timing of certain payments and excluding the transactions with Fannie Mae and Freddie Mac, however, mandatory outlays would have risen by \$71 billion (or 3.5 percent) in 2013.

5. The decline in total outlays would have been even larger if \$31 billion in payments that ordinarily would have been made on October 1, 2011, which fell on a weekend, had not been shifted into September 2011 (and thus into the previous fiscal year). Without that shift, the decline in outlays between 2012 and 2013 would have been \$114 billion (or 3.2 percent).

By comparison, mandatory outlays grew at an average annual rate of more than 6 percent during the preceding decade (between 2003 and 2012).

Social Security. Outlays for Social Security rose by \$40 billion (or 5 percent) in 2013. Beneficiaries received a 1.7 percent cost-of-living adjustment in January (which applied to three-quarters of the fiscal year; the increase in the previous year was 3.6 percent). In addition, the number of people receiving benefits grew by 2.4 percent.

Federal Housing Administration's Credit Programs. The Department of Housing and Urban Development increased its earlier estimates of the subsidy costs of loan guarantees previously made by the Federal Housing Administration by a total of \$28 billion in 2013; those adjustments were about \$21 billion larger than the ones recorded the year before.⁶

Medicare and Medicaid. Net outlays for Medicare—excluding the effects of the shift of the first scheduled payments to private health plans from fiscal year 2012 into fiscal year 2011—increased in 2013 by \$11 billion (or 2 percent), a slower rate of growth than any recorded since 1999. (Those amounts are net of receipts from premiums paid by the program's beneficiaries and other offsetting receipts.) Medicaid spending increased more rapidly in 2013—by \$15 billion (or nearly 6 percent), which is above its annual rate of growth during the previous decade.

The Troubled Asset Relief Program. Outlays recorded for the Troubled Asset Relief Program fell in 2013. By law, the costs of investments made under that program are estimated as the present value of anticipated net outlays, calculated using a discount rate that incorporates market risk. The estimates are adjusted annually to account for an updated valuation of the cash flows associated with the

6. Those calculations of subsidy costs follow the procedures called for in the Federal Credit Reform Act of 1990 (Public Law 101-508): A program's subsidy costs are calculated by subtracting the discounted present value of the government's projected income from the discounted present value of its projected costs. The estimated subsidy costs can be increased or decreased in subsequent years to reflect updated assessments of the costs and income 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.

program. In 2013, the estimated costs of the program's transactions made in earlier years were revised downward by almost \$13 billion. Partially offsetting that reduction, the program recorded \$4 billion in new spending, primarily for mortgage assistance. Thus, on net, the program caused the Treasury to record about \$9 billion in negative outlays in 2013. That total is \$33 billion less than the outlays recorded for the program in 2012, when a \$21 billion upward revision of previous estimates and \$3 billion in new spending caused the Treasury to record outlays of \$25 billion for the program.

Unemployment Compensation. Spending for unemployment compensation dropped for the third consecutive year in 2013. The number of people receiving first-time payments of regular unemployment benefits fell to 8.1 million from 8.7 million the year before (and compared with a peak of 14.4 million in 2009). As a result, outlays for unemployment compensation dropped by \$23 billion last year, to \$69 billion.

Other Mandatory Spending. Spending for all other mandatory programs increased by \$41 billion (or 9 percent) from 2012 to 2013 (after adjusting for a shift in the timing of certain payments). The largest increases were for agriculture programs (up by \$12 billion, mostly for crop insurance) and for veterans' benefits (up by \$8 billion).

Discretionary Spending. Discretionary outlays fell by \$84 billion (or 6.5 percent) in 2013—the third consecutive year that such outlays have fallen. Part of that decrease stemmed from a decline in total discretionary budget authority (that is, the authority provided in appropriation acts to incur financial obligations that will result in immediate or future outlays), which dropped by \$53 billion (or 4.4 percent) in 2013. Outlays last year also fell in part because total funding for discretionary programs has declined for the past several years.

Defense outlays fell by \$46 billion (or 7 percent) in 2013, as spending for overseas contingency operations decreased by roughly \$20 billion. In addition, the automatic spending reductions put in place by the Budget Control Act reduced defense outlays not related to such operations by about \$16 billion in 2013, CBO estimates. The remaining decrease in outlays was spread across most major categories of defense spending.

Similarly, nondefense discretionary outlays fell by \$39 billion (or 6 percent) last year. Spending from funds

provided in the American Recovery and Reinvestment Act of 2009 (P.L. 111-5), which dropped by \$16 billion, accounted for about 40 percent of that decline. In addition, an increase in the receipts credited to the Federal Housing Administration reduced discretionary outlays by \$12 billion, and the automatic spending reductions decreased such outlays by another \$12 billion, CBO estimates.

The Budget Outlook for 2014

If there are no changes in laws governing taxes and spending, the budget deficit will decline once again in fiscal year 2014, to \$514 billion, or 3.0 percent of GDP, CBO estimates (see Table 1-2).

Revenues

CBO projects that if current laws remain unchanged, revenues will increase by \$255 billion (or about 9 percent) in 2014, exceeding \$3.0 trillion for the first time. As a share of GDP, revenues are projected to increase from 16.7 percent in 2013 to 17.5 percent in 2014, which is about the average for the past 40 years. The largest increases relative to GDP are expected to occur in receipts from corporate income taxes (rising from 1.6 percent to 2.0 percent of GDP) and social insurance taxes (climbing from 5.7 percent to 6.0 percent).

About two-thirds of the projected increase in revenues as a share of GDP comes from changes in various tax provisions. Projected receipts from individual and corporate income taxes are boosted in 2014 by the expiration, at the end of calendar year 2013, of a number of provisions that reduced those taxes, most notably one that allowed businesses to immediately deduct a significant portion of their investment in equipment. In addition, the expiration of the two-year reduction in the Social Security payroll tax rate, which increased revenues in fiscal year 2013, further boosts revenues in 2014, the first full fiscal year following that expiration. Other provisions affecting individual income and excise taxes also contribute to the projected increase in revenues.

Revenues are expected to rise relative to GDP this year for other reasons as well. In particular, corporate income tax revenues, which fell significantly during the recession, are expected to climb as the economy strengthens. The factors that caused those revenues to decline have diminished since the recession ended, and CBO expects that trend to continue.

Table 1-2.**CBO's Baseline Budget Projections**

	Actual,												Total	
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2015-2019	2015-2024
In Billions of Dollars														
Revenues														
Individual income taxes	1,316	1,381	1,542	1,647	1,752	1,851	1,948	2,051	2,161	2,279	2,403	2,533	8,741	20,168
Social insurance taxes	948	1,033	1,070	1,115	1,164	1,215	1,266	1,317	1,372	1,432	1,494	1,559	5,830	13,004
Corporate income taxes	274	351	402	439	459	458	450	450	455	463	475	487	2,208	4,539
Other	236	263	290	280	256	246	268	285	300	316	330	347	1,340	2,919
Total	2,774	3,029	3,305	3,481	3,631	3,770	3,932	4,104	4,288	4,490	4,702	4,926	18,120	40,630
On-budget	2,101	2,285	2,534	2,676	2,789	2,890	3,015	3,149	3,295	3,456	3,627	3,807	13,904	31,238
Off-budget ^a	673	743	771	805	842	880	918	955	994	1,034	1,076	1,119	4,215	9,392
Outlays														
Mandatory	2,032	2,116	2,323	2,502	2,614	2,722	2,877	3,039	3,213	3,437	3,573	3,737	13,039	30,038
Discretionary	1,201	1,194	1,192	1,192	1,194	1,210	1,239	1,266	1,293	1,329	1,356	1,383	6,026	12,653
Net interest	221	233	268	326	404	493	569	635	694	755	819	880	2,059	5,842
Total	3,454	3,543	3,783	4,020	4,212	4,425	4,684	4,939	5,200	5,522	5,749	6,000	21,124	48,534
On-budget	2,821	2,838	3,038	3,231	3,372	3,531	3,733	3,924	4,115	4,364	4,513	4,678	16,906	38,499
Off-budget ^a	634	705	745	789	840	894	951	1,016	1,085	1,158	1,236	1,322	4,219	10,034
Deficit (-) or Surplus	-680	-514	-478	-539	-581	-655	-752	-836	-912	-1,031	-1,047	-1,074	-3,005	-7,904
On-budget	-720	-553	-504	-555	-583	-641	-719	-775	-821	-907	-886	-871	-3,001	-7,261
Off-budget ^a	40	38	26	16	2	-14	-34	-61	-91	-124	-160	-203	-3	-642
Debt Held by the Public	11,982	12,717	13,263	13,861	14,507	15,218	16,028	16,925	17,899	19,001	20,115	21,260	n.a.	n.a.
Memorandum:														
Gross Domestic Product	16,627	17,273	18,126	19,083	20,052	20,954	21,867	22,799	23,755	24,746	25,774	26,830	100,082	223,984
As a Percentage of Gross Domestic Product														
Revenues														
Individual income taxes	7.9	8.0	8.5	8.6	8.7	8.8	8.9	9.0	9.1	9.2	9.3	9.4	8.7	9.0
Social insurance taxes	5.7	6.0	5.9	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Corporate income taxes	1.6	2.0	2.2	2.3	2.3	2.2	2.1	2.0	1.9	1.9	1.8	1.8	2.2	2.0
Other	1.4	1.5	1.6	1.5	1.3	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Total	16.7	17.5	18.2	18.2	18.1	18.0	18.0	18.0	18.1	18.1	18.2	18.4	18.1	18.1
On-budget	12.6	13.2	14.0	14.0	13.9	13.8	13.8	13.8	13.9	14.0	14.1	14.2	13.9	13.9
Off-budget ^a	4.0	4.3	4.3	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Outlays														
Mandatory	12.2	12.3	12.8	13.1	13.0	13.0	13.2	13.3	13.5	13.9	13.9	13.9	13.0	13.4
Discretionary	7.2	6.9	6.6	6.2	6.0	5.8	5.7	5.6	5.4	5.4	5.3	5.2	6.0	5.6
Net interest	1.3	1.3	1.5	1.7	2.0	2.4	2.6	2.8	2.9	3.1	3.2	3.3	2.1	2.6
Total	20.8	20.5	20.9	21.1	21.0	21.1	21.4	21.7	21.9	22.3	22.3	22.4	21.1	21.7
On-budget	17.0	16.4	16.8	16.9	16.8	16.9	17.1	17.2	17.3	17.6	17.5	17.4	16.9	17.2
Off-budget ^a	3.8	4.1	4.1	4.1	4.2	4.3	4.3	4.5	4.6	4.7	4.8	4.9	4.2	4.5
Deficit (-) or Surplus	-4.1	-3.0	-2.6	-2.8	-2.9	-3.1	-3.4	-3.7	-3.8	-4.2	-4.1	-4.0	-3.0	-3.5
On-budget	-4.3	-3.2	-2.8	-2.9	-2.9	-3.1	-3.3	-3.4	-3.5	-3.7	-3.4	-3.2	-3.0	-3.2
Off-budget ^a	0.2	0.2	0.1	0.1	*	-0.1	-0.2	-0.3	-0.4	-0.5	-0.6	-0.8	*	-0.3
Debt Held by the Public	72.1	73.6	73.2	72.6	72.3	72.6	73.3	74.2	75.3	76.8	78.0	79.2	n.a.	n.a.

Source: Congressional Budget Office.

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

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.

Outlays

In the absence of changes to laws governing federal spending, outlays in 2014 will total \$3.5 trillion, CBO estimates, \$89 billion more than spending in 2013. That rise would represent an increase of 2.6 percent, less than half the average rate of growth experienced between 2003 and 2012. Outlays are projected to total 20.5 percent of GDP this year, the lowest percentage since 2008.

Mandatory Spending. Under current law, spending for mandatory programs will rise by \$85 billion (or 4.2 percent) in 2014, measuring 12.3 percent of GDP, up slightly from 2013.

Social Security. CBO anticipates that, under current law, Social Security outlays will increase by \$38 billion (or 4.8 percent) in 2014, a rate of increase that is somewhat slower than last year's growth. This January's cost-of-living adjustment (1.5 percent) was slightly smaller than the increase in January 2013, as is the projected growth in the number of beneficiaries (2.1 percent).

Medicaid. Medicaid spending is expected to accelerate in 2014, because about 25 states have expanded coverage significantly in keeping with provisions of the Affordable Care Act.⁷ All told, CBO projects that, under current law, enrollment in the program will increase by about 5 percent and outlays will climb by \$33 billion (or 12 percent); the projected rate of growth in outlays is about twice the rate recorded in 2013.

Health Insurance Subsidies and Related Spending. Subsidies that help people who meet income and other eligibility criteria purchase health insurance through exchanges, pursuant to the Affordable Care Act, became available on January 1, 2014. Those subsidies, along with related spending, are expected to total \$18 billion this year if no changes are made to current law.

Medicare. CBO estimates that Medicare's outlays will continue to grow slowly in 2014 under current law, increasing by \$13 billion (or 3 percent). The projected growth rate is only slightly faster than last year's rate (adjusted for a shift in the timing of payments) and well below the average annual increase of about 8 percent experienced between 2003 and 2012. That projection of spending for Medicare reflects the assumption that the

fees that physicians receive for their services will be reduced by about 24 percent in April 2014 as required under current law. If lawmakers override those scheduled reductions—as they have routinely done in the past—spending on Medicare in 2014 would be greater than the amount projected in CBO's baseline.

Fannie Mae and Freddie Mac. Transactions between the Treasury Department and Fannie Mae and Freddie Mac will again reduce federal outlays in 2014, CBO estimates. The payments from those entities to the Treasury are projected to total \$81 billion, about \$16 billion less than the payments recorded in 2013.

Unemployment Compensation. The decline in spending for unemployment compensation is expected to continue—falling from \$69 billion in 2013 to \$46 billion in 2014—primarily because the authority to pay emergency benefits expired at the end of December 2013.

Discretionary Spending. Discretionary budget authority enacted for 2014 totals \$1,130 billion, which is \$15 billion (or 1 percent) less than such funding totaled in 2013. Under the limits set in the Bipartisan Budget Act of 2013 (P.L. 113-67), defense funding has increased by \$6 billion (or 0.9 percent) this year. Funding for non-defense discretionary programs is \$21 billion lower than in 2013, primarily because the \$48 billion in appropriations provided in response to Hurricane Sandy last year has not been repeated; all other nondefense discretionary funding has increased by \$27 billion. If no additional appropriations are enacted for this year, discretionary outlays will fall by \$7 billion (or 0.6 percent) from the 2013 amounts, CBO estimates.

Defense outlays in CBO's baseline again decline in 2014, largely because of a drop in spending for overseas contingency operations. All told, defense outlays are expected to fall by \$21 billion (or 3.3 percent), about half the rate of decrease recorded for such outlays in 2013. The largest reductions are for procurement (\$9 billion), operation and maintenance (\$5 billion), and research and development (\$5 billion). As a result, defense outlays will total \$604 billion in 2014, CBO estimates.

Outlays for nondefense programs are projected to rise by \$14 billion (or 2 percent) this year, to \$590 billion. About half of that increase results from lower estimated receipts credited to the Federal Housing Administration.

7. See Appendix B for more information about that act and its budgetary effects.

CBO's Baseline Budget Projections for 2015 to 2024

CBO constructs its baseline in accordance with provisions set forth in the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177) and the Congressional Budget and Impoundment Control Act of 1974 (P.L. 93-344). For the most part, those laws require that the baseline projections incorporate the assumption that current laws governing taxes and spending remain in place in future years.

Under that assumption, CBO projects that the budget deficit will continue shrinking in 2015—to \$478 billion, or 2.6 percent of GDP. But beginning in 2016, the deficit is projected to increase again both in dollar terms and as a share of the economy, totaling 4.2 percent of GDP by 2022 before dipping back down to 4.0 percent in 2024. That decline in the deficit is the result of shifts in the timing of certain payments; without those shifts, the deficit would increase from 3.9 percent of GDP in 2022 to 4.2 percent in 2024.⁸

Most of the projected decline in the deficit next year under CBO's baseline is the result of a significant rise in projected revenues. In total, revenues are estimated to increase by 9 percent in 2015—in part because of the recent expiration of various tax provisions—reaching 18.2 percent of GDP. They are projected to remain fairly stable as a share of GDP through 2024.

Outlays in CBO's baseline grow to about 21 percent of GDP in 2015 and then generally follow an upward trend, reaching 22.4 percent of GDP by 2024.⁹ Because of the aging of the population, rising health care costs, and a significant expansion in eligibility for federal subsidies for health insurance, outlays for Social Security and the federal government's major health care programs are projected to rise substantially relative to the size of the economy over the next 10 years. In addition, growing debt and rising interest rates will boost net interest pay-

ments. Total spending on all other programs is projected to decline relative to GDP between 2015 and 2024, primarily because of improving economic conditions and the spending limits in current law.

Revenues

If current laws remained unchanged, revenues would increase as a share of GDP by 0.7 percentage points from 2014 to 2015, by CBO's estimates. Slightly more than half of that increase would result from changes in tax provisions, including the recent expiration of various provisions affecting corporate and individual income taxes and the implementation of fees and fines established by the Affordable Care Act (see Chapter 4 for more details on those changes).

From 2016 through 2024, revenues in CBO's baseline remain between 18.0 percent and 18.4 percent of GDP, largely reflecting offsetting movements in receipts from individual and corporate income taxes and remittances from the Federal Reserve. Individual income taxes are projected to generate increasing revenues relative to the size of economy, growing from 8.5 percent of GDP in 2015 to 9.4 percent in 2024. The increase stems largely from real bracket creep (a phenomenon in which growth in real, or inflation-adjusted, income of individuals pushes more income into higher tax brackets) and from increases in withdrawals from tax-deferred retirement accounts as baby boomers retire.

In contrast, after the first few years of the projection period, corporate income tax receipts and remittances from the Federal Reserve decline relative to the size of the economy in CBO's baseline. Corporate income tax receipts are projected to decrease relative to GDP after 2016 because of an anticipated drop in domestic economic profits relative to GDP, the result of rising interest payments on businesses' debt, growing labor costs, and increasing deductions for depreciation on the larger stock of business capital. Remittances from the Federal Reserve, which have been very high by historical standards in the past four years because of changes in the size and composition of the central bank's portfolio of securities, decline in CBO's projections to more typical levels.

Outlays

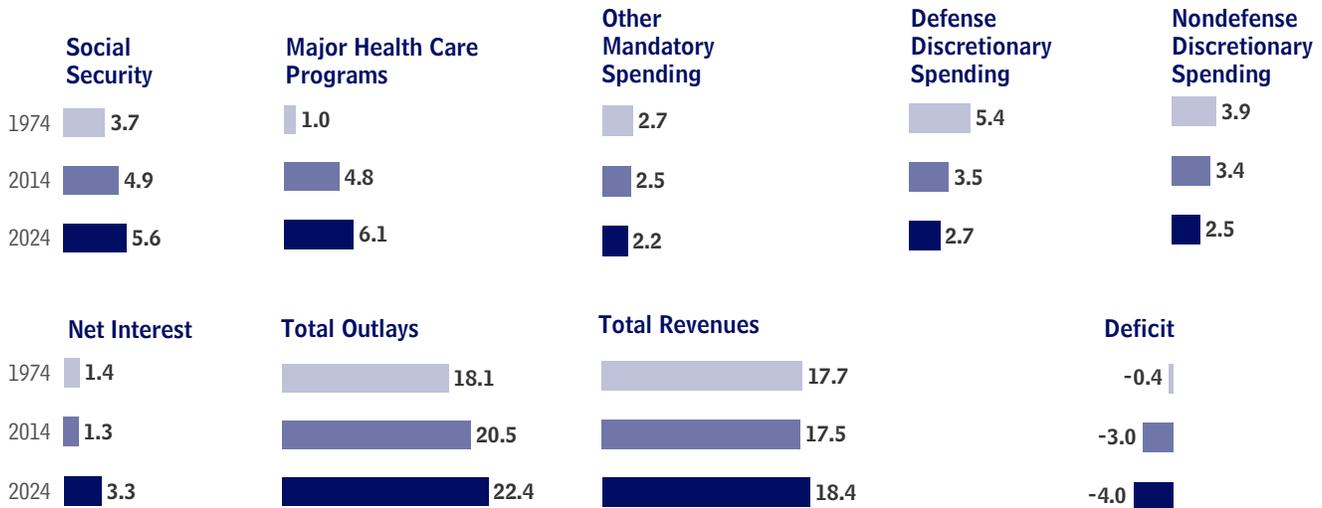
The Deficit Control Act requires CBO's projections for most mandatory programs to be made in keeping with

8. Because both October 1, 2022, and October 1, 2023, fall on a weekend, 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.

9. Without the shift in the timing of certain payments, outlays would total 22.6 percent of GDP in 2024, CBO estimates. Timing shifts also affect spending from 2016 through 2018.

Figure 1-2.**Spending and Revenues Projected in CBO's Baseline, Compared With Levels in 1974**

(Percentage of gross domestic product)



Source: Congressional Budget Office.

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

the assumption that current laws continue unchanged.¹⁰ Thus, CBO's baseline projections for mandatory spending reflect expected changes in the economy, demographics, and other factors, as well as the across-the-board reductions in certain mandatory programs that are required under current law. For discretionary spending, CBO's baseline incorporates the caps on such funding that are currently in place through 2021 and then reflects the assumption that funding keeps pace with inflation in later years; the elements of discretionary funding that are not constrained by the caps, such as appropriations for overseas contingency operations, are assumed to increase with inflation throughout the next decade. On that basis, total outlays are projected to increase relative to GDP in most years through 2024—averaging 21.7 percent over the decade, which is above the 20.5 percent of GDP that has been the average for outlays over the past 40 years.

Mandatory spending (net of offsetting receipts, which reduce outlays) is projected to increase by close to 10 percent next year and then to grow at an average rate of 5.4 percent annually, reaching about 14 percent of GDP in 2024 (compared with 12.2 percent in 2013). Discretionary outlays are estimated to decrease by 0.2 percent in 2015 and then to grow at an average rate of 1.7 percent from 2016 to 2024; that rate is less than half of the projected growth rate of nominal GDP.

Although CBO's 10-year baseline does not fully reflect the long-term budgetary pressures facing the United States in the coming decades, those pressures are evident in the path of federal outlays over the coming decade. Specifically, three major categories of spending are projected to increase relative to the size of the economy, particularly in the latter part of the decade (see Figure 1-2). In CBO's baseline:

10. The Deficit Control Act specifies some exceptions. For example, spending programs whose authorizations are set to expire are assumed to continue if they have outlays of more than \$50 million in the current year and were established at or before enactment of the Balanced Budget Act of 1997. Programs established after that law was enacted are not automatically assumed to continue but are considered individually by CBO in consultation with the House and Senate Budget Committees.

- Outlays for Social Security are projected to total 4.9 percent of GDP next year and stay near that percentage for the next few years, but then climb to 5.6 percent of GDP by 2024.
- Outlays for the major health care programs—Medicare (net of premiums and other offsetting

receipts), Medicaid, the Children's Health Insurance Program, and subsidies offered through health insurance exchanges and related spending—soon exceed outlays for Social Security. Spending for those programs is estimated to total 5.1 percent of GDP in 2015 and to grow rapidly in coming years because of changes mandated by the Affordable Care Act, reaching 6.1 percent of GDP in 2024.

- Net interest equals 1.5 percent of GDP in 2015, but rising interest rates and mounting debt push that total to 3.3 percent of GDP by 2024.

By the end of the projection period, those three categories of spending would be the largest in the budget. In contrast, under current law, all other mandatory spending will decrease from 2.9 percent of GDP in 2015 to 2.2 percent in 2024, CBO estimates. That decline is projected to occur because spending for many of the programs included in that category rises roughly with inflation, and the rate of inflation is projected to be well below the rate of growth of nominal GDP.

Outlays for defense and nondefense discretionary programs fall more sharply under CBO's baseline assumptions. Outlays for defense are projected to drop from 3.3 percent of GDP in 2015 to 2.7 percent in 2024, 1.8 percentage points below the average from 1974 to 2013 and the lowest share in any year since 1962 (the earliest year for which such data have been reported). For nondefense discretionary spending, outlays are projected to drop from 3.2 percent of GDP in 2015 to 2.5 percent in 2024, 1.3 percentage points below the average from 1974 to 2013 and also the lowest share in any year since 1962.

Federal Debt

Federal debt held by the public consists mostly of securities that the Treasury issues to raise cash to fund the federal government's activities and to pay off its maturing liabilities.¹¹ The Treasury borrows money from the public by selling securities in the capital markets; that debt is purchased by various buyers in the United States, by private investors overseas, and by the central banks of other

countries. Of the \$12.0 trillion in federal debt held by the public at the end of 2013, 53 percent (\$6.3 trillion) was held by domestic investors and 47 percent (\$5.7 trillion) was held by foreign investors.¹² Other measures of federal debt are sometimes used for various purposes, such as to provide a more comprehensive picture of the government's financial condition or to account for debt held by federal trust funds.

Debt Held by the Public. Debt held by the public increased by more than \$700 billion in 2013, reaching 72 percent of GDP, higher than the percentage in 2012 (70 percent) or in any other year since 1950. As recently as 2007, it had been only 35 percent of GDP. Under the assumptions that govern CBO's baseline, the federal government is projected to borrow another \$9.3 trillion from 2014 through 2024, pushing debt held by the public up to 79 percent of GDP by the end of the projection period (see Table 1-3).

The amount of money the Treasury borrows by selling securities (net of the maturing securities it redeems) is determined primarily by the annual budget deficit. However, several factors—collectively labeled “other means of financing” and not directly included in budget totals—also affect the government's need to borrow from the public. Those factors include changes in the government's cash balance, investments in the Thrift Savings Plan's G fund, as well as the cash flows associated with federal credit programs (such as student loans) because only the subsidy costs of those programs (calculated on a present-value basis) are reflected in the budget deficit.

CBO projects that the increase in debt held by the public will exceed the deficit in 2014 by \$221 billion, for two main reasons—first, because the Treasury has reinvested the Thrift Savings Plan's G fund in Treasury securities after disinvesting in 2013 as a result of debt-ceiling constraints, and second, because the government will need

11. A small amount of debt held by the public is issued by other agencies, mainly the Tennessee Valley Authority.

12. The largest U.S. holders of Treasury debt are the Federal Reserve System (17 percent) and individual households (8 percent); investors in China and Japan have the largest foreign holdings of Treasury securities, accounting for about 21 percent of U.S. public debt. For additional information, see Congressional Budget Office, *Federal Debt and Interest Costs* (December 2010), Chapter 1, www.cbo.gov/publication/21960.

Table 1-3.
Federal Debt Projected in CBO's Baseline

(Billions of dollars)

	Actual,											
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Debt Held by the Public at the Beginning of the Year	11,281	11,982	12,717	13,263	13,861	14,507	15,218	16,028	16,925	17,899	19,001	20,115
Changes in Debt Held by the Public												
Deficit	680	514	478	539	581	655	752	836	912	1,031	1,047	1,074
Other means of financing	20	221	67	60	65	56	58	61	62	71	67	72
Total	701	735	545	599	645	711	811	896	974	1,102	1,114	1,145
Debt Held by the Public at the End of the Year	11,982	12,717	13,263	13,861	14,507	15,218	16,028	16,925	17,899	19,001	20,115	21,260
Memorandum:												
Debt Held by the Public at the End of the Year (As a percentage of GDP)	72.1	73.6	73.2	72.6	72.3	72.6	73.3	74.2	75.3	76.8	78.0	79.2
Debt Held by the Public Less Financial Assets ^a												
In billions of dollars	10,955	11,609	12,059	12,569	13,121	13,747	14,472	15,283	16,173	17,183	18,210	19,265
As a percentage of GDP	65.9	67.2	66.5	65.9	65.4	65.6	66.2	67.0	68.1	69.4	70.7	71.8
Gross Federal Debt ^b	16,717	17,694	18,371	19,087	19,896	20,786	21,739	22,742	23,786	24,901	26,033	27,190
Debt Subject to Limit ^c	16,699	17,677	18,354	19,070	19,879	20,769	21,722	22,725	23,769	24,883	26,016	27,173

Source: Congressional Budget Office.

Note: GDP = gross domestic product.

- Debt held by the public minus the value of outstanding student loans and other credit transactions, financial assets (such as preferred stock) purchased from institutions participating in the Troubled Asset Relief Program, cash balances, and other financial instruments.
- Federal debt held by the public plus Treasury securities held by federal trust funds and other government accounts.
- 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 Treasury and the Federal Financing Bank is excluded from the debt limit. That limit was most recently set at \$16.7 trillion but has been suspended through February 7, 2014. On February 8, the debt limit will be raised to its previous level plus the amount of federal borrowing that occurred while the limit was suspended.

cash to finance student loans and other credit programs.¹³ Each year from 2015 to 2024, borrowing by the Treasury

is expected to exceed the amount of the deficit, mostly because of the need to provide financing for student loans. CBO projects that the government will need to borrow nearly \$65 billion more per year, on average, during that period than the budget deficits would suggest.

13. The Thrift Savings Plan is a retirement program, similar to a 401(k) plan, for federal civilian employees and members of the uniformed services. The G fund, one component of that plan, is invested entirely in Treasury securities. On May 31, 2013, the Treasury announced that it would no longer be able to fully invest the G fund in Treasury securities because of debt-ceiling constraints. The Continuing Appropriations Act, 2014 (P.L. 113-46) suspended the debt ceiling from October 17, 2013, through February 7, 2014, which gave the Treasury the ability to fully reinvest securities, including any forgone interest, into the G fund; that reinvestment was completed soon after the enactment of P.L. 113-46.

Under current law, federal debt held by the public as a percentage of GDP in 2024 is projected to reach its highest level in more than 75 years and roughly double the average of about 40 percent experienced over the 1974–2013 period. Debt that high by historical standards—and heading higher—would have significant consequences for the budget and the economy:

- The nation's net interest costs would be very high (after interest rates moved up to more typical levels) and rising.
- National saving would be held down, leading to more borrowing from abroad and less domestic investment, which in turn would decrease income in the United States compared with what it would be otherwise.
- Policymakers' ability to use tax and spending policies to respond to unexpected challenges—such as economic downturns, natural disasters, or financial crises—would be constrained. As a result, unexpected events could have worse effects on the economy and people's well-being than they would otherwise.
- The likelihood of a fiscal crisis would be higher. During such a crisis, investors would lose so much confidence in the government's ability to manage its budget that the government would be unable to borrow funds at affordable interest rates.

Other Measures of Federal Debt. Three other measures are sometimes used in reference to federal debt. *Debt held by the public less financial assets* subtracts from debt held by the public the value of the government's financial assets, such as student loans. That measure provides a more comprehensive picture of the government's financial condition and its overall impact on credit markets than does debt held by the public. Calculating that measure is not straightforward, however, because neither the universe of such assets nor the method for evaluating them is well defined. Under CBO's baseline assumptions, that measure is smaller than debt alone but varies roughly in line with it.

Gross federal debt consists of debt held by the public and debt issued to government accounts (for example, the Social Security trust funds). The latter type of debt does not directly affect the economy and has no net effect on the budget. In CBO's projections, debt held by the public is expected to increase by \$9.3 trillion between the end of 2013 and the end of 2024, and debt held by government accounts is estimated to rise by \$1.2 trillion. As a result, gross federal debt is projected to rise by \$10.5 trillion over that period and total \$27.2 trillion at the end of 2024. About one-fifth of that sum would be debt held by government accounts.

Debt subject to limit is the amount of debt that is subject to the statutory limit on federal borrowing; it is virtually identical to gross federal debt. Currently, there is no statutory limit on the issuance of new federal debt. The Continuing Appropriations Act, 2014 suspended the debt ceiling from October 17, 2013, through February 7, 2014. In the absence of any legislative action on the debt limit before the suspension ends, the amount of borrowing accumulated during that period will be added to the previous debt limit of \$16.699 trillion on February 8. The amount of outstanding debt subject to limit is now about \$17.2 trillion; under current law, it is projected to reach \$27.2 trillion at the end of 2024.

If the current suspension is not extended and a higher debt limit is not specified in law before February 8, 2014, the Treasury will have no room to borrow under standard borrowing procedures beginning on that date. Therefore, to avoid a breach in the debt ceiling, the Treasury would begin employing its well-established toolbox of so-called extraordinary measures to allow continued borrowing for a limited time. CBO anticipates that the Treasury will probably exhaust those measures in late February or early March, and it will probably run out of cash sometime during the first half of March. If that occurred, the Treasury might be unable to fully pay its obligations, a development that could lead to delays of payments for government activities and possibly to a default on the government's debt obligations. However, the government's cash flows, especially the amount and timing of tax refunds, cannot be predicted with certainty, and the actual cash flows during the next several weeks could affect the date on which the Treasury runs out of cash in one direction or the other.¹⁴

Changes in CBO's Baseline Since May 2013

CBO completed its previous set of baseline projections in May 2013. Since then, the agency has reduced its estimate of the deficit in 2014 by \$46 billion and added a total of \$1.0 trillion to its baseline projection of the cumulative deficit from 2014 through 2023 (see Appendix A). A revised economic outlook increased the projection of the cumulative deficit by \$1.2 trillion, mostly because CBO now anticipates slower growth in real GDP and lower inflation, which reduce projected

14. For more information on the debt limit and extraordinary measures, see Congressional Budget Office, *Federal Debt and the Statutory Limit, November 2013* (November 2013), www.cbo.gov/publication/44877.

Table 1-4.**Changes in CBO's Baseline Projections of the Deficit Since May 2013**

(Billions of dollars)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total	
											2014-	2014-
											2018	2023
Deficit in CBO's May 2013 Baseline	-560	-378	-432	-482	-542	-648	-733	-782	-889	-895	-2,394	-6,340
Changes												
Legislative												
Revenues	*	*	*	*	1	1	1	1	1	1	2	7
Outlays	45	21	-8	-33	-41	-53	-59	-63	-84	-101	-16	-376
Subtotal ^a	-45	-21	9	33	41	54	60	64	85	102	18	382
Economic												
Revenues	77	16	-66	-136	-168	-187	-209	-231	-249	-262	-276	-1,415
Outlays	-10	-17	-19	-24	-25	-29	-30	-28	-27	-19	-95	-229
Subtotal ^a	87	33	-47	-111	-143	-158	-179	-203	-222	-242	-181	-1,186
Technical												
Revenues	-91	-110	-59	-13	-6	16	32	25	7	3	-278	-196
Outlays	-94	2	10	8	6	15	16	16	12	14	-69	5
Subtotal ^a	3	-112	-69	-21	-11	1	17	8	-5	-11	-210	-200
Total Effect on the Deficit^a	46	-100	-107	-99	-113	-104	-103	-130	-143	-151	-373	-1,004
Deficit in CBO's February 2014 Baseline	-514	-478	-539	-581	-655	-752	-836	-912	-1,031	-1,047	-2,767	-7,344

Source: Congressional Budget Office.

Note: * = between zero and \$500 million.

a. Positive numbers indicate a decrease in the deficit; negative numbers indicate an increase in the deficit.

revenues by \$1.4 trillion (see Table 1-4). Other, technical changes increased projected deficits by an additional \$0.2 trillion.

In contrast, legislation enacted since last May led CBO to lower projected deficits by \$0.4 trillion through 2023 (including debt-service costs). The largest such effect was related to emergency funding provided in 2013. As mandated by law, discretionary funding in CBO's previous baseline was based on 2013 appropriations and therefore reflected the assumption that amounts equal to the \$48 billion in such funding provided last year after Hurricane Sandy (with adjustments for inflation) would be appropriated each year. The projections of discretionary spending in CBO's new baseline are based on 2014 appropriations. No additional funding has been provided for such purposes in 2014, so CBO's current baseline includes no funding of that sort during the coming decade. As a result, projected outlays have fallen by about \$365 billion through 2023. Other legislation—including

the Bipartisan Budget Act—further reduced the cumulative deficit by about \$20 billion (see Box 1-1 for a discussion of the changes in the budget process that are included in the Bipartisan Budget Act).

Uncertainty in Budget Projections

Even if federal laws remained unchanged for the next decade, actual budgetary outcomes would differ from CBO's baseline projections because of unanticipated changes in economic conditions and in a host of other factors that affect federal spending and revenues. The agency aims for its projections to be in the middle of the distribution of possible outcomes given the baseline assumptions about federal tax and spending policies.

CBO's budgetary projections of outlays depend on the agency's economic projections for the coming decade, including forecasts for such variables as interest rates, inflation, and the growth of real GDP. Discrepancies

Box 1-1.**Implications of the Budget Control Act of 2011 and Subsequent Changes**

The Budget Control Act of 2011 (Public Law 112-25) imposed caps on discretionary funding for the 2012–2021 period. It also created a Congressional Joint Select Committee on Deficit Reduction to propose further budgetary savings and established automatic procedures for reducing spending if legislation that achieved a specified amount of savings was not enacted.

Because no legislation was reported by the committee, automatic procedures went into effect to reduce both discretionary and mandatory spending. Those automatic reductions took the form of equal cuts (in dollar terms) in funding for defense and nondefense programs from 2013 through 2021. For 2013, the cuts were achieved by across-the-board reductions (that is, a sequestration) applied to most discretionary funding and to funding for certain mandatory programs. For 2014 through 2021, the reductions were to be achieved by lowering the caps on discretionary funding and by continued sequestration of funding for certain mandatory programs.

Subsequent legislation has further modified the restrictions on discretionary funding and extended the period of sequestration for mandatory funding.

Caps on Discretionary Funding

The original caps on discretionary funding established by the Budget Control Act totaled \$1,047 billion for 2013; those caps applied separately to security and nonsecurity spending (see footnote “a” of the table). For years after 2013, the caps rose gradually to \$1,234 billion in 2021.¹ The sequestration of discretionary funding in 2013 reduced budget authority subject to the caps by an estimated \$55 billion (and reduced budget authority for spending not constrained by the caps by an additional \$8 billion). From 2014 to 2021, CBO estimates, the automatic spending reductions would reduce the caps by about \$90 billion per year.

Later laws modified the caps for 2014 and 2015. The American Taxpayer Relief Act of 2012 (P.L. 112-240) delayed the implementation of the automatic spending reductions from January 2 to March 1, 2013, and

lowered the amount to be sequestered in 2013 by \$24 billion. It also reduced the caps by \$4 billion for 2013 and \$8 billion for 2014.

In December 2013, the Bipartisan Budget Act of 2013 (P.L. 113-67) increased the caps for 2014 and 2015 relative to what they would have been if the automatic reductions had taken effect. For 2014, the caps on defense and nondefense funding were each boosted by about \$22 billion; for 2015, they were each raised by about \$9 billion. The caps that are now in place total \$1.01 trillion for this year and remain at about that level through 2016. After that year, the caps rise by about 2.4 percent annually, reaching \$1.15 trillion in 2021.

Sequestration of Mandatory Funding

Most large programs (such as Social Security, Medicaid, civil service and military retirement, and veterans’ benefits) are not subject to the automatic reductions. Cuts to most components of Medicare spending are limited to 2 percent; the reductions to other nonexempt programs are calculated on the basis of a formula in the law.²

The Bipartisan Budget Act extended such reductions through 2023 by requiring that the sequestration percentage applied to nonexempt mandatory accounts in 2021 be applied in the same way for two additional years. Furthermore, the Pathway for SGR Reform Act of 2013 (also part of P.L. 113-67) increased the reduction to Medicare spending for the first half of the 2023 sequestration year to 2.90 percent but adjusted it to 1.11 percent for the second half.³

The Office of Management and Budget (OMB), which is responsible for administering the sequestration, calculated that the reduction for 2013 for nonexempt mandatory programs in the defense category was 7.8 percent and in the nondefense category (other than Medicare), 5.1 percent. For 2014, OMB

1. The law allows for adjustments to the discretionary caps when appropriations are provided for certain purposes. For more details, see Congressional Budget Office, *Final Sequestration Report for Fiscal Year 2014* (January 2014), www.cbo.gov/publication/45013.

2. Medicare spending related to subsidies for low-income people, coverage for catastrophic costs, and qualified individual premiums is exempt from sequestration. Administrative costs for Medicare that are classified as mandatory are subject to the same sequestration rate as other nondefense programs.

3. The Deficit Control Act specifies that sequestration for the Medicare program begin in the first month after an order is issued. As a result, the period of sequestration for Medicare (its “sequestration year”) under a normal schedule would start in February. (The 2013 sequester was ordered in March 2013, so Medicare sequestration began in April 2013.)

Continued

Box 1-1.**Continued****Implications of the Budget Control Act of 2011 and Subsequent Changes****Limits on Discretionary Budget Authority for 2013 to 2021, Excluding Adjustments**

(Billions of dollars)

	Actual, 2013 ^a	2014	2015	2016	2017	2018	2019	2020	2021
Caps Set in the Budget Control Act of 2011^b									
Defense	546	556	566	577	590	603	616	630	644
Nondefense	501	510	520	530	541	553	566	578	590
Total	1,047	1,066	1,086	1,107	1,131	1,156	1,182	1,208	1,234
Effect of Automatic Enforcement Procedures^c									
Defense	-34	-54	-54	-54	-54	-54	-54	-54	-54
Nondefense	-21	-37	-37	-37	-37	-37	-36	-35	-34
Total	-55	-91	-91	-91	-91	-91	-90	-89	-88
Changes to the Caps Enacted in Subsequent Legislation^d									
Defense	-2	18	9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Nondefense	-2	18	9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total	-4	37	18	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Revised Caps									
Defense	510 ^e	520	521	523	536	549	562	576	590
Nondefense	478 ^e	492	492	493	504	516	530	543	556
Total	988^e	1,012	1,014	1,016	1,040	1,065	1,092	1,119	1,146

Source: Congressional Budget Office.

Note: n.a. = not applicable.

- Caps for 2013 applied to security and nonsecurity spending rather than to defense and nondefense spending. The security category comprised discretionary appropriations for the Departments of Defense, Homeland Security, and Veterans Affairs; the National Nuclear Security Administration; the intelligence community management account (Treasury account 95-0401-0-1-054); and discretionary accounts in budget function 150 (international affairs). The nonsecurity category comprised all other discretionary appropriations. The defense–nondefense allocation shown in this column corresponds to the amounts used to calculate the automatic spending reductions and the effects of sequestration.
- Appropriations for overseas contingency operations, activities receiving emergency designations, disaster relief, and spending designed to enhance program integrity by reducing overpayments in certain benefit programs are not constrained by the caps. Such adjustments are not included in this table.
- Because the Joint Select Committee on Deficit Reduction did not report a bill to reduce the deficit, reductions in the caps on discretionary budget authority went into effect for 2014 through 2021. Funding provided for 2013 was subject to sequestration, applied independently of the caps; the amounts shown in this table are estimates made by CBO.
- The caps were reduced in the American Taxpayer Relief Act of 2012 and increased in the Bipartisan Budget Act of 2013.
- The figures for 2013 subtract CBO's estimate of the amount of the sequestration from the statutory caps, though the caps themselves were not reduced by the sequestration.

calculated that the reductions for defense and non-defense are 9.8 percent and 7.2 percent, respectively.¹

CBO estimates that mandatory spending was reduced by a total of about \$8 billion in 2013 as a result of the

sequestration of mandatory funding and will be reduced by about \$15 billion in 2014. From 2015 to 2022, the estimated effect of such reductions ranges from \$18 billion to \$22 billion, and the proportion accounted for by cuts to Medicare rises from about 60 percent to about 80 percent. In 2023, the total reduction will be \$27 billion as a result of the legislated adjustment to the Medicare reduction; another \$6 billion in cuts would spill into 2024, almost entirely from Medicare.

1. See Office of Management and Budget, *OMB Sequestration Preview Report to the President and Congress for Fiscal Year 2014* (corrected version, May 20, 2013).

between those forecasts and actual economic outcomes can result in significant differences between baseline budgetary projections and budgetary outcomes. For instance, CBO's baseline economic forecast anticipates that interest rates on 3-month Treasury bills will increase from 0.2 percent in 2015 to 3.7 percent in 2024 and that interest rates on 10-year Treasury notes will rise from 3.6 percent to 5.0 percent over that same period. If interest rates on all types of Treasury securities were 1 percentage point higher or lower each year from 2015 through 2024 and all other economic variables were unchanged, cumulative outlays projected for the 10-year period would be about \$1.1 trillion higher or lower (excluding the additional costs of servicing the federal debt) and revenues would be \$0.1 trillion lower or higher. (For further discussion of how various economic assumptions affect budget projections, see Appendix D.)

Uncertainty also surrounds myriad technical factors that can substantially affect CBO's baseline projections of outlays. For example, spending per enrollee for Medicare and Medicaid—which generally has grown faster than GDP per person—is very difficult to predict. If per capita costs in those programs rose 1 percentage point faster or slower per year than CBO has projected for the next decade, total federal outlays for Medicare (net of receipts from premiums) and Medicaid would be about \$800 billion higher or lower for that period. The impact of the Affordable Care Act is another source of significant uncertainty. To estimate the effects of the law's broad changes to the nation's health care and health insurance systems, CBO and the staff of the Joint Committee on Taxation (JCT) have made projections concerning an array of programs and institutions, some of which (such as the health insurance exchanges) have only recently begun.

Projections of revenues also are quite sensitive to many economic and technical factors. Revenues depend on total amounts of wages and salaries, corporate profits, and other income, all of which are encompassed by CBO's economic projections. For example, if the growth of real GDP and taxable income was 0.1 percentage point higher or lower per year than in CBO's baseline projections, revenues would be roughly \$270 billion higher or lower over the 2015–2024 period.

In addition, forecasting the amount of revenue that the government will collect from taxpayers for a given amount of total income requires technical assumptions

about the distribution of income and about many aspects of taxpayers' behavior. (Taxpayers' behavior, for example, determines the amount of deductions and credits people receive and how much income in the form of capital gains they realize from selling assets.) Differences between CBO's judgments about such behavior and actual outcomes can lead to significant deviations from the agency's baseline projections of revenues.

Even relatively small deviations in revenues and outlays relative to CBO's projections could have a substantial effect on budget deficits. For example, if revenues projected for 2024 were too high by 5 percent (that is, if average annual growth during the coming decade was about 0.5 percentage points less than CBO estimated) and outlays projected for mandatory programs were too low by 5 percent, the deficit for that year would be about \$430 billion greater than the \$1.1 trillion in CBO's baseline—or 5.6 percent of GDP, rather than 4.0 percent. Outcomes could differ just as much in the other direction as well.

Alternative Assumptions About Fiscal Policy

CBO's baseline budget projections—which are constructed in accordance with provisions of law—are intended to show what would happen to federal spending, revenues, and deficits if current laws generally remained unchanged. Future legislative action, however, could lead to markedly different budgetary outcomes.

To assist policymakers and analysts who may hold differing views about the most useful benchmark against which to consider possible changes to laws, CBO has estimated the effects on budgetary projections of some alternative assumptions about future policies (see Table 1-5). The discussion below focuses on how those policy actions would directly affect revenues and outlays. Such changes also would influence the costs of servicing the federal debt (shown separately in the table).

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

CBO's projections of discretionary spending for the next 10 years include outlays for military operations and diplomatic activities in Afghanistan and other possible overseas contingency operations. The outlays projected in the baseline come from budget authority provided for

those purposes in 2013 and prior years, the \$92 billion in budget authority provided for 2014, and the \$1.0 trillion that is assumed to be appropriated over the 2015–2024 period (under the assumption that annual funding is set at \$92 billion plus adjustments for anticipated inflation, in accordance with the rules governing baseline projections).¹⁵

In coming years, the funding required for overseas contingency operations—in Afghanistan or other countries—may eventually be smaller than the amounts in the baseline if the number of deployed troops and the pace of operations diminish over time. Thus, CBO has formulated a budget scenario that assumes a reduction in the deployment of U.S. forces abroad for military actions and a concomitant reduction in diplomatic operations and foreign aid. Many other scenarios—some costing more and some less—are also possible.

In 2013, the number of U.S. active-duty, Reserve, and National Guard personnel deployed for war-related activities averaged about 85,000, CBO estimates. In this alternative scenario, the average number of military personnel deployed for war-related purposes would decline over three years: from 60,000 in 2014, to 40,000 in 2015, 35,000 in 2016, and 30,000 in 2017 and thereafter. (Those forces could be allocated between Afghanistan and other locations in many different ways.) Under that scenario, and assuming that the war-related funding for diplomatic operations and foreign aid declined at a similar rate, total discretionary outlays over the 2015–2024 period would be \$572 billion less than the amount in the baseline.¹⁶

Other Discretionary Spending

Policymakers could vary discretionary funding in many ways from the amounts projected in the baseline. For example, if appropriations grew each year through 2024 at the same rate as inflation after 2014 rather than adhering to the caps, discretionary spending would be about \$735 billion higher for that period than it is in the baseline. If, by contrast, lawmakers kept appropriations for 2015 through 2024 at the nominal 2014 amount, total discretionary outlays would be \$688 billion lower over that period. Under that scenario (sometimes called a

freeze in regular appropriations), total discretionary spending would fall from 6.9 percent of GDP in fiscal year 2014 to 4.5 percent in 2024.

Medicare's Payments to Physicians

Spending for Medicare is constrained by a rate-setting system—called the sustainable growth rate—to control the fees that physicians receive for their services. If the system is allowed to operate as currently structured, physicians' fees will be reduced by about 24 percent in April 2014 and will increase by small amounts in subsequent years, CBO projects. If, instead, lawmakers overrode those scheduled reductions—as they have every year since 2003—spending on Medicare might be greater than the amounts projected in CBO's baseline. For example, holding payment rates through 2024 at current levels would raise outlays for Medicare (net of premiums paid by beneficiaries) by \$5 billion in 2014 and by \$115 billion (or about 2 percent) between 2015 and 2024. The effect of the policy on Medicare (and on the deficit) would depend on whether lawmakers offset the effects of the change, as they often have done in the past, with other changes to reduce deficits.

Automatic Enforcement Procedures

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. The Bipartisan Budget Act canceled the reductions for 2014 and 2015 and instead set new caps for those years. That act also extended the reductions to mandatory spending through 2023. If lawmakers chose to prevent those automatic cuts each year after 2014 without making other changes that reduced spending by offsetting

15. Funding for overseas contingency operations in 2014 includes \$85 billion for military operations and indigenous security forces and \$7 billion for diplomatic operations and foreign aid.

16. Legislation that placed limits on appropriations for overseas contingency operations that were below the amounts in CBO's baseline would result in estimated reductions in spending relative to the outlays in CBO's baseline, which are based on the projection of \$1.0 trillion in budget authority over 10 years, extrapolated from 2014 funding. That sum, however, is just a baseline projection; such funding has not yet been provided, and there are no funds in the Treasury set aside for that purpose. As a result, reductions relative to the baseline might simply reflect policy decisions that have already been made and that would be realized even without such funding constraints. Moreover, if future policymakers believed that national security required appropriations above the capped amounts, they would almost certainly provide emergency appropriations that would not, under current law, be counted against the caps.

Table 1-5.**Budgetary Effects of Selected Policy Alternatives Not Included in CBO's Baseline**

(Billions of dollars)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Total 2015- 2015-	
												2019	2024
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	10	36	49	59	64	68	70	72	72	72	219	572
Debt service	0	*	1	2	5	8	11	14	18	22	26	16	107
Increase Discretionary Appropriations at the Rate of Inflation After 2014 ^c													
Effect on the deficit ^b	0	-23	-47	-60	-68	-75	-82	-88	-93	-97	-100	-274	-735
Debt service	0	*	-1	-3	-7	-10	-13	-18	-22	-27	-33	-21	-135
Freeze Most Discretionary Appropriations at the 2014 Amount ^d													
Effect on the deficit ^b	0	-10	-12	2	22	46	71	98	128	157	187	48	688
Debt service	0	*	*	-1	*	1	4	7	12	19	27	*	68
Policy Alternative That Affects Mandatory Outlays													
Maintain Medicare's Payment Rates for Physicians at the Current Rate ^e													
Effect on the deficit ^b	-5	-10	-11	-10	-9	-10	-11	-12	-13	-14	-16	-49	-115
Debt service	*	*	*	-1	-2	-2	-3	-3	-4	-5	-5	-5	-25
Policy Alternative That Affects Both Discretionary and Mandatory Outlays													
Remove the Effect of the Automatic Enforcement Procedures Specified in the Budget Control Act ^f													
Effect on the deficit ^b	n.a.	-14	-68	-90	-98	-101	-104	-103	-105	-110	-96	-371	-888
Debt service	n.a.	*	-1	-4	-9	-14	-18	-23	-29	-35	-41	-29	-174

Continued

amounts, mandatory outlays would be \$14 billion higher in 2015. Over the 2015–2024 period, total outlays would be \$888 billion (or about 2 percent) higher than the amounts in CBO's current baseline. Total discretionary outlays would be \$747 billion (or 5.9 percent) higher, and outlays from mandatory programs—most of which are not subject to sequestration—would be \$141 billion (or 0.5 percent) higher.¹⁷

Revenues

A host of tax provisions, many of which have been extended repeatedly, have recently expired or are scheduled to expire over the next decade. If all of those provisions were permanently extended, CBO and JCT

estimate, revenues would be lower—and, although a much smaller effect, outlays for refundable tax credits would be higher—by a total of \$913 billion over the 2015–2024 period. Most of those tax provisions expired at the end of 2013. They include a provision allowing businesses to immediately deduct 50 percent of new investments in equipment, which JCT estimates accounts for about \$263 billion of the budgetary effects of extending all of the provisions. The budgetary cost of extending all of the tax provisions would be higher in the latter part of the 10-year period than in the first several years because certain provisions affecting refundable tax credits are scheduled to expire at the end of 2017. Extending those provisions would boost outlays for refundable credits and reduce revenues by a total of about \$163 billion over the 2019–2024 period. (Payments for refundable credits are typically made a year after the applicable tax year.)

17. 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.

Table 1-5.

Continued

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

(Billions of dollars)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Total		
												2015-	2015-	
Policy Alternative That Affects the Tax Code														
Extend Expiring Tax Provisions ^g														
Effect on the deficit ^b	-51	-92	-83	-78	-77	-96	-93	-93	-96	-101	-104	-426	-913	
Debt service	*	-1	-4	-8	-13	-17	-22	-27	-33	-39	-45	-44	-209	
Memorandum:														
Outlays for Overseas Contingency Operations in CBO's Baseline	105	97	96	95	97	98	100	102	104	106	108	484	1,004	
Deficit in CBO's Baseline	-514	-478	-539	-581	-655	-752	-836	-912	-1,031	-1,047	-1,074	-3,005	-7,904	

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 \$92 billion in budget authority for military operations, diplomatic activities, and foreign aid in Afghanistan and other countries provided for 2014. Rather, the alternative incorporates the assumption that, as the number of troops falls to about 30,000 by 2017, funding for overseas contingency operations declines as well, to \$62 billion in 2015, \$46 billion in 2016, and then an average of about \$35 billion per year from 2017 on—for a total of \$380 billion over the 2015–2024 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 and will instead grow at the rate of inflation from their 2014 level. Discretionary funding related to federal personnel is inflated using the employment cost index for wages and salaries; other discretionary funding is adjusted 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 2014 level through 2024.
- e. Medicare's current payment rates for physicians' services are scheduled to drop by 24 percent on April 1, 2014, and to increase by small amounts in subsequent years. In this alternative, payment rates are assumed to continue at their current levels through 2024.
- f. 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 2022–2024 period, CBO has extrapolated the reductions estimated for 2021. Nonexempt mandatory programs will be reduced through sequestration; those provisions have been extended through 2023. The budgetary effects of this option cannot be combined with those of any of the alternatives that affect discretionary spending, other than the one to reduce the number of troops deployed for overseas contingency operations.
- g. These estimates are mainly from the staff of the Joint Committee on Taxation and are preliminary. They reflect the impact of extending about 70 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.

The Long-Term Budget Outlook

Beyond the coming decade, the fiscal outlook is even more worrisome. In CBO's most recent long-term projections—which extend through 2038—budget deficits rise steadily under the extended-baseline scenario, which follows CBO's 10-year baseline projections for the first decade and then extends the baseline concept for subse-

quent years.¹⁸ Although long-term budget projections are highly uncertain, the aging of the population and rising costs for health care would almost certainly push federal spending up significantly relative to GDP after 2024 if

18. See Congressional Budget Office, *The 2013 Long-Term Budget Outlook* (September 2013), www.cbo.gov/publication/44521.

current laws remained in effect. Federal revenues also would continue to increase relative to GDP under current law, reaching significantly higher percentages of GDP than at any time in the nation's history—but they would not keep pace with outlays. As a result, public debt would reach roughly 110 percent of GDP by 2038, CBO estimates, about equal to the percentage just after World War II.¹⁹ Such an upward path would ultimately be unsustainable.

19. Ibid. When CBO issued its most recent long-term projections, which showed debt close to 110 percent of GDP in 2038, debt held by the public in the 10-year baseline was about \$1 trillion lower in 2023 than CBO currently estimates. Hence, CBO estimates that debt held by the public in 2038 would probably be higher than previously projected if current laws remained in place.

Continued rising debt would dampen economic growth and thus reduce people's income compared with what it would otherwise be. It would also increasingly restrict policymakers' ability to use tax and spending policies to respond to unexpected challenges and would boost the risk of a fiscal crisis, in which the government would lose its ability to borrow at affordable rates. To avoid those consequences, lawmakers will ultimately have to make significant changes to tax and spending policies—letting revenues rise more than they would under current law, reducing spending for large benefit programs below the projected amounts, cutting other federal spending to even lower levels by historical standards than currently projected, or adopting some combination of those approaches.