

## Changes in CBO's Long-Term Projections Since July 2014

**T**he long-term projections of federal revenues and outlays presented in this report are generally similar to the ones that the Congressional Budget Office published in 2014 despite certain changes in law, revisions to some of the agency's assumptions and methods, and the availability of more recent data.<sup>1</sup> Without macroeconomic feedback taken into account, debt is projected to rise from about 74 percent of gross domestic product (GDP) this year to 101 percent in 2039 under the extended baseline, whereas last year, CBO projected that debt would rise to 106 percent of GDP in 2039 (see Figure B-1). The difference stems primarily from a change in CBO's projection of the interest rates on federal debt. Under the extended alternative fiscal scenario with macroeconomic feedback, debt is projected to rise to 166 percent of GDP in 2039; last year, that figure was 183 percent.

### Changes in Methods Underlying the Extended Baseline

Since last year, CBO has changed its projections of economic output and interest rates in the long term, has modified its expectations about the share of payroll that will be subject to Social Security's payroll tax, and has revised its projections of enrollment in Medicaid. Those changes, taken together, result in a projected path for debt that is slightly lower than the one last year.

#### Lower GDP

CBO's current projection of nominal GDP in 2039 is about 3 percent smaller than its estimate last year. Mostly, that change occurred because CBO lowered its projection of real (inflation-adjusted) GDP in the 10-year economic projections that it published in January 2015.<sup>2</sup> That

revision derived mostly from a reduced estimate of total factor productivity (that is, the efficiency with which labor and capital are used to produce goods and services) in the first 10 years of the projection period. Because the projected growth rate of real GDP after 2025 is about the same this year as it was last year, that difference persists. CBO also reduced its projection of the rate of inflation by 0.1 percentage point.

#### Lower Interest Rates

In last year's long-term analysis, the real interest rate on 10-year Treasury notes—calculated by subtracting the rate of increase in the consumer price index from the nominal yield on such notes—was projected to be 2.5 percent in the long term. CBO now projects that rate to be 2.3 percent. Similarly, last year, the projected average real interest rate on government debt was 2.2 percent, but the agency now expects it to be 2.0 percent (thus lower by the same amount). Primarily, CBO's revision to projected interest rates results from incorporating financial market participants' expectations for low interest rates well into the future. Gleaning market participants' predicted path of interest rates over the long term from prices of financial instruments is subject to enormous uncertainty because current interest rates are also influenced by transitory liquidity and risk factors that are difficult to disentangle from expectations about future interest rates. Nonetheless, a review of the results from the available models and evidence linking current rates to future rates suggests that participants in financial markets expect low interest rates well into the future, and the paths that they anticipate have fallen notably over the past year.

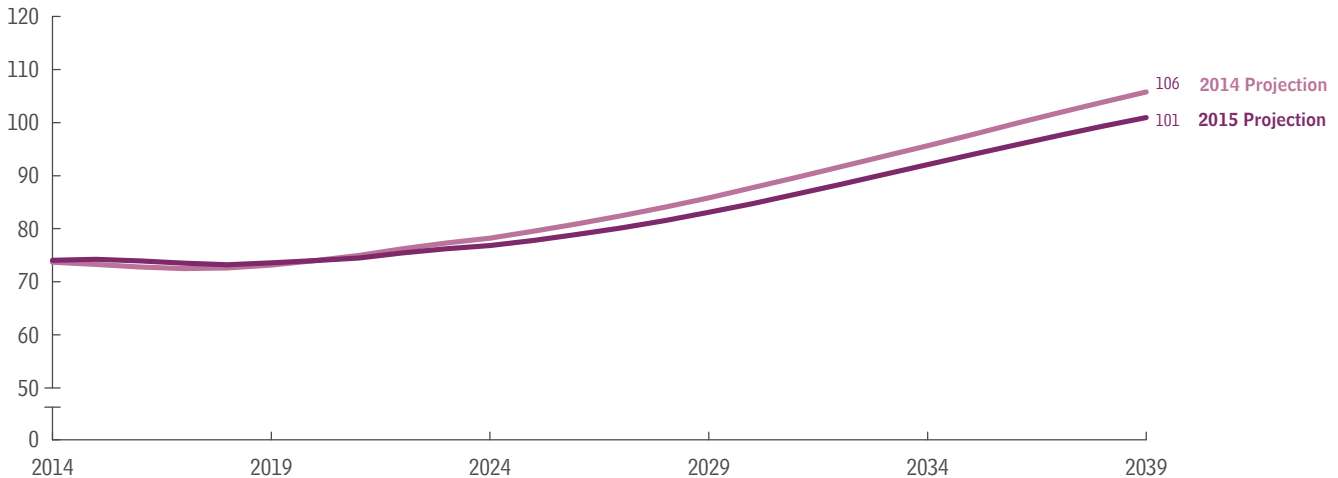
1. See Congressional Budget Office, *The 2014 Long-Term Budget Outlook* (July 2014), [www.cbo.gov/publication/45471](http://www.cbo.gov/publication/45471).

2. For further discussion, see Congressional Budget Office, *The Budget and Economic Outlook: 2015 to 2025* (January 2015), pp. 52–55, [www.cbo.gov/publication/49892](http://www.cbo.gov/publication/49892).

**Figure B-1.**

### Comparison of CBO's 2014 and 2015 Projections of Federal Debt Held by the Public Under the Extended Baseline

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

Note: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period. These projections do not reflect the macroeconomic effects of the policies underlying the extended baseline. (For an analysis of those effects and their impact on debt, see Chapter 6.)

#### A Lower Share of Earnings That Are Subject to the Social Security Payroll Tax

Since last year, a methodological improvement has led CBO to lower its projection of the share of earnings that are subject to the Social Security payroll tax, from an average of 82 percent to an average of 78 percent for the 2025–2039 period. Specifically, the agency has better aligned its methods for projecting revenues and its methods for projecting the earnings of workers covered by Social Security. This year, the estimated share of earnings below the taxable maximum (reported in Appendix A) for years beyond the next decade incorporates the increase in earnings inequality that underlies CBO's baseline projection of revenues over the next decade.

#### Lower Enrollment in Medicaid

This year, CBO has revised an assumption that affects the projected enrollment in Medicaid. Specifically, CBO now anticipates that states will take fewer actions that would maintain Medicaid spending over the long term (through such means as obtaining program waivers to expand eligibility to new population groups, enhanced outreach efforts to increase enrollment of eligible people, and expansion of covered benefits) as rising earnings over time reduce the number of people who would be eligible for

the program as it is currently implemented. Last year, CBO assumed that states' actions would offset all of the effect of earnings growth on eligibility; this year, CBO assumes that those actions will offset only half of that effect. The change reduces the agency's projection of the number of Medicaid beneficiaries by an increasing amount over time and by a total of 4 percent after 25 years.

#### Changes in Spending and Revenues Under the Extended Baseline

In CBO's extended baseline, noninterest spending exceeds revenues throughout the next quarter century; the shortfall is similar to that projected in 2014 (see the bottom panel of Figure B-2). Interest costs on the debt are lower than last year because of lower interest rates.

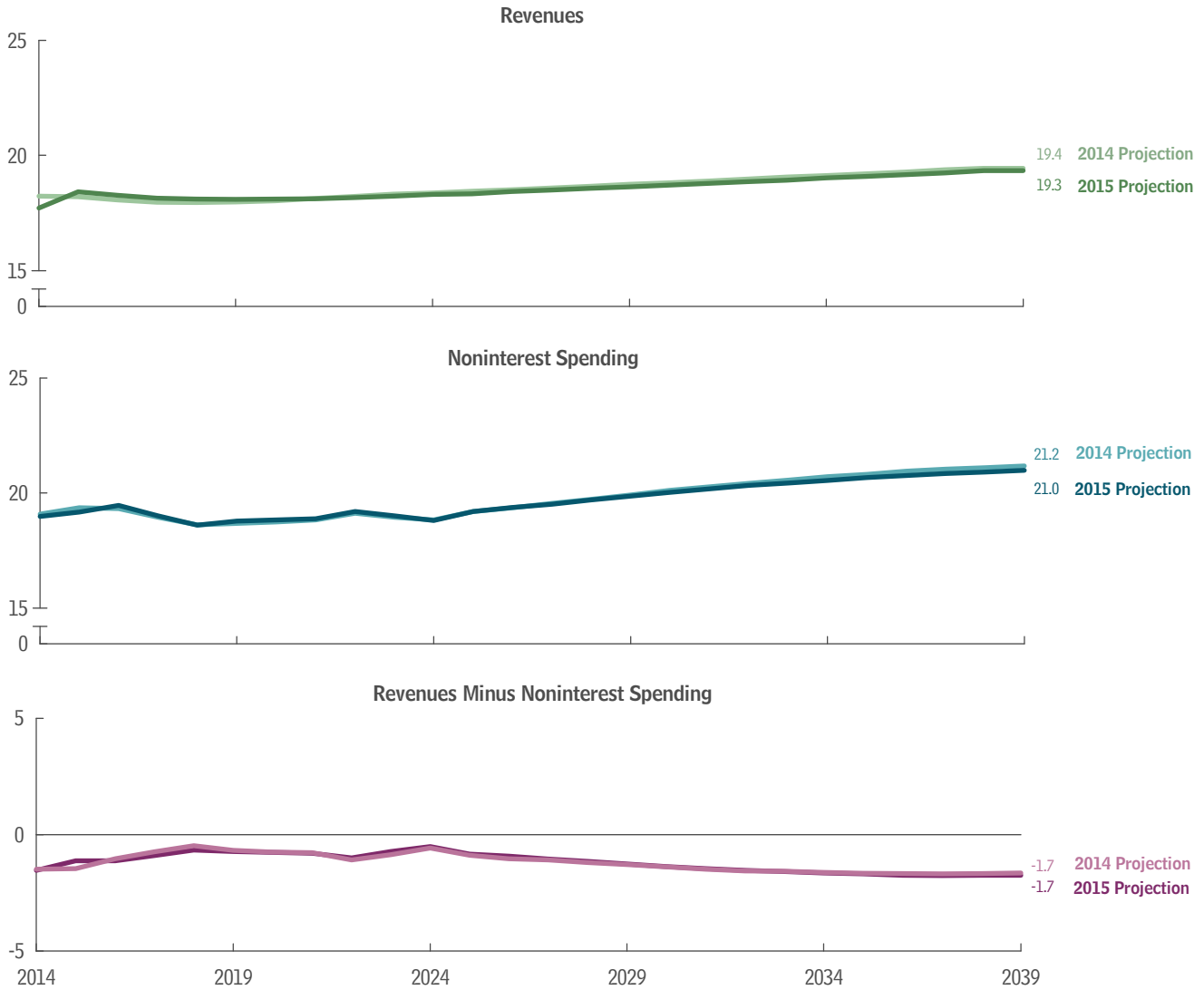
#### Revenues

Federal revenues are projected to be slightly lower relative to GDP in coming decades than the amounts CBO projected in 2014 (see the top panel of Figure B-2). By 2025, revenues are projected to be 18.3 percent of GDP, whereas last year, the estimate was 18.4 percent. That difference is estimated to persist in subsequent years,

**Figure B-2.**

**Comparison of CBO’s 2014 and 2015 Budget Projections Under the Extended Baseline**

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

Note: The extended baseline generally reflects current law, following CBO’s 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period. These projections do not reflect the macroeconomic effects of the policies underlying the extended baseline. (For an analysis of those effects and their impact on debt, see Chapter 6.)

reflecting slightly slower growth in realizations of capital gains that are taxable and other factors. By 2039, revenues are now projected to equal 19.3 percent of GDP, or 0.1 percentage point lower than the 19.4 percent estimate last year.

**Noninterest Spending**

Noninterest spending is projected to be about the same relative to GDP as what CBO projected in 2014 (see the middle panel of Figure B-2). In particular, noninterest

spending is projected to be slightly higher than last year’s estimates for about the first decade of the projection period and then to fall below last year’s estimates beginning in 2027. In 2039, it is projected to be 21.0 percent of GDP, or 0.2 percentage points lower than last year’s estimate. Federal health care spending is projected to be about the same, Social Security spending lower, and other noninterest spending about the same relative to GDP compared with the amounts CBO projected last year.

**Federal Health Care Spending.** CBO's current long-term projection of federal spending on major health care programs is largely the same as last year's—though the growth rate of Medicare spending is faster than that projected last year, and the growth rate of the spending for Medicaid and exchange subsidies is much slower. Spending for Medicare net of offsetting receipts is now estimated to amount to 5.0 percent of GDP in 2039, or about 0.4 percentage points higher than what CBO estimated last year. That difference reflects higher projected spending for the program in the first 10 years and slightly higher estimates of the rate of excess cost growth (or growth in spending per beneficiary beyond the growth in potential output per capita) through the end of the projection period. In total, federal spending for Medicaid, the Children's Health Insurance Program, and the exchange subsidies is projected to amount to 2.8 percent of GDP in 2039, or 0.5 percentage points lower than the sum projected last year; that difference reflects less spending for Medicaid and exchange subsidies in the first 10 years, lower average excess cost growth, and lower enrollment in Medicaid after 2025.

**Social Security Spending.** The current 25-year projection of Social Security spending is lower as a percentage of GDP than last year's, largely because CBO projects that a smaller portion of earnings would be subject to the Social Security tax. The program's benefits are based on taxable earnings, so that a reduction in the share of taxable earnings, which would yield lower tax revenues, would also result in smaller benefits in the future. The 75-year actuarial deficit currently projected for Social Security, 4.4 percent of taxable payroll, is greater than the 4.0 percent estimated last year (see Table 3-1 on page 54). Revised projections of economic factors, primarily lower projected interest rates, account for about half of the 0.4 percentage-point increase, and revised projections of taxable payroll account for the other half. Smaller changes—arising from updated data, the effects of the one-year shift in the projection period, and estimating changes—largely offset one another.

**Other Noninterest Spending.** This year, total federal spending as a share of GDP on everything other than the major health care programs, Social Security, and net interest is projected to be similar throughout the next 25 years to the share CBO projected last year.

### Interest Costs

Although CBO's current projection of debt held by the public expressed as a share of GDP is only slightly lower than the agency's estimate last year, interest outlays are significantly lower in this year's analysis because of lower projected interest rates and a lower projected cumulative deficit (see Figure B-1 on page 122). In this year's report, interest spending in 2039 is projected to equal 4.2 percent of GDP, whereas last year, that figure was 4.7 percent.

### The Fiscal Gap

The magnitude of the changes in noninterest spending or revenues that would be needed to make federal debt equal its current percentage of GDP at a specific date in the future is often called the fiscal gap.<sup>3</sup> The estimated fiscal gap is slightly smaller this year than last year, largely because CBO projects lower interest rates. All else held equal, a lower interest rate leads to a smaller fiscal gap. For the 2016–2040 period, CBO estimates that cuts in noninterest spending or increases in revenues equal to 1.1 percent of GDP in each year through 2040 would be required to have debt that year equal the same percentage of GDP that it constitutes today; last year, for the 2015–2039 period, CBO estimated that changes equal to 1.2 percent of GDP would be required. By itself, the reduction in projected interest rates on federal debt would have brought the gap down by 0.3 percent of GDP, but changes in projected GDP and the shift in the projection period offset most of that effect.

## Changes in Assumptions Incorporated in the Extended Alternative Fiscal Scenario

Under its extended alternative fiscal scenario last year, CBO assumed that Medicare's payment rates for services provided by physicians would be held constant at the 2014 level rather than being cut by about a quarter early in 2015, as was scheduled under current law and therefore reflected in the extended baseline. The Medicare

3. The fiscal gap equals the present value of noninterest outlays and other means of financing minus the present value of revenues over the projected period with adjustments to make the ratio of federal debt to GDP at the end of the period equal to the current ratio. Specifically, current debt is added to the present value of outlays and other means of financing, and the present value of projected debt at the end of the period (which equals GDP in the last year of the period multiplied by the ratio of debt to GDP at the end of 2015) is added to the present value of revenues.

Access and CHIP Reauthorization Act of 2015 set new rules for updating those payment rates starting in April 2015. So for that element, the extended alternative fiscal scenario and the extended baseline are now the same.

### **Changes in Estimated Economic Effects of Various Fiscal Policies**

In this year's long-term analysis, the estimated effects on gross national product of fiscal policies that would increase or decrease future debt relative to that in the extended baseline are smaller than those in last year's analysis. Those reductions stem primarily from two factors. First, CBO reduced its projection of interest rates, so a given change in the deficit in one year cumulates to a smaller change in debt in future years and therefore has less effect on output. Second, under the extended alternative fiscal scenario, deficits excluding interest payments differ from those under the extended baseline by slightly less than they did in last year's analysis and, again, affect output less.

### **Changes in Methods for Analyzing Uncertainty**

CBO changed its approach to analyzing the long-term budgetary effects of simultaneous changes in multiple economic factors—namely, mortality rates, growth of total factor productivity, interest rates on federal debt, and the growth rate of federal spending per beneficiary for Medicare and Medicaid (as discussed in Chapter 7). An occasion when one of those factors is at the end of the range used in the analysis of uncertainty is more likely than having all four of the factors at the end of their ranges simultaneously; so last year, adopting a rough approximation for the latter occasions, CBO narrowed those ranges by half. This year, CBO undertook more

detailed analysis of the simultaneous movement in the four factors since 1967 and concluded that slightly wider ranges (60 percent as wide as the ranges applicable to individual factors in isolation) more accurately reflect the historical data.

### **Changes in the Presentation of Projections Beyond 25 Years**

In the past, CBO included projections for years 25 years in the future in an appendix to the report, but after reassessing the considerable uncertainty surrounding projections of deficits and debt that far into the future, the agency decided to post them only as supplemental data on its website ([www.cbo.gov/publication/50250](http://www.cbo.gov/publication/50250)).

### **Changes in the Presentation of Summarized Financial Measures for the Hospital Insurance Trust Fund**

CBO is no longer reporting summarized financial measures, such as actuarial balances over 75 years, for Medicare's Hospital Insurance (Part A) trust fund. After reassessing those measures, the agency concluded that they do not provide meaningful information given the formulaic methodology CBO uses to project Medicare spending over the long term. Changes over time in the nature of health care and in the system for delivering health care might affect Part A and the other portions of Medicare differently, but the summarized financial measures for the Hospital Insurance trust fund that CBO previously provided did not take that possibility into account. Because CBO has yet to develop the analytic capability to project such developments, it concluded that projections for just Part A of the Medicare program were not useful.