CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Phillip L. Swagel, Director

August 12, 2019

Honorable Steve Womack
Ranking Member
Committee on the Budget
U.S. House of Representatives
Washington, DC 20515

RE: The Impact of Various Levels of Federal Debt on GNP and GNP per Capita

Dear Congressman:

In response to your request, the Congressional Budget Office is providing additional information about its extended baseline projections and three alternative scenarios that the agency analyzed in June in *The 2019 Long-Term Budget Outlook*.[1] Specifically, CBO is providing estimates of gross national product (GNP) and GNP per capita in all four cases.

The Extended Baseline Projections

CBO's extended baseline projections incorporate the assumption that current laws generally do not change. They are consistent with the 10-year baseline budget projections that CBO published in May 2019 and the economic forecast that the agency published in January 2019. Current laws underlying those 10-year baseline budget projections reflect the lower caps on discretionary appropriations for 2020 and 2021 that were in place before the enactment of the Bipartisan Budget Act of 2019 (Public Law 116-37) earlier this month. The extended baseline projections extend most of the concepts underlying the 10-year budget projections for an additional 20 years, and they reflect the macroeconomic effects of projected fiscal policy over the entire 30-year period.

In the extended baseline projections, federal debt held by the public equals 144 percent of gross domestic product (GDP) in 2049 (see Figure 1).

The Extended Alternative Fiscal Scenario

In what CBO calls its extended alternative fiscal scenario, certain major policies that were in place in June 2019 but scheduled to change under current law at that

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[1] Congressional Budget Office, *The 2019 Long-Term Budget Outlook* (June 2019), www.cbo.gov/publication/55331.

time are assumed to continue instead. For example, the scenario incorporates the assumption that the caps on discretionary appropriations cease after 2019 and that appropriations thereafter grow at the rate of inflation, as well as the assumption that expiring revenue provisions in the 2017 tax act are extended. Those assumptions both result in larger deficits than in the extended baseline projections. Like the extended baseline projections, the extended alternative fiscal scenario reflects the macroeconomic effects of projected fiscal policy.

Under the extended alternative fiscal scenario, debt in 2049 equals 219 percent of GDP, rather than the 144 percent that is projected in the extended baseline.

Two Other Scenarios
CBO also analyzed two scenarios in which deficits would be reduced by constant percentages of GDP in order to meet two targets for debt in 2049. In the first scenario, the target for debt is 42 percent of GDP, which is the average level of debt over the past 50 years. To meet that target, lawmakers would need to make the primary deficit (the difference between revenues and noninterest spending) 2.9 percent of GDP smaller than it is in CBO's extended baseline projections every year beginning in 2020. In the second deficit-reduction scenario, the target for debt is 78 percent of GDP, which is the level that CBO projects for the end of 2019. To meet that target, lawmakers would need to make the primary deficit 1.8 percent of GDP smaller than it is in CBO's extended baseline projections every year beginning in 2020.

The two deficit-reduction scenarios incorporate an effect of reduced federal borrowing on the economy. When the federal government borrows in financial markets, it competes with other participants for financial resources. In the long term, it crowds out private investment, reducing economic output and income and increasing interest rates. Reductions in federal borrowing thus lead to less crowding out, greater output and income, and lower interest rates. The increased output and lower interest rates under the two deficit-reduction scenarios would further reduce deficits and debt by increasing revenues, lowering federal spending on interest, and lowering other spending (measured as a percentage of GDP).

The scenarios do not, however, reflect the results of any particular policies that would change spending or revenues, because CBO has made no assumptions about what those policies would be. For example, the analysis for the two deficit-reduction scenarios does not incorporate short-term effects resulting from lower noninterest spending or higher revenues that bring about reduced primary deficits. Such changes would be expected to hold down short-term economic growth and income. In addition, the analysis does not incorporate the ways in which changes in fiscal policy can affect people's incentives to work or save or can affect productivity growth, other than through changes in federal borrowing.

Projected Effects on GNP and GNP per Person in 2049
In each of the scenarios that CBO analyzed, both GNP and GNP per person grow in real (inflation-adjusted) dollars, but the size of those increases varies (see

Figure 2). The analysis gives estimates of overall economic effects, not the effects on particular income groups.

- In CBO's extended baseline projections, GNP grows from $22 trillion in 2019 to $37 trillion in 2049 (in 2019 dollars), and GNP per capita increases from $65,000 to $94,000.

- In CBO's extended alternative fiscal scenario, real GNP in 2049 would be 3.6 percent lower, and real GNP per capita would be about $3,400 lower, than in the extended baseline projections.

- In the scenario in which debt falls to 42 percent of GDP, real GNP in 2049 would be 5.8 percent higher, and real GNP per capita would be about $5,500 higher, than in the extended baseline projections.

- In the scenario in which debt remains at 78 percent of GDP, real GNP in 2049 would be 3.7 percent higher, and real GNP per capita would be about $3,600 higher, than in the extended baseline projections.

In sum, CBO projects that actions to reduce deficits would lead to higher income in the long term. Like all long-term budget projections, the outcomes described here are uncertain.

I hope you find this information useful. If you have any additional questions, please contact me or Julie Topoleski.

Sincerely,

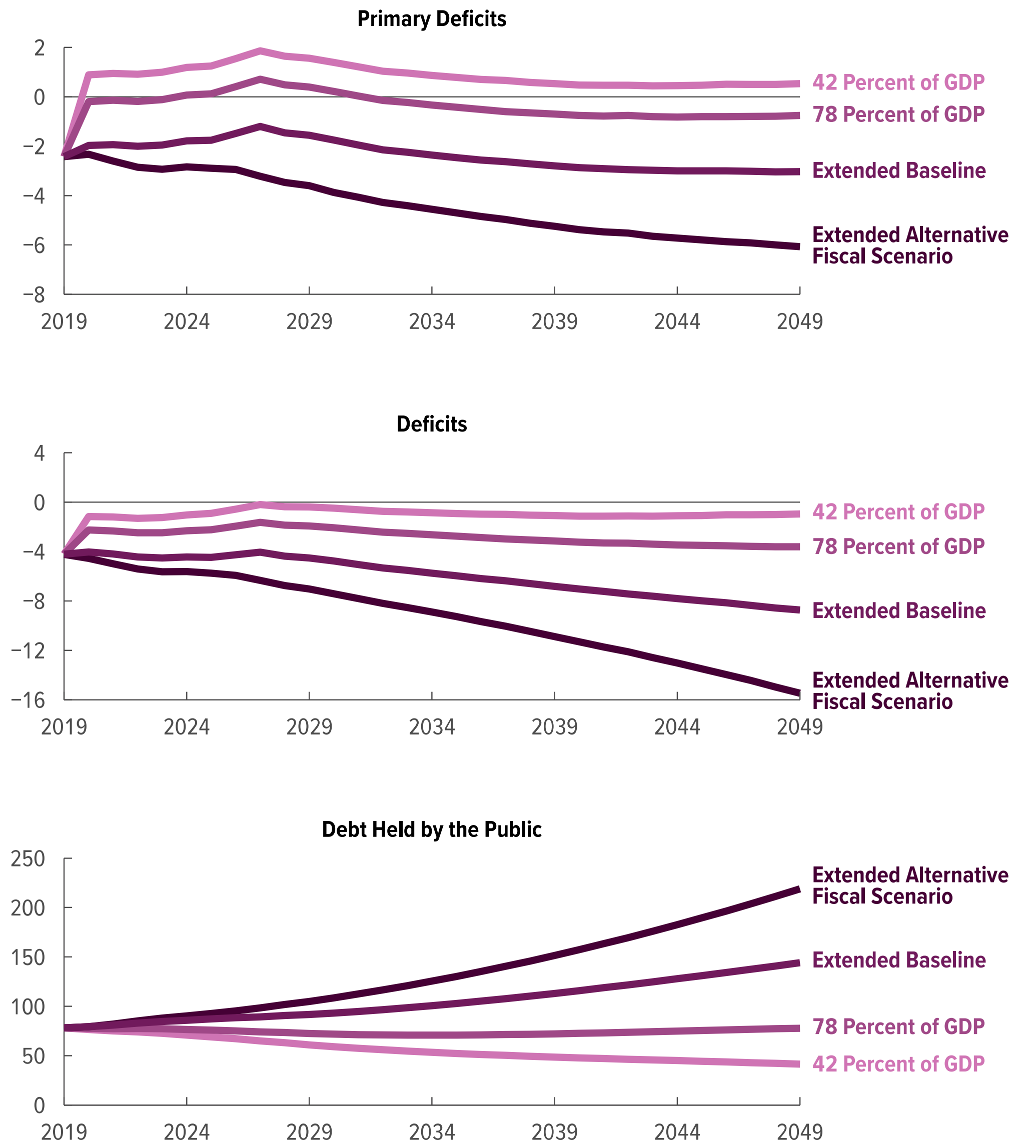
Phillip L. Swagel
Director

cc: Honorable John Yarmuth
Chairman

Figure 1.

Deficits and Debt in CBO's Extended Baseline Projections and Three Alternative Scenarios

Percentage of Gross Domestic Product



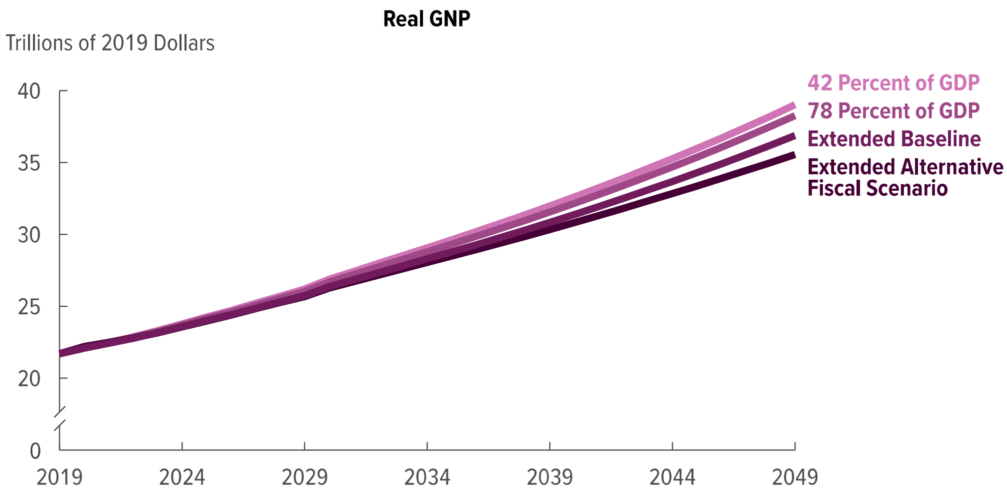
Source: Congressional Budget Office.

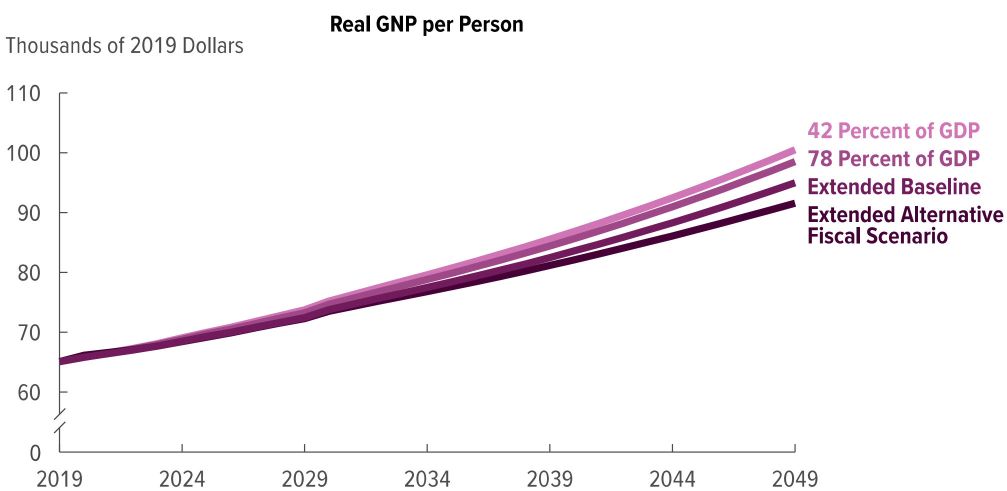
The extended baseline projections generally reflect current law, following CBO's 10-year baseline budget projections through 2029 and then extending most of the concepts underlying those projections for the rest of the long-term projection period. The extended baseline projections are consistent with the 10-year baseline budget projections that CBO published in May 2019 and reflect current law as of that date. In the extended alternative fiscal scenario, certain major policies that were in place in June 2019 but that were scheduled to change under current law at that time are assumed to continue. In the remaining two scenarios, debt equals 42 percent and 78 percent of gross domestic product in 2049.

For more details, see Congressional Budget Office, *The 2019 Long-Term Budget Outlook* (June 2019), www.cbo.gov/publication/55331.

Figure 2.

Gross National Product and Gross National Product per Person Under CBO's Extended Baseline Projections and Three Alternative Scenarios





Source: Congressional Budget Office.

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