



Budgetary and Economic Outcomes Under Paths for Federal Revenues and Noninterest Spending Specified by Chairman Enzi, September 2017

At the request of the Chairman of the Senate Budget Committee, Senator Mike Enzi, the Congressional Budget Office has projected budgetary and economic outcomes over the next decade under paths for federal revenues and spending (excluding interest payments) specified by the Chairman and his staff. The projections do not represent a cost estimate for legislation or an analysis of the effects of any specific policies. In particular, CBO has not considered the effects of any policies on economic growth beyond the effects of changes in federal borrowing resulting from the specified paths. In addition, CBO has not considered whether the specified paths are consistent with the policy proposals or budget numbers that Chairman Enzi released on September 29, 2017, as part of his proposed budget resolution.¹

Summary

The projections in this report represent CBO's assessment of how federal debt and economic output would evolve from 2018 to 2027 under Chairman Enzi's specified paths for revenues and noninterest spending. The benchmark for those projections is the 10-year baseline that CBO published in June 2017, which reflects

the assumption that current law will generally remain unchanged.²

The projections show how the reductions (relative to the baseline) in federal revenues and spending—and the resulting changes in federal borrowing—under those paths would affect the economy and how those macroeconomic effects would, in turn, feed back into the federal budget. The projections do not show any other potential effects on the economy of specific policies that might be used to generate those paths.

In Chairman Enzi's specified paths, noninterest spending decreases from 18.5 percent of gross domestic product (GDP) in 2018 to 17.2 percent in 2027, and revenues increase from 16.9 percent of GDP to 17.9 percent. In CBO's 10-year baseline, noninterest spending measured as a share of GDP increases from 19.0 percent in 2018 to 20.7 percent in 2027, and revenues increase from 17.7 percent of GDP to 18.4 percent over the same span (see Figure 1).

1. CBO does not analyze or prepare estimates of budget resolutions because they are targets for the Congress and its committees and do not contain legislative language for proposals whose budgetary effects can be estimated. For more on CBO's role in analyzing budget resolutions, see Congressional Budget Office, "CBO's Role in Budget Resolutions," *CBO Blog* (March 15, 2016), www.cbo.gov/publication/51379.

2. See Congressional Budget Office, *An Update to The Budget and Economic Outlook: 2017 to 2027* (June 2017), www.cbo.gov/publication/52801. CBO recently updated its health insurance coverage projections; see Congressional Budget Office, *Federal Subsidies for Health Insurance Coverage for People Under Age 65: 2017 to 2027* (September 2017), www.cbo.gov/publication/53091. This report does not incorporate those updated projections, but CBO anticipates that if they were incorporated, the estimated effects of Chairman Enzi's specified paths on the budget and the economy would be similar to the estimated effects reported here.

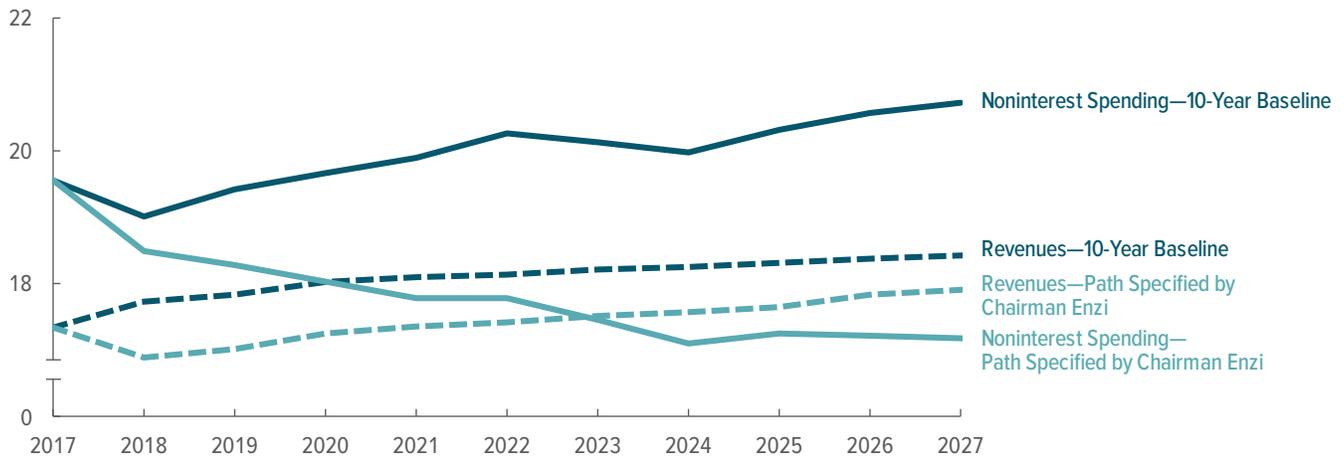
Notes: Unless otherwise indicated, years referred to in describing budget numbers are fiscal years, which run from October 1 to September 30 and are designated by the calendar year in which they end; years referred to in describing economic output are calendar years.

Numbers in the text may not add up to totals because of rounding.

Figure 1.

Revenues and Noninterest Spending Under Paths Specified by Chairman Enzi and in CBO's 10-Year Baseline, Without Macroeconomic Effects, 2017 to 2027

Percentage of Gross Domestic Product, by Fiscal Year



Source: Congressional Budget Office.

CBO's **10-year baseline** reflects the assumption that current law will generally remain unchanged. Projections under the baseline incorporate effects from changes over time in incentives to work or save under current law.

The **paths for revenues and noninterest spending specified by Chairman Enzi** reduce deficits (excluding interest payments), measured as a percentage of gross domestic product, below those in the 10-year baseline by increasing amounts over time.

The paths shown above are those specified by the Chairman. They do not include the effects of any changes in economic conditions that might result from reducing revenues and noninterest spending to the amounts specified in the paths.

Over the next decade, the specified paths would result in noninterest spending that was a total of \$5.8 trillion less than projected in the baseline and revenues that were a total of \$1.6 trillion less. If such changes were made, the federal government would borrow less than it is projected to borrow under current law, reducing interest payments below the amount projected in the baseline by a total of \$423 billion over the next decade.

Macroeconomic feedback would reduce the cumulative budget deficit by an additional \$178 billion, CBO estimates. Including that effect, the cumulative budget deficit under the specified paths would be \$5.4 trillion—\$4.7 trillion lower than in CBO's baseline. The deficit would shrink from \$693 billion in 2017 to \$424 billion by 2027, which is about \$1 trillion less than the amount projected for that year in CBO's June baseline.

Federal debt held by the public measured as a share of GDP would fall to 74 percent in 2027 under the

specified paths, CBO projects; it is 91 percent in that year in the baseline (see Figure 2). Economic output would be lower than projected in CBO's baseline over the next few years because changes in federal spending and revenues relative to amounts projected under current law would reduce total demand for goods and services. By calendar year 2027, output would be about 0.8 percent higher than in the baseline because less federal borrowing would free up resources for private investment.

What Would Outcomes Be Under Current Law?

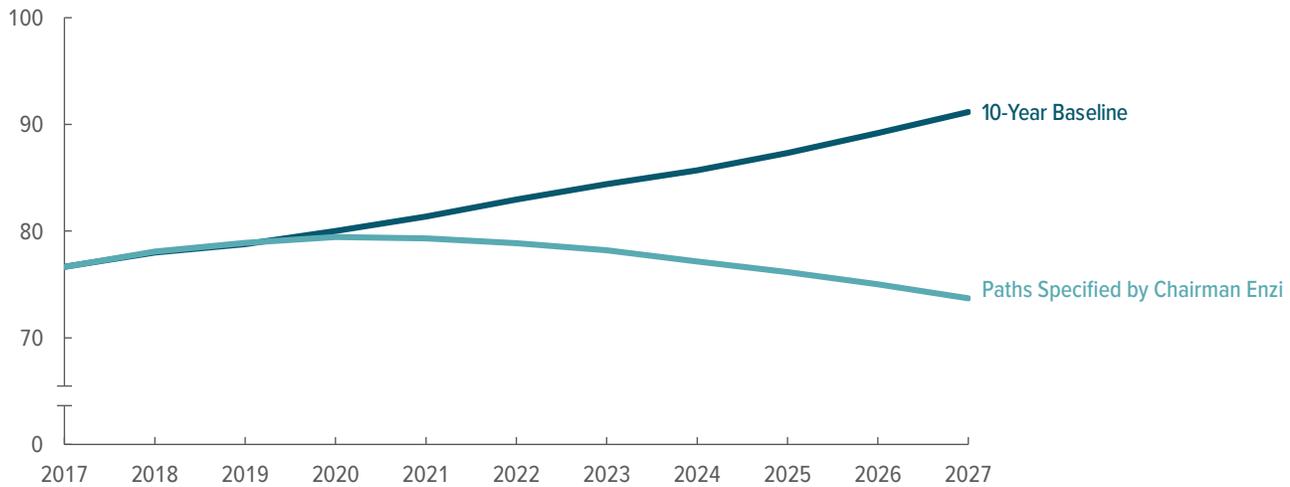
Because they incorporate the assumption that current law will generally remain unchanged, CBO's 10-year baseline budget projections serve as a benchmark against which to measure the potential effects of proposals that would alter federal taxes or spending. CBO published its most recent baseline projections in June.

The total deficit in CBO's baseline grows from 3.6 percent of GDP in 2017 to 5.2 percent in 2027; the

Figure 2.

Federal Debt Held by the Public Under Paths Specified by Chairman Enzi and in CBO’s 10-Year Baseline, With Macroeconomic Effects, 2017 to 2027

Percentage of Gross Domestic Product, by Fiscal Year



Source: Congressional Budget Office.

CBO’s **10-year baseline** reflects the assumption that current law will generally remain unchanged. Projections under the baseline incorporate effects from changes over time in incentives to work or save under current law.

The **paths for revenues and noninterest spending specified by Chairman Enzi** reduce deficits (excluding interest payments), measured as a percentage of gross domestic product, below those in the 10-year baseline by increasing amounts over time.

In the short term, reducing revenues and noninterest spending to the amounts specified in the paths would change demand for goods and services. In the long term, the changes in the amount of federal debt held by the public that resulted from those reductions would alter investment in capital goods (such as factories and computers) and, consequently, after-tax wages, which would then affect the supply of labor. Those changes in the economy would, in turn, feed back into the federal budget. The estimates shown above incorporate that feedback. Because CBO was not provided specific policies that might underlie the paths, the estimates do not incorporate any changes in incentives to work or save or in government investment that might stem directly from such policies.

cumulative deficit between 2018 and 2027 is \$10.1 trillion. CBO projects that federal debt held by the public would, under current law, grow from 77 percent of GDP in 2017 to 91 percent—more than twice the average over the past five decades—by 2027.

Although output and income per person will be higher in 2027 than they are now, the high and rising debt that is projected would have serious negative consequences for the budget and the nation:

Even as increasing deficits and debt led to less output and income than there otherwise would have been, the continued growth of productivity projected under current law would make future output and income per person higher than they are now. Expressed in 2017 dollars, real (inflation-adjusted) gross national product (GNP) per person is projected to be about \$60,000 in 2018 and about \$66,000 in 2027 under current law (see Figure 3).³

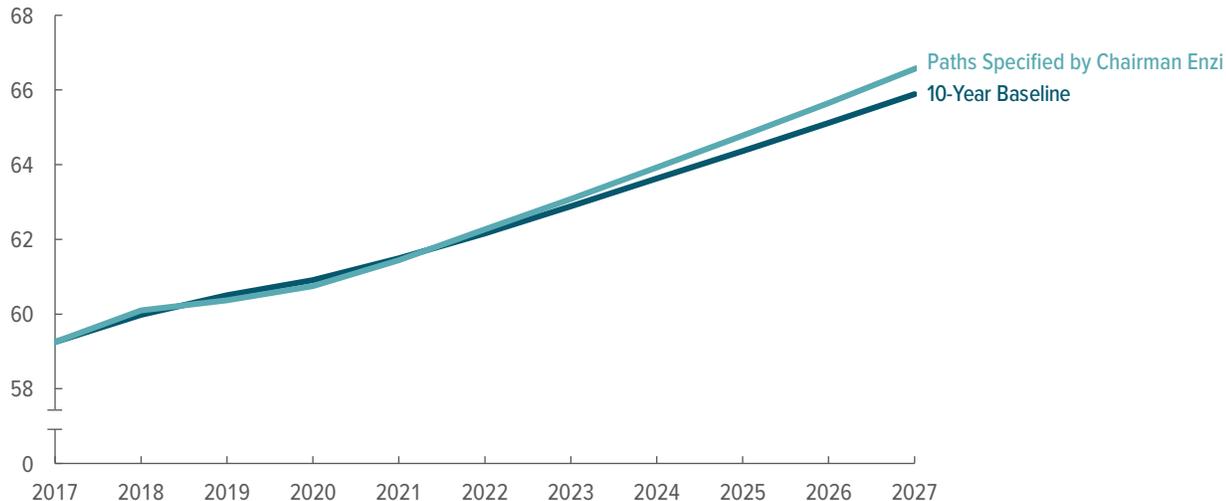
more commonly cited GDP because GNP is a better measure of the resources available to U.S. households. Unlike GDP, GNP includes the income that U.S. residents earn abroad and excludes the income that foreigners earn in the United States. When the federal government runs larger budget deficits, more capital tends to flow into the United States from other countries, providing financing for private investment even as national saving is reduced. However, over time, more income must be paid to foreign investors as profits or interest on that invested capital. Therefore, other things being equal, increases in debt reduce GNP (and the income of U.S. households) more than GDP, and decreases in debt increase GNP more than GDP. In the short run, by contrast, fiscal policies affect GNP and GDP similarly through their effects on total demand.

3. In assessing the long-term impact of tax and spending policies on output, CBO focuses on effects on GNP rather than on the

Figure 3.

Real Gross National Product per Person Under Paths for Revenues and Noninterest Spending Specified by Chairman Enzi and in CBO's 10-Year Baseline, 2017 to 2027

Thousands of 2017 Dollars, by Calendar Year



Source: Congressional Budget Office.

Unlike the more commonly cited gross domestic product, real (inflation-adjusted) gross national product includes the income that U.S. residents earn abroad and excludes the income that foreigners earn in the United States.

CBO's **10-year baseline** reflects the assumption that current law will generally remain unchanged. Projections under the baseline incorporate effects from changes over time in incentives to work or save under current law.

The **paths for revenues and noninterest spending specified by Chairman Enzi** reduce deficits (excluding interest payments), measured as a percentage of gross domestic product, below those in the 10-year baseline by increasing amounts over time.

In the short term, reducing revenues and noninterest spending to the amounts specified in the paths would change demand for goods and services. In the long term, the changes in the amount of federal debt held by the public that resulted from those reductions would alter investment in capital goods (such as factories and computers) and, consequently, after-tax wages, which would then affect the supply of labor. The estimates shown above reflect those changes in the economy. Because CBO was not provided specific policies that might underlie the paths, the estimates do not incorporate any changes in incentives to work or save or in government investment that might stem directly from such policies.

- Federal spending on interest payments would increase substantially as a result of increases in interest rates, such as those projected to occur over the next few years.
- Because federal borrowing reduces total saving in the economy over time, the nation's capital stock would ultimately be smaller than it would be if debt was smaller, and productivity and total wages would be lower.
- Lawmakers would have less flexibility to use tax and spending policies to respond to unexpected challenges.
- The likelihood of a fiscal crisis in the United States would increase. The risk that investors would become unwilling to finance the government's borrowing needs unless they were compensated with very high interest rates would be greater. If that happened, interest rates on federal debt would rise suddenly and sharply.

How Did CBO Analyze the Effects of the Budgetary Paths?

The estimated economic effects of the paths specified by Chairman Enzi incorporate no assumptions about the specific policies that might be adopted to produce those paths. Meeting the targets for revenues and spending set in the paths would, however, require major changes to

current law. For example, by 2027 noninterest spending under the paths would be roughly 17 percent less than the amount in the baseline. A proportional reduction in 2017 would amount to a decrease of roughly \$640 billion in noninterest spending relative to CBO's June baseline. Revenues would be about 3 percent lower by 2027. A proportional reduction in 2017 would amount to a decrease of roughly \$93 billion in revenues. The specific policies adopted to produce the paths would affect overall economic output not only by reducing federal borrowing but also by altering incentives to work and save as well as federal investment, which in turn would affect private-sector productivity. This analysis, however, includes only those macroeconomic effects stemming from changes (relative to the baseline) in federal debt. Because CBO was not provided specific policies that might be implemented to meet the targets for revenues and noninterest spending specified in the paths, this analysis does not include the effects of any such policies on output or the resulting feedback to the federal budget. This analysis also does not consider the effects of particular policies on other aspects of people's well-being.

The economic effects of changes in projected deficits would differ over the short and long terms. Over the next few years, any policy changes that decreased federal spending or increased taxes—and thus shrank budget deficits—would generally reduce total demand for goods and services. Therefore, such fiscal policies would reduce output and employment below the levels projected in CBO's baseline. Policy changes that increased federal spending or decreased taxes would generally have the opposite effect. Because CBO did not analyze specific policies that might underlie the Chairman's paths, the agency relied on the same assumption that it used in *The 2017 Long-Term Budget Outlook* to estimate the effects of unspecified policies underlying illustrative deficit reduction paths.⁴ In particular, the agency assumed that when the Federal Reserve responded to the resulting reduction in aggregate demand by reducing short-term interest rates, each dollar of deficit reduction would reduce GDP by amounts that accumulated to one-third of a dollar over several quarters.

In the long term, policy changes that decreased budget deficits would lower the amount of federal debt held by the public below the amount projected under current

law. Over time, smaller federal deficits and debt would leave more funds available for private investment and thereby cause output to be higher, and interest rates to be lower, than the amounts projected in the baseline. Larger federal debt would have the opposite effect: It would “crowd out” private investment, decrease output and income, and increase interest rates.⁵ Lower income would reduce tax revenues, and by decreasing long-term spending on health care and retirement programs, it would also reduce federal spending, though by a smaller amount.⁶

What Paths for Federal Revenues and Noninterest Spending Did Chairman Enzi Specify?

Chairman Enzi and his staff specified the following paths for federal revenues and noninterest spending (not including macroeconomic effects) for CBO to analyze (see Figure 1 on page 2):

- For revenues, annual amounts as a share of the economy are lower than those projected in CBO's June 2017 baseline. After an initial decline in 2018, they increase from 16.9 percent of GDP in 2018 to 17.9 percent in 2027. In CBO's baseline, revenues increase from 17.7 percent of GDP in 2018 to 18.4 percent in 2027.
- Noninterest spending falls over time in relation to the size of the economy. As a percentage of GDP, noninterest spending decreases from 18.5 percent in 2018 to 17.2 percent in 2027.⁷ In CBO's baseline, noninterest spending measured as a share of GDP increases from 19.0 percent in 2018 to 20.7 percent in 2027.
- Together, those paths would result in revenues' falling short of noninterest spending (excluding macroeconomic effects) by a declining share of GDP

5. For a discussion of CBO's analytical methods, see Congressional Budget Office, *How CBO Analyzes the Effects of Changes in Federal Fiscal Policies on the Economy* (November 2014), www.cbo.gov/publication/49494.

6. Federal spending would be lower if income was lower because Social Security benefits are linked to earnings and because spending on health care tends to vary with total income over the long term. This analysis reflects the assumption that changes in income do not affect other noninterest spending.

7. For more details, see the supplemental material posted with this report on CBO's website (www.cbo.gov/publication/53152).

4. Congressional Budget Office, *The 2017 Long-Term Budget Outlook* (March 2017), www.cbo.gov/publication/52480.

through 2022. In 2023, revenues minus noninterest spending would be 0.1 percent of GDP, and that difference would reach 0.7 percent of GDP in 2027. In CBO's baseline, revenues fall short of noninterest spending by 1.3 percent of GDP in 2018, and that shortfall increases to 2.3 percent in 2027.

Chairman Enzi's specified paths for revenues and noninterest spending would require changes to current law. In particular, significant steps would need to be taken to reduce noninterest spending, which by 2027 would be about 17 percent less under the paths than CBO projects under current law. In addition, steps would also need to be taken to reduce revenues, which would be about 3 percent lower than projected under current law by 2027.

What Would Budgetary and Economic Outcomes Be Under the Paths Specified by Chairman Enzi?

The paths for federal revenues and noninterest spending specified by Chairman Enzi and his staff would result in the federal government's borrowing less than projected under current law. With macroeconomic feedback incorporated, federal debt held by the public measured as a share of GDP would fall to 74 percent in 2027 under the specified paths, whereas it is projected to be 91 percent in that year in CBO's June 2017 baseline (see Figure 2 on page 3). Such significant declines in federal debt measured as a share of GDP would have additional positive consequences beyond their effects on output and on the budget. For example, because federal debt would be much lower under the paths than it is in the baseline, policymakers would have more leeway to use tax and spending policies to respond to economic downturns or other contingencies, such as wars, and the risk of a fiscal crisis would therefore be much smaller.

Real GNP per person would be lower under Chairman Enzi's specified paths than it is in the baseline from 2019 to 2021, CBO estimates, because the lower federal spending under the paths would dampen overall demand for goods and services (see Figure 3 on page 4).⁸

8. Throughout this report, differences in real GNP per person—which are shown in Figure 3—are assumed to be proportional to the estimated differences in real GNP because CBO has no basis for estimating any changes in the size of the population arising from the paths for revenues and noninterest spending specified by Chairman Enzi.

Starting in 2022, however, real per capita GNP would be higher than projected under current law by increasing amounts each year. By 2027, it would be 1 percent higher than in the baseline. GNP would be higher in those years because smaller federal deficits and debt would lead to an increase in private investment and domestic production. In addition, reduced government borrowing would cause net inflows of foreign capital and net payments of interest and profits to foreigners to be lower than they would be under current law. Average real family income, before federal transfer payments and taxes, would also be higher than projected in the baseline. The effects would, however, differ among families: Some would receive more income, and others could receive less. Effects on individual family incomes after federal transfer payments and taxes would depend on how the particular policies adopted to meet the targets specified in the paths compared with the policies under current law. Moreover, the specific policies adopted would affect people's well-being in various ways beyond their effects on economic output. This analysis includes the macroeconomic effects of changes in federal debt but not the effects of any specific policies on output or other aspects of people's well-being because CBO did not analyze a set of policies that might underlie the specified paths.

Similarly, real GDP growth under the paths (including the economic effects of the deficit reductions that would occur under them) would be lower in 2019 and 2020 than projected under current law. Specifically, CBO estimates that annual real GDP growth in those calendar years would average 1.3 percent under the paths—down from an average of 1.6 percent in CBO's baseline. But in later years, real GDP growth would be higher, CBO estimates: It would average 2.0 percent annually under the paths, whereas in the baseline, such growth is projected to average 1.9 percent. By 2027, real GDP under the specified paths would be about 0.8 percent higher than projected in the baseline.

Significantly changing the paths for revenues and noninterest spending from the paths they are projected to follow under current law would almost certainly involve changing the amount of federal investment and altering people's incentives to work and save, thereby affecting output. However, the estimates presented here do not incorporate any effects of such changes in people's incentives to work or save because CBO did not analyze specific policies. For the purposes of this analysis,

for example, CBO assumed that effective marginal tax rates (the percentage of an additional dollar of income that is unavailable to an individual because it is paid in taxes or offset by reductions in benefits from government programs) would be the same under the specified paths as they are under current law. This analysis also reflects the assumption that the paths do not alter policies that influence productivity growth, such as those that govern federal investment.⁹

How Uncertain Are the Projected Outcomes?

The projections for federal debt and economic output presented in this report are highly uncertain, primarily because of the difficulties inherent in projecting the effects of federal fiscal policies. The projections are based on CBO's central estimates (that is, the midpoint of the range of probable outcomes) for key parameters of economic behavior—including the extent to which government borrowing crowds out capital investment in the long run. Estimates of those and other economic parameters are uncertain, and analysis using different parameters can produce results substantially higher or lower than CBO's central estimates. For example, consider the full ranges of estimates that CBO uses for the crowding out of investment and the responsiveness of the labor supply, which are intended to cover roughly the middle two-thirds of the likely values for those parameters. Using those ranges, CBO projects that real GNP in 2027 under the paths specified by Chairman Enzi and his staff would be between 0.5 percent and 1.6 percent higher than in the baseline.

9. For a discussion of the long-term economic benefits of federal investment, see Congressional Budget Office, *The Macroeconomic and Budgetary Effects of Federal Investment* (June 2016), www.cbo.gov/publication/51628, and *How CBO Analyzes the Effects of Changes in Federal Fiscal Policies on the Economy* (November 2014), pp. 9–10, www.cbo.gov/publication/49494.

This type of analysis is also sensitive to other uncertain factors. For example, differences in future interest rates would alter the rate at which changes in deficits contributed to the debt. Moreover, the macroeconomic effects of the paths specified by Chairman Enzi could differ from the estimates reported here, depending on the particular policies chosen to achieve those budgetary outcomes and how households and businesses responded to those policies.

This Congressional Budget Office report was prepared at the request of the Chairman of the Senate Committee on the Budget. In keeping with CBO's mandate to provide objective, impartial analysis, the report makes no recommendations.

Devrim Demirel, Jonathan Huntley, and John Seliski prepared the report or contributed to the analysis, with guidance from Felix Reichling, Julie Topoleski, and Jeff Werling. Adam Staveski fact-checked it. John McClelland and Sam Papenfuss provided helpful comments.

Wendy Edelberg and Jeffrey Kling reviewed the report, Bo Peery edited it, and Jorge Salazar prepared it for publication. An electronic version is available on CBO's website (www.cbo.gov/publication/53152).



Keith Hall
Director
September 2017

